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J. WITHERSPOON
10/21/73

STATE OF ALASKA
THE LEGISLATURE
LEGISLATIVE AFFAIRS AGENCY

POUCH Y - STATE CAPITOL
JUNEAU, ALASKA 99801

October 31, 1973

The attached transcript contains the remarks made by Professor Joseph Witherspoon on October 21, 1973 before the Senate Resources Committee. It is a verbatim transcript of Professor Witherspoon's remarks. There is occasionally a word missing or other minor gaps in certain places, which are due to the speaker's testimony being indecipherable at that point. However, it is believed that these occasions are rare and the transcript presents a fair picture of the thoughts expressed by the witness before the committee.

Senator John Sackett
Chairman
Resources Committee

AGO 533512

SENATE RESOURCE COMMITTEE

October 21, 1973

TESTIMONY FROM PROFESSOR JOSEPH WITHERSPOON

CHAIRMAN: Today we have with us Professor Joseph Witherspoon; Professor Witherspoon is a professor in petroleum law and constitutional law.

PROF. WITHERSPOON: Constitutional law, administrative law, legislation, but not petroleum law.

CHAIRMAN: I have asked the professor to give us testimony initially and then be available for questioning.

PROF. WITHERSPOON: Mr. Chairman, it is a pleasure to be back in your wonderful state. I've had an opportunity to read the measures that have been proposed and I'm still in the process of learning. I'm sure that I'll learn more by further study which I will continue to do tonight and many of the days and hours that I'm here. So I preface all that I say at this point simply saying I have addressed myself to these materials since they were given to me last week, and I'll try to make as good a statement as I can in light of that.

The first proposition I think can be made is, and I have focused primarily upon the Alaska Pipeline Commission Act and the Alaska Pipeline Right-of-Way Leasing Act and to a lesser extent upon the common purchaser provision that has been proposed. I must say that the proposed legislation would largely, distinctly--substantially change--the character of the legislation and

although my testimony at the last hearing before a committee here, related to the Right-of-Way Leasing Act, I would like to start today with the proposals insofar as they affect the Alaska Pipeline Commission Act.

The first provision that I would like to note in the Act relating to oil and gas pipelines and the Alaska Pipeline Commission and providing for an effective date, is Sec. 42.06.150. That section as proposed would mean that Secs. 240 through 420 and Secs. 140 (3), 140 (8), 140 (9), on Senate Bill 6, page 1, line 48, do not apply to a pipeline or pipeline carrier--and I want to emphasize the phrase, "or pipeline carrier", subject to the jurisdiction of the Interstate Commerce Act or the Natural Gas Act. The focus here with respect to the emphasized language "pipeline carrier" is that that pipeline carrier so subject to one of these acts is not subject to this act. That means, as I read it, and as I think courts generally would read it, that--despite the language that follows--an intrastate activity of this pipeline simply is not subject to your law. To me, it seems that that creates a very anomalous situation. I think its clear that this, as I understand it-the way it was explained to me--that this act was originally adopted with a view to handling the activities of interstate carriers to the extent that they could be handled. It was the activities of interstate pipeline carriers that primarily presented the problem that you felt as a Legislature, should be addressed by this legislation. It

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was expected, undoubtedly, that intrastate carriers might come into being, that they might increase, but the occasion for the legislation was the intrastate activities of an interstate pipeline carrier and to the extent that they could be reached without being in conflict with, or inconsistent with, federal legislation or federal administration of federal legislation that that too would be subject to the act and reached by the act. It seems to me that this principle here, which covers the main body of this act, what it is designed to do, this principle--this rule--really says that a pipeline carrier that is subject to the Interstate Commerce Act as would be the tremendous pipeline that is proposed to develop, simply would not be subject to your act at all, either as to its interstate activities or its intrastate activities. The remarkable thing is, it seems to me, the problem of constitutional law that this presents. It would seem to me that there would be a severe question of the constitutionality of such a provision insofar as the equal protection of law clause of the 14th amendment, which bears upon states of course, and says that they may not deny equal protection of the law to a person. It may be that that was not intended but I think it may well have been intended. In any event, I think the legal effect of this provision is to take the intrastate activities--pipeline activities--of this pipeline carrier subject to the Interstate Commerce Act, completely off from control of this act, as well as interstate activities. Get them totally out from under. Now that is one proposition, and I have state the reasons for it

and suggested a constitutional difficulty. I would think there would be a difficulty of legislative policy as well. That this act, which was designed to meet a great problem of the State of Alaska, now has its impact upon local intrastate pipelines. They are subjected to this regulation and the intrastate activities of interstate pipeline carriers or not, I should think perhaps one might feel that the act should be repealed if the intrastate activities of an interstate pipeline carrier are not to be subject at all to a piece of legislation that is designed to deal with intrastate pipeline activities, why have it at all? Why not treat everyone the same way?

The second proposition that it seems to me emerges and reveals that the philosophy that must have been in the mind of the draftsman of this act is, and I need to emphasize very carefully the language of that, its been very carefully drafted by a very excellent and a very agile draftsman. It says that--and I'll read again, but I want to talk about something else contained in that sentence. Secs. 240 through 420, and Secs. 140(3),(8) and (9) of this chapter do not apply to a pipeline or pipeline carrier, now I emphasize the words "subject to the jurisdiction of the Interstate Commerce Act or the Natural Gas Act." The words being emphasized then "subject to the jurisdiction." What is it to be subject to the jurisdiction of the Interstate Commerce Act. I have here Title 49, United States Code, Sec. 1. This

is the base provision of coverage, or jurisdiction, of the Interstate Commerce Act as it was amended in 1906 to apply to pipelines. This provision reads: "The provision of this chapter shall apply to common carrier engaged in. . .(b) the transportation of oils or other commodity. . .by pipeline or partly by pipeline and partly by railroad or by water. . .from one state or territory of the United States or the District of Columbia, to any other state or territory of the United States." There's a lot of other language, but I think that is the basic information. To repeat it, this is saying that the provisions of the 1906 Act to the Interstate Commerce Act, applies only to common carriers insofar as they are engaged in the transportation of oil by pipeline, or partly by pipeline partly by railroad or water, from one state to another place--another state or territory, and so on. Now, that's what it is to be subject to this jurisdiction. You must be a common carrier, you must be engaged in transportation, and it must be by pipeline or partly by pipeline and something else indicated here, and it must be transportation which is interstate commerce--to pick a very important item of the kind of commerce that is covered. That's what it takes to be subject to the jurisdiction. Now, let us read another clause of this very important piece of this statute as proposed to be modified in subsection b. That states: "For purposes of this

chapter, the TransAlaska Pipeline and any other crude oil pipeline in the State submitting to the jurisdiction of the Inter-State Commerce Commission and transporting crude oil within the State for subsequent transportation outside the State, are considered to be subject to the jurisdiction of the Interstate Commerce Commission, under the Interstate Commerce Act." At this point, I want to emphasize that they're not saying that they are or that it is subject, they're saying its considered to be and unless and until a final determination is made by the Interstate Commerce Commission that the pipeline is not subject to the jurisdiction of the Interstate Commerce Commission. That is a remarkable piece of draftmanship, I suggest again, because it accomplishes a great deal and in voting for it or considering it favorably I think you should be very clear what this will do.

This has not a unit about what the oil or gas pipeline companies agree to do. Its just if something happens, if they submit to the jurisdiction of Interstate Commerce Commission and they are transporting, then they are to be considered subject to the Interstate Commerce Commission's jurisdiction. Now, suppose you enact this act, and suppose whatever submitting to the jurisdiction means--and that's another big question of interpretation--suppose they do not do so, what is the effect of this act. I'm not saying they would not do this, I think there are reasons why very well they would do it, but let us suppose something would

happen. That the TransAlaska pipeline interests or some other crude oil pipeline in the State did not submit--let's take a look at this first sentence which says, "subject to the jurisdiction of", it would mean that that pipeline, if it were subject to the jurisdiction, is not covered by this act, but if it did not in fact submit to the jurisdiction, it would not in fact be operating under the Interstate Commerce Act. You would have an unregulated entity. You would have perhaps the largest economic entity in your State or perhaps in any state of its kind in the nation subject to state regulations as to what it is doing and with respect to the saying that you put into this act to regulate such activities at the same time, it would not be operating under the Interstate Commerce Act. Let us take this a step further. Suppose the Interstate Commerce Commission elects not to exercise its jurisdiction. Now there's some good reasons why it may not exercise this jurisdiction here. First of all, it hasn't very vigorously exercised its jurisdiction over a period of 67 years. This is the language of scholars regularly in printed books of unquestioned authority, this is the common statement you see everywhere in the literature, that the Interstate Commerce Commission has not exercised its jurisdiction. So that if this TransAlaska Pipeline group does not in fact do the things that submits to the jurisdiction and yet have an agency that is reluctant to exercise doesn't act positively, you don't have any

regulation operating with respect to the activities of the pipeline. So that the assumption of this act on the surface seems to be that by not having it under the jurisdiction of this act, it will be under the jurisdiction of some other act, a federal act, and some federal agency created by that federal act. I'm simply saying there's nothing in this act that secures or requires the Trans-Alaska pipeline interests or any other crude oil line ___ ___ ___ in the State, asking them to go forward and submit to that jurisdiction. This was one of the things that the Alaska Pipeline Right-of-Way Leasing Act was designed to deal with. It doesn't leave a gap. We come later to discussing that if we do have time this afternoon, I would like very much to do so. But it was designed to make sure that if the Interstate Commerce Commission was not exercising its jurisdiction at all or not exercising it vigorously, or perhaps didn't even have jurisdiction--there's a very good argument that there is no jurisdiction really (thats another problem), that at least, you would have one act that would be focused upon it. Of course, I'm assuming right now that its not operated either, because the proposal with respect to the Alaska Pipeline Right-of-Way Leasing Act is that substantially its strange--I mean it doesn't really govern--it really doesn't speak to, it really doesn't solve the kinds of problems of which this is one kind of problem.

Now, suppose there is a submission to the Jurisdiction of

the Interstate Commerce Commission, and suppose there is this transporting of crude oil, which there is, from the state--or within the state for subsequent transportation outside the state and--in other words, there is the choice is made in accordance with what is here, that the TransAlaska pipeline group will submit to the jurisdiction. I assume they mean by that and there is a question as to what it means--it means apparently, that at least there would be a filing of a tariff and perhaps some other things, the filing of some reports--proving type reports. And this would be a submitting to the jurisdiction and that is to be treated as if it is subject to the jurisdiction, not that it is not contingent upon it really in fact being subject to the jurisdiction, this is to be treated as if it were. Now, this is a question really of federal and state relationships. Do you want to create an act that deals with a situation that is well within your power to deal and that most states deal with by state acts. Do you want to have that loss to you because papers are filed with a federal agency and that is treated as if it really is a jurisdictional matter for the Interstate Commerce Commission. It is a remarkable piece of legislation that is being proposed. There are some questions as to whether the Interstate Commerce Commission even has jurisdiction. First of all, this is a common carrier that it has to be. But is the TransAlaska pipeline a common carrier? I don't think you want

a total inquiry this afternoon into the cases that have handled this matter. I know the lawyers for TransAlaska pipeline group are well aware of decisions such as the pipeline cases of 1913 34 U.S. 548, but one of the clearest things decided by the Supreme Court is that if a producer of oil is shipping its own oil over its own pipeline this is not a common carrier situation.

I doubt if its changed at all by virtue of the fact that you have a producing company that wholly owns a subsidiary pipeline company. The Supreme Court has time and again pierced this corporate veil and I suggest to you that you do not have a common carrier. So what you have here is a draftsman who has proposed making this thing controlled within your state and I suggest wholly and completely within your power to regulate, is proposing a piece of legislation whereby, though it may well not and I do not think it is subject to this act as a common carrier, the federal act, the state act is treating it as if it were and you are, by this act, divesting yourself of jurisdiction which you have. This is the question then comes down to it, if I am correct in this reading of the case and of this federal act, what you're coming down to is a piece of faith legislation that is turning over to the federal government and one of the agencies created under an old act, that is not a very good agency and not a very vigorous act to protect the interests of the people. What you're doing is to turn over to that federal agency something that is well within your jurisdiction to regulate, you did create a vigorous act to deal with it, and the question then is one of policy. How wise is it to turn this thing over, this matter of jurisdiction, which

is within your jurisdiction, to the federal government which really doesn't have jurisdiction over it. I can imagine what a hard-pressed federal agency would say with not much of a budget, or, much of an interest in this. They'd see the filing, they wouldn't do anything about it. Why should they do anything about it? I mean, people file papers as an impact at the state level, but why should the federal government or the federal agency do anything about it. So that's another problem.

The fourth proposition--this goes to really what the Interstate Commerce Act as amended in 1906 is all about. You had a very able person before you earlier, a Mr. Furman of the firm of Cox, Langford & Brown, this is back in 1970 in comments upon an earlier bill. I simply want to confirm what he said--I have the book here in which it can be demonstrated that what he says is correct. The Interstate Commerce Commission is essentially created to regulate rates of an interstate pipeline and to prevent discrimination in the charging of these rates. It has some operation with respect to the tendering of oil to these pipelines that are subject to the Interstate Commerce Commission regulations. And it has some accounting requirements, but by way of comparison with the Natural Gas Act of 1938, which is a highly developed, sophisticated form of regulation of the Inter-State Natural Gas pipeline, its a very weak statute. It has very, very little in it to speak to the numerous regulatory

problems that are presented. All you'd need to do would be to compare Title 15 of the United States Code, Sec. 71784 through the Natural Gas Act with Title 49 United States Code, Sec. 1 of the Act with respect to crude oil and products pipeline. There just is very little resemblance. True, both of them cover the regulation of rates charged, they cover the problem, as I indicated of discrimination in rates and they cover the problem of accounting and thats about it. But there is no control no authority in the Interstate Commerce Commission at all to regulate crude oil pipeline to the same extent as it regulates other carriers, like railroads. There is no control over the construction of new pipelines. This is going to be a great problem for you and its something that you spoke to in the Alaska Pipeline Commission Act, and you spoke very well. You're going to face the ICC--they have no control over changes then, modifications of, or extensions of existing lines. And as you discover, if you do discover more crude oil in this state, this is going to become an extraordinarily important problem for you, particularly if you're going to confine your pipelines to a limited area in your state, for reasons that we all know. Its going to be terribly important for you to be able to speak to this problem of extending a line or expanding a line or modifying a line or getting a complete new line. In turning this over, allowing this entity, the TransAlaska pipeline entity to turn itself over to the ICC for regulation by it and non-regulation by it, you're really turning it over to an entity that has no

statutory authority whatsoever to deal with this. And you have statutory authority in the act that you passed last year to deal with it. There is no control over the abandonment of pipeline in the Interstate Commerce Act. There might be reasons why the Prudhoe pipeline or a portion of it were abandoned and that might have a serious adverse affect on this state. You can send the proposed new commissioners to warn them to advocate but they'll have nothing to advocate about because the Interstate Commerce Commission can do nothing about that. It has no statutory authority to do anything about it. The problem of extension, modification, existing lines and the building of new lines by existing carrier subject to this act or to the Alaska Pipeline Right-of-Way Leasing Act that was enacted about the same time, that problem was very thoroughly dealt with in those two acts and you would not be left without statutory authority to deal with them.

There is no control over security issues of pipeline companies. There is no regulation in the Interstate Commerce Act upon the failure of the pipeline or passing of pipeline interest in the pipeline by a carrier over to some other carrier. That was carefully spoken to especially in the Alaska Pipeline Right-of-Way Leasing Act. You've got the problem of inter-connection which is something that most of your state acts have--pipeline regulatory acts have--at the state level that was also in your act. What was put their by the draftsman was put there for your

consideration and adopting after looking at state acts elsewhere. But that goes by the board--its one of the things that goes by the board as I read the proposal. There is nothing in the Interstate Commerce Act that gives authority to the Interstate Commerce Commission to deal with it.

But now let us look at the thing that the Interstate Commerce Act does deal with. One of these is, of course, the rates charged by a pipeline common carrier engaged in interstate commerce. I don't claim to be any kind of expert at all in the economics of the oil pipeline industry. In the memorandum that I submitted to the joint pipeline impact committee in 1971-72, I did review the material that has been written about the effectiveness of rate regulation by the Interstate Commerce Act. It does have this authority and lets assume that this TransAlaska pipeline group submits itself to the jurisdiction of the ICC and you want its rates then regulated by filing its tariff; and lets assume further, which is a large assumption, that the Interstate Commerce Commission will then look at this set of rates and then will say this is worthy of investigation, will then hold hearings and will then come to a decision and the decision will be favorable to regulating the rates. Now, when thats all done, if that rate regulation is about what it has been with respect to other rates regulations, the authorities tell us, and I refer you to the specific authorities quoted in

March--that, by and large, this rate regulation is such that it operates in two ways. First of all, it gives a very considerable and happy return to the pipeline company. Its a high enough return that they can depreciate their crude oil pipelines and then have from 15 to 25 years of useful life of the pipeline left.

Secondly, these prices, the rates for transportation are so high that no one takes advantage of them. The truth of it is that your pipeline companies that are nominal common carriers, where there is no question of them being common carriers. There is a real question here whether they're common carriers. But where they are in law by virtue of facts that are not present here with respect to the TransAlaska pipeline group, where they are common carriers in fact, not talking about law, talking about in fact, they are not common carriers--nobody transports, or the great percentage of the oil they carry is not other people's oil. Other people's oil is disposed of otherwise than in the pipeline that are in law common carriers. I'm simply saying that because of the rates, because of their effects upon the competition between people who own oil that might go in those lines, these rates are assessed at a high enough level despite the decisions that limit their height, amount and character. These rates are sufficiently high that these pipelines are not really common carriers. And they are sufficiently high that they allow this amount of extra use of the pipeline after depreciation.

So, one can raise the question--how effective is the rate regulation? How effective is the rate regulation? Should you be turning rate regulation over--that isn't the right way to put it, that would be an incorrect way to put it--should you be relinquishing jurisdiction to fix the rates if you have it. Assuming that you have it. I have asserted that you would for many many purposes have it, if you don't have a common carrier here. Should you be turning rate regulation over to the Interstate Commerce Commission that produces that kind of rate structure.

Thats the four basic propositions that I have, Mr. Chairman, with respect to this act and I do suggest that it is important to see that there is nothing left as a result of the proposed amendments to the Alaska Pipeline Right-of-Way Leasing Act--theres nothing left in it and there's nothing left in (if there ever was anything in there) the original act to make this Trans-Alaska pipeline a common carrier. There is an extraordinarily good argument that the Alaska Pipeline Commission Act only applies to common carriers. So you've got to have a common carrier. The TransAlaska pipeline has to be a common carrier before its subject to this act. In one way, one could raise the question--why are they worried about this act if they're not a common carrier. One could raise that question. Perhaps they seem that it is just an anchor to windward, they're not going to be common carriers and they don't have to worry about this act, but if they have to worry about it, go ahead and make these arrangements and you don't have to worry anyway. That would be

one way of look at it, but I refer to page 176 of your 1972 Cumulative Supplement to your Alaska Statutes and definitions 9 and 10, 9 is of a pipeline or pipeline character. Three items are listed for coverage of a pipeline or pipeline facility. That it is a facility of a total system of points, used by a pipeline carrier for transportation for hire and as a common carrier. There are many decisions which I could cite to you, one of them, an outstanding decision of the Supreme Court of the United States which would say that you have to be a common carrier under that definition of pipeline or pipeline facility. Certainly I can tell you that at the time time of the joint pipeline impact committee was going through its consideration of this act in its original form--and it went through several forms--the Alaska Pipeline Right-of-Way Leasing Act as the Committee went through this and its staff went through this and as I attempted to assist them, it was clear that we weren't following who was a common carrier in this regulatory act. What we were relying upon essentially the agreement of a lessee carrier in a pipeline right-of-way lease to assume the status of a common carrier. We've seen this problem with respect to the TransAlaska pipeline group. That it probably would not be a common carrier, it probably, though it had transportation that would be subject to the Interstate Commerce Act, that didn't make it subject unless it was also a common carrier. If it wasn't a

the federal act that was designed for common carriers. And so in writing the state act, if you were going to write one for common carriers, it is very important to solve the problem of whether or not a crude oil pipeline like the TransAlaska pipeline group was a common carrier. So how better to solve it than for giving up something of value to the State of Alaska. Something that it owns and turning it over to a group for who knows how many years for common benefit of the lessee and the lessor,-- what better way to obtain common carrier status than to get an agreement by the lessee to be a common carrier. Thats how this problem was solved in the Alaska State legislation. Now, with these two acts to be--proposed to be--revised, if they are so revised, you have a state act even if you keep it intact which really doesn't apply anyway, because what you have is not a common carrier and you have no act left by which to bargain for and use your leverage for getting assumption of the status for common carrier by the TransAlaska pipeline group. This is the way I see it, it seems to me to be a fair way of reading the three statutes together; the Interstate Commerce Act as amended in 1906 and these two acts which the Alaska State Legislature enacted at its regular session.

I do think its important to see that this act was well-drafted and that it does follow the best of the state legislation to be found. It never was contemplated that this would regulate interstate rates of the TransAlaska pipeline company

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this obviously is something that couldn't be regulated. Couldn't be regulated at all. It was handled by, however inefficiently, by the Interstate Commerce Act, a federal act. If the Trans-Alaska pipeline company is subject to the act, we've covered the questions with respect to that, then that act applies and covers that, and this act--the state act--the State pipeline Commission Act, simply does not apply, it so says. It applies to oil and gas pipeline carriers regulated under the Interstate Commerce Act only to the extent not preempted on the federal act. So its clear that this being something regulated by the federal act, the state is not attempting to exercise that jurisdiction. There really is no need to take that out of the act. Its clear that it isn't covered. Anything that is currently being regulated, and theres not much thats regulated in the federal Interstate Commerce Act, Sec. 15042.06.150 says its not covered here. The beauty of your carrier act and I had not contemplated until I got more deep into this regulatory act, that we would be talking about it as much as I am rather than the right-of-way leasing act, the more you go into it, the more you see the philosophy that seems to be there. What is also means, in addition to turning us over to the federal government and ICC, it represents a whole area of problems that you could regulate, you may want to regulate in the future and that you can't regulate because of this act.

It is clear from the most recent authorities, and I have here a summary by and large of the authorities with respect to

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is a vast area of power in the state, authority in the state, in light of the commerce clause of the federalconstituti n to regulate the activities of interstate businesses, including interstate transportation businesses. If anything, the power is increasing. I think perhaps the Supreme Court of the United States is beginning to understand that there needs to be a redress in this relationship between state and federal government in our federalism. The latest cases seems to be going very definitely in that direction. I would just talk about a case like the Huron/Portland Cement Company vs City of Detroit, 362 U.S. 440 (1960) in which it was held that Detroit apply its smoke abatement code to ships that were just in the port for awhile. This called for rather substantial modification of the boilers of those ships. I could take you to another case, which involves very much the same reasoning, they're simply saying today state regulations based on the police power which does not discriminate against interstate commerce or operate to disrupt it uniformity may constitutionally stand. Thats almost the last statement of the Supreme Court of the United States. This act is going in the direction of turning loose the power that the court is trying to return to the states if there is a good place for it. It does seem to me here in the face of a weak federal statutue, weakly administered by a weak agency that is not seemingly interested in doing what it can do with the little power it has,

should do the job that the federal government has not done. I think that concludes, and I realize I've taken far more than 10 minutes, Mr. Chairman, but it does conclude my presentation on that act. Perhaps there would be questions.

MR. CHAIRMAN: Are there any questions of Prof. Witherspoon?

Q. Professor, I'm a little surprised at something. I'd always thought that such a pipeline as this existed automatically as a common carrier. There was no way that the State ___ ___ ___ ___ ___ ___ ___, but I gather from what you said that this act is being composed and __ ___ ___ _____ back automatically to common carrier. We could get out from under that just by a little old act ___ ___ ___ ___ ___ __. Do I understand you to say that there really is a question as to whether it would be a common carrier?

A. I would say there is a very substantial question. I don't say that it can't be argued on the other side, but I would start and I'd be glad to supply this committee with a memorandum on this. Its well documented in the law reviews and the law journals, but I will be glad to start with the pipeline cases and bring them down. Its a confused area of the law first of all, as I think ___ _____ on either side of this question would tell you, but there are very strong reasons for believing that this oil in this intercorporate relationship that is involved with each pipeline company with its parent company. There are very strong reasons for believeing that this is not a dealing with another persons oil. Its not a purchase of oil from someone who is

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as one company dealing in its own oil, well within the Uncle Sam oil company exception in the pipeline case.

Q. Could you cite one or two elements that are missing in this situation that would make it not a common carrier.

A. I think I would rely primarily upon the notion that, and if it is the fact, that the oil produced is essentially the oil of an oil-producing company and that it is not purchased oil, it is oil that comes from its own wells and this oil is put into the line or a portion of the line that is owned by a subordinate or subsidiary company so that it represents, although it is in interstate commerce a dealing of a person, a corporate person, with its own oil.

Q. Wouldn't this line have to take the oil of non-owner producers.

A. No sir, not unless you make them do it as you would do it as you would get their agreement to do under the Alaska Pipeline Right-of-Way Leasing Act. That is the reason that it was designed to secure their agreement to become common carriers. They have to be either in law or by factual basis by which law is applicable common carriers. They are not without more just because they're transporting oil. It is law that makes a transporter of oil a common carrier.

Q. Aren't the stipulations made to the Secretary of the Interior such that it is in fact going to be a common carrier, or do you. . .

A. That would be true for the federal land that is involved, that is right. Under Title 30, Sec. 185, U. S. Code. But in that provision, they did not neglect to put in the condition in the lease or the permit, and this is specifically spelled out in that statute that they must be not only a common carrier, they must be a common purchaser, this is put into the statute.

Q. SENATOR GROH: Didnt the stipulations with the Department of the Interior require them to be a common carrier, for all purposes, not only that portion of the line which is over federal land. It requires them to be a common carrier subject to the ICC?

A. There is a limited provision, I'm not sure what the full scope of it is. There is a subordinate provision following this provision which does call for them specifically to agree that they will utilize. . . (tape stopped)

Q. . . .my recollection also is that they've also agreed to one of their provisions before they can get a federal permit is that they agree to be a common carrier under ICC. Isn't that correct?

A. No, there's no provision, if you're talking about the Alaska pipeline. . .

No sir, about the federal act. . .aren't they obligated. . under the federal pipeline act, doesn't that require them to be a common carrier under ICC?

A. No, it does not. Absolutely not. I mean there's nothing in the Interstate Commerce Act, in my opnion, under these circumstances that requires them to be a common carrier. Under Title 30, Sec. 185 with respect to federally owned lands, there is the requirement that ends with a permit or lease ___ _____ this stipulation.

Q. I'm sure its my fault, but I don't think we're communicating. I'm talking about the act of the federal Congress which allows the pipeline to be built, which is before Congress now. Doesn't that require them to be a common carrier under the Interstate Commerce Act.

A. This is what I've understood. I've asked for a copy of that bill and asked for it today because its been very difficult to get and I'm anxious to see it. I've not actually seen it. I've heard this, and of course, that would solve that particular problem. Then we would get back to some other questions and whether having the authority to deal with other activities of importance that are dealt with by the Alaska Pipeline Commission Act, whether it would be then important to have such an act as this, rather than lets say to turn it over to the regulation of the ICC under an act that may not be substantially different from the present one.

Q. To the extent though that you raise that question, there is a very substantial part of your comments on this act. If they are in fact required to be a common carrier under the Inter tate

Commerce Act, at least that objection would be . . .

A. About 25% of the objection would be modified.

Q. Isn't it also a fact, for example, that Cook Inlet pipeline which presently operates in the Cook Inlet area is under the jurisdiction of the Interstate Commerce Act.

A. I don't know the precise facts of that.

Q. There was testimony as I recall last year when you were here--Mr. Chairman, perhaps you recall it. . .by poeple from Cook Inlet pipeline in which they submitted to us copies of their tariffs and of their various submissions to the Interstate Commerce Act which indicates that at least that little pipeline, I don't remember how long it is, is already under the ICC act, and treated as a common carrier under that act. It was before one of the committees of the legislature, Mr. Chairman, I can't remember which one.

A. Senator, if youdirected that question to me, I would say that submitting a tariff goes to the other question--does this constitute really making one subject to the act without more? This is the whole problem and I would suggest at least in the circumstances that I've tried to describe today that that would not. In any event, it would still leave you with the problem of what does the federal act do; then it would leave you with the further problem, whatever it does still remains open to the state to speak to as it is spoken to by the Alaska Pipeline Commission Act.

Q. Was there any communication from the State to you, Professor, at the time that the discussions on settlement were going on to solicit your opinion as to what should be done in relationship to the settlement.

A. Yes, there was some indication that I would hear later; I did not hear. This was back in January, I offered my services without charge to the Attorney General and I did not hear further.

Q. Did you have an opportunity, by any chance, to read through the stipulations of fact, the pleadings, briefs--the papers that have been filed in the litigation.

A. I have not had anything other than the very first pleading. I believe I had the first proposed or unamended stipulation of fact that was filed.

Q. So your judgment as to what the legislature is going to be judges in the matter, which I suppose by the nature of the situation we are, is not related necessarily on the basis of what transpired in the litigation.

Q. Prof. Witherspoon, let's take a hypothetical case. Say that the federal pipeline act does not pass the Congress for some reason, or in the event that it might be vetoed, would you recommend this legislature passing then Senate Bill 6.

A. No sir, I would not.

Q. Any Portion thereof?

A. No sir, I would not.

MR. CHAIRMAN: We'll now take a ten minute break.

Q. Mr. Chairman, I'd like to ask the Professor about the _ ___ _____. Of course, we're speaking now of Sec. 38.35.120 which speaks to the various reported covenants to be included in any lease that is executed by the Commissioner administering the act and this would be subsection 7 which is now on page 102 of the Cumulative Supplement which has been using the Alaska Statute. If I may read it first: "The lessee carrier expressly covenants in the lease in consideration of the rights acquired by it under the lease that. . .the lessee grants to the state the right to purchase upon reasonable notice an undivided interest in the entire length of the pipeline within the state not to exceed 20%. The purchase price shall be a reasonable [at a reasonable] figure set out in the lease at the time of the lease's execution. The purchase of this interest may, at the option of the State, be made in stages. Exercise of an option to purchase an interest under this paragraph a project or facility _____ ___ ___ ____ approval.

Now the substitute for that is as follows, of course with the lead-in sentence about the express covenant that you have on page 7 of this bill--it is also subsection seven: This is an express covenant that it will afford the State an opportunity to negotiate for the purchase of any interest in the pipeline and here is the crucial language: ". . .offered for sale by it." This simply means that there is no opportunity to negotiate--there

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is no duty to negotiate unless an interest in the pipeline is offered for sale by the owner of that interest, and until there is that offer, until it reaches a decision to offer it for sale, except for sales or transfers ofinterest in the pipeline among the owners of the pipeline, including their subsidiaries, parents, and affiliates. So if there is a sale or transfer of an interest in the pipeline from Owner A to Owner B, that is not an offer for sale that gives rise to this duty. Then there is another type of sale that is exempted, I mean an offer for sale--this is one where there is a sale or transfer resulting from merges or reoganization, providing the sale to the State. And then all of this is provided--the sale to the State will not interfere with exisitng contract rights or obligations among the owners of the pipeline or with any other third party. Of course, all I would suggest that it will always interfere. I mean, as it was contemplated here, it will always be an interference with a prior contract if the arrangement has been made for a joint venture pipeline, there will always be in a joint venture pipeline some contractual provision which speaks to the allocation of ownership among the particlpants in the joint venture. So I would say if there's any kind of change of a percentage ownership that this would be on appearances as would seem to be in the scope of this clause. Its difficult to conceive _ _____ interest in the total line. Then a further proviso provided the term of the offer for sale are solely at the discretion of the lessee. This means that

you don't have to have an offer for sale, but you're going to negotiate with respect to terms for sale that the State has no capacity, no rights to speak to, there's nothing in the lease that can formulate in any sense the __ ___ ___ of the State at the time the Commissioner grants this lease that will speak to the terms of that offer. As I see it, this is one of these provisions is at the North Pole and the other is at the South Pole. For all practical purposes, this provision, if it is the valuable provision that it was deemed to be when this Alaska Pipeline Right-of-Way Leasing Act was enacted, it is totally exhausted--there is nothing really left of a right to purchase.

I would simply think that you might do better without it; actually it tends to double negative really, and one might be better off not to be encumbered by these limitations. Just sit around a bargaining table and bargain. To come to the other point, it does seem to me that very much can be said for the reservation of this right to purchase. It was hoped that this would never have to be exified. I think in the discussions of the joint pipeline impact committee that I recall and in the discussions afterwards, there was never really a feeling that if this act were--and things were accomplished by it by people sitting around the bargaining table in a cooperative spirit that they're bargaining not only for each other but for the good of the people of the State of Alaska, that you would normally come out with terms in the right-of-way lease that would serve both

parties. Each would get something substantial out of it. This was kind of a last ditch reservation--if all else fails, this wouldn't be as good as some other things that were hoped for, but at least the State could enter into the ownership of the line. It could be an equal participant almost in the private sector of our economy. It would be a 20% owner. A 20% owner is fairly significant owner in a joint venture pipeline. While it isn't 50%, one would hope that one would find friends among at least 50 plus per cent of the ownership. There are things that a state could do as an owner of a portion of the line that might make another owner want to join with the State. Its the notion that really as an owner of the pipeline, a part-owner, owner of an undivided interest in the pipeline, that it could reason at the Board of Directors table so to speak. It could know what was going on. It could know hte purposes. It had not been able, let's say, at the bargaining table for the lease to get an agreement to do a number of things that are possible for the commissioner to set up in the lease. For example, he might want to get them to agree as to the rate they would propose in their tariffs to the ICC, which might be at a lower level than they currently had. Which, let's say, the Commissioner might feel was a more reasonable rate--that they really should not have so high a rate. Although it was one they could get from the ICC, if they filed it. But for a quid pro co, theymight agree in this lease to have a more economical rate. That might become a very important

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thing, but suppose you could not get that kind of agreement. Suppose you couldn't get an agreement to employ Alaskans--native Alaskans on this pipeline. That you couldn't get an agreement to provide educational facilities, on the job training facilities. This is one of the things that at one time was contemplated to be an express provision. But because it was a new piece of legislation, it was felt that this might well be left to the discretion of the Commissioner. And at the bargaining table, in giving up some things, he might get provisions in here that would be extraordinarily beneficial and the company would see that it was something that it could give without hurting its own interests in the matter. But if these things were not obtainable, that the Commissioner felt were appropriate, the Canadian government for example deem important to put in their arrangements with the pipeline companies, that lease companies find important to put in their arrangements with the pipelines companies, then there was always the possibility that the State could become an owner up to the amount of 20%, which as we know was tailored to the State's ownership interests and the percentage of production that one of its taxes represented. This was that kind of a feature.

It seems to me that the provision has another virtue that it would enable not only the State to participate in meetings of the board of directors and know whats going on, the purposes of decision, it would enable it in a sense to have some kind of weight in those decisions, but in addition it would be able to

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get at company records in a very thorough way and just perhaps would have had better information for that reason.

Q. (not clear on tape)

A. I think I would prefer for experts--economic experts like Mr. Lipton to comment upon that. It may very well be a fact--an economic and important fact. It does seem to me speaking from the standpoint of the conception of this law, the Governor had at one time proposed ownership of the entire line. Of course, this is not possible under this provision. This is a portion of that. It was contemplated, I gather, then that financing might be a problem, but financing of the whole line was not that impossible. It was conceived to be feasible. I remember reading a document surely over a quarter inch thick prepared with respect to the feasibility of that and there were arguments both ways, but as I recall, this item was not deemed to be an overpowering item, with respect to feasibility. That financing was possible. I think at one of our hearings we mentioned too that there are some very important and large natural gas pipeline interests in our county, who, I don't know what the fact would be, but I'm just wondering whether they might not be interested in building this line and operating it as a common carrier. Perhaps as contract operators of it. Perhaps--I'm just wondering out loud with you whether past decisions don't relate to this question of feasibility.

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I have stated four general propositions about the proposal for amending the Alaska Pipeline Commission Act. I think I really only need to state one proposition with respect to the Alaska Pipeline Right-of-Way Leasing Act, and that is that the Act does not resemble, at all, in any essential respect, what you now have on the books. Indeed, it has a provision in it that I have never seen before in my life, and I have been--in my professional life--in administrative law, administrative process, but I have never, and I may be proved wrong--there may be several of them--but I have never seen a provision with respect to judicial review such as you have in this action. I just think its amazing. And I say its amazing because. . .

Q. Which one are you dealing with now?

A. This is Senate Bill 3 relating to the provision on judicial review of decisions at page 14, subsection b. The only grounds for which judicial review of a decision of a commissioner--I guess they must mean there are to be provided--are failure to follow the procedures set out in this chapter, or abuse of discretion so capricious, arbitrary, or consistory as to constitute a denial of due process. What this really means is that his decisions for all facts and purposes in an impregnable decision. It is rare, and it should be rare when we should reverse someone for violating the Constitution. Its unfortunate when we have a violation of the Constitution by a legislature or a court or by the Chief Executive even. When it comes, we hope always we'll

have the courage to face up in the courts to correcting it, but this doesn't happen very often. This simply means for all practical purposes, there is not the usual statutory standards for review. Its a constitutional law standard for review in a statute. It is confining the scope of review extraordinarily narrowly. By and large, no decision of this Commissioner will be reviewable or reversable. It is almost airtight.

The two comments about this: Whether you want an administrative agency to be so impregnable to reexamination in the courts of the validity of what that administrative agency has done. Anyone can err. They can err in any one instance, and perhaps there should be broader grounds for review and reversal of the decision. It might be unreasonable without being constitutionally unreasonable. By and large thats the standard we have utilized. We've often said there ought to be evidence where it is an administrative agency decision that is to be based upon evidence, it must be relevant competent and probitive evidence to support the determination by the administrative agency. It must be substantial. If there is a substantial evidence to support what has been done before the facts if it is in accordance with the law that is stated in this fashion, why it stands. But this is a broader standard that this very narrow standard, at least as I read it, on page 14. I did want to point that out.

Really, it doesn't make much difference how impregnable the

decision is when you look at the rest of the statute, becuase the rest of the statute really means that there isn't too much the Commissioner has to do anyway. He is not focused upon the problems that the joint pipeline impact committee was focused upon and this is the awful problem of being limited in what the State can do through its regulatory power. After all, what we're dealing with here, is an interstate crude oil pipeline or an interstate natural gas pipeline, both have to be thought about. And there are important problems even with respect to interstate natural gas pipelines. Now the Natural Gas Act of 1938 administered by the Federal Power Commission is an act, as I indicated before the break, as extraordinarily sophisticated, excellent piece of regulatory legislation. It leaves very little that needs to be done as far as regulation is concerned. If regulation should be with the federal government and that was the judgment of the federal government through its authorized decision makers, then it does the job. We can only quarrel possibly there, that the public utility regulation concept may, nevertheless, set rates to high. And this is a comment that has been made about either the common carrier or the public utility regulation concept. These authorities that I've stated, or cited in my memorandum of January and March of 1972 for the joint pipeline impact committee, but it is a very carefully drawn instrument and that's about the only criticism that you could make of that act. Well, obviously, if there are goals which Alaska wants to achieve with respect to

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to a natural gas pipeline, but I don't spend much time with that kind of pipeline because I know your thoughts are in another direction. But if you do, at some time in the future, want to do something for Alaska with respect to the activities of natural gas pipelines, you cannot utilize by and large your Alaska pipeline commission Act. You're excluded. The only hope that you have, the only way that you can deal with it is through another means--regulatory means. It was for that reason that the joint pipeline impact committee conceived the concept, not a new one,of the use of the State contract and the State property control and property disposition power, and this is an extensive power. It has been extensively used by both the federal and state governments. It has been termed really a power of government that has gone unnoticed as its been utilized more and more and more. The constitutionality of the existence of this power, the constitutionality of its exercise has long since been established and it is the device that is utilized here. But having this power, this authority to deal with the matter by giving something and receiving agreement back for giving something, that's essentially what its all about. Having this power, this package, so far as the kinds of economic problems and social problems, civil rights problems really even to which this package was addressed, these are not touchable with respect to Natural gas pipelines without what is in the current existing form of the Alaska Pipeline Right-of-Way Leasing Act. With respect to crude oil pipelines, there was some authority, as we indicated earlier this afternoon,

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fairly considerable authority for dealing with activities at a local impact, even though they were activities of an interstate crude oil pipeline carrier. It was on the view that nevertheless the use of the contract power and the property control and disposition power of the State was to be preferred. It was to be preferred because it would make less questionable, it would largely take out itself of the realm of constitutional questions. If this power was utilized rather than the regulatory _____. Moreover, there were aspects, activities of the operation of an interstate crude oil pipeline company that could not be reached through the exercise of the regulatory power--holding out over "do this" don't do this" and then sanctioning that pipeline with civil penalties, civil sanctions for violation of the rule. For that reason this was the route adopted by the joint pipeline impact committee and submitted to and adopted by the legislature. There are many many things that are wrong. I would say that the crucial provision of the act are those that are required covenants. I would say one of the most crucial parts of the act are those covenants set out in Sec. 38.35.120. These are dealt with in this act at the page we--the section we were referring to--but which begins back here on page 4 and then continues forward for several pages--I would like really to begin with two--subsection 2--which is as I see the proposed legislation, completely removed as is subsection 1.

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One of the principle purposes of that required covenant was to give the State a continuing kind of leverage, with respect to the lessee under a right-of-way--a pipeline right-of-way lease. It was just simply felt that no Commissioner, however wise, however experienced, even as the present Commissioner is so wise and so experienced, no one at the outset could decide everything that needed to be decided here. A lease was going to be executed that might be in being for 25 years or 50 years and what goes into that lease at the outset, simply may not be all that it should have been. At least, with respect to detail. Even so far as the route that the pipeline was to take and the physical specifications of it. This provision was designed to permit some negotiation, some flexibility after the general guidelines were laid down for this route or the pipeline. The specifications of the construction so that if a problem developed, they could sit down at the table again, and before certification of a specific kind of construction or acquisition was made that the parties could agree and there would be this leverage in the State to say, well look, consider this before we're willing to issue this further certificate, we want this kind of arrangement. Of course, here is a place where other parties would have to face each other at the table and they would have to bargain it out. Still another was this notion of the common carrier. We've seen already in the discussion before the break how important the status of common

carrier is. Again, to mention natural gas pipelines, there is nothing in even the most sophisticated Natural Gas Act of 1938, which makes a natural gas company a common carrier, it can become a common carrier in several ways. It can do the kinds of things that under the law would make it a common carrier. One of the ways is that it can agree to become a common carrier. That has always been recognized as one of the ways. If you want it later on, you discover vast resources of natural gas here, and if it becomes important to the people of Alaska to have that natural gas pipeline; deal with people who own natural gas and are producing it, who have no pipeline, no way to get it to market--there's no way they're going to get it to market. Not under the federal act, unless you have an Alaska Pipeline Right-of-Way Leasing Act which says to someone who leases this land and does it for pipeline purposes that they agree before they get that lease to be a common carrier--then, they are a common carrier. Then you have an impact upon the federal act. This isn't in conflict with the federal act. The federal act doesn't speak one way or the other. Its quite possible for a natural gas company to be a pipeline company, to engage in interstate transportation and not be a common carrier at all. Most of them are not. But Alaska may be different. There are some natural gas companies operating interstate which are common carriers. This was here as a hedge, as an anchor to windward for the future.

It will be very important someday perhaps, depending upon what you discover of your natural resources, to be able to say to a lessee carrier--look, you have agreed from the beginning for your crude oil pipeline to be a common carrier. There's no question about it and you're to perform the duties of a common carrier. With respect to natural gas pipeline company, you'd say, well, you don't have to be one unless it is determined by the Commissioner sometime after the lease that its appropriate for you to operate as a common carrier because they had agreed at the outset to be a common carrier, if that determination was made, then they would have to be so if the Commissioner so found.

As I read this provision that replaces the common carrier provision, Section 3 which is set out at pages 5 and 6, there is a total loss of the capacity to require a lessee carrier which will operate a natural gas pipeline to be a common carrier. What will the people do if this develops? I don't know whether it will develop or not. What if they want to produce it themselves or someone to whom they convey an interest in their land who wants to produce that natural gas and they're not pipeline owners. How are they going to get that gas to market? There's no way you can take care of it in the Alaska Pipeline Commission Act. The only way it can be taken care of by the Natural Gas Act of 1938, the only way it can be taken care of is by a provision such as in Section 3. That's lost entirely.

Now, with respect to a crude oil pipeline company, its made discretionary with the Commission. It simply provides now that if the lessee will perform all of its functions under the lease as a common carrier if the Commission determines at the time the lease is issued or, if at any time after the execution of the lease, the Commissioner after public hearing determines that assumption of the status of common carrier is required in order to serve the public interest. Now, that at least has the merit that it might be required, but also it might not be required. It was felt that this was such an important problem that it should be required. Specifically, I might say, the federal government, when it leases its lands has this provision, state governments typically, in either giving the power of eminent domain over to pipelines or when it leases its lands, at least a considerable number of them do have a similar provision to what you have here. That the common carrier status will be assumed. So that is law.

The notion of common purchaser, as it was originally in the statute, it was required that the lessee expressly covenant that it will assume the status of and shall be a common purchaser of crude oil and natural gas depending upon the kind of pipeline involved. Now, basically, I think we can say the common purchaser covenant, like the common purchaser statutes, contemplate that a pipeline in or near an oil fielt is required to purchase

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gas in the case of gas or crude oil in the case of crude oil fields from owners of that gas or crude oil upon some reasonable equitable basis. This provision would be an affirmative duty. It would be an affirmative duty at the outset of the execution of the lease and it would be triggered, of course, again, by a determination afterthe execution of the lease by the Commissioner at the public hearings that assumption of this status at a particular time is required to serve the public interests. That, I gather, is lost entirely. Now, what will that mean with respect to natural gas pipelines? Its clear under the decisions of the Supreme Court today that you cannot impose by a regulatory act utilizing your regulatory powers setting out a rule that you shall do this and then applying a civil or criminal sanction for not doing it. Its clear that such an act of imposing the status of common purchaser upon an interstate natural gas pipeline subject to the jurisdiction of the Federal Power Commission under the Natural Gas Act of 1938 is unconstitutional. There's just no way that you can do it. And yet, if it is important for you to achieve this end, the only way that is available to you is by an agreement with the lessee to assume voluntarily this obligation because of the value of what they are getting from the state. I say again, this is the kind of thing that the federal government has long since done since 1920--there's nothing particularly new in this. Where I personally learned about it was

reading Title 30, United State Code, Section 185. Its not the best statute in the world, but in the first statute that was the federal government acting through its Congress put such a provision in the right-of-way act, with respect to pipelines being put on federal lands. It seems to be that this is a very great loss. It may be very important with respect to natural gas lines for people who want to get their gas to market to be able to have it purchased on some equitable, ratable basis by the owners of a natural gas pipeline.

The same arguments can be made with respect to crude oil pipelines. There, there is no constitutional inhibition upon the State of Alaska, anymore than on the State of Texas or another state imposing the common purchaser requirement by a regulatory statute. If that's what you want to do, even with respect to an interstate pipeline, I would suggest that you can do it. There is a proposal to do that in the Governor's spectrum of bills. Then the question would become, if that's the way you want to do it, rather than through the Alaska Pipeline Right-of-Way Act, the question is how wise is this particular proposal. What will be your gains, if any? What will be your losses? I certainly would be happy to speak to that. I can--perhaps it would be wise to speak to that now, if you think so Mr. Chairman.

I have in one hand the Texas Statute, again, its an old

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statute, but its worked pretty well and its been--I won't say its a model of perfection for other states--but it has been copies and by and large its administration has not caused many problems. It creates the statutory duty, even with respect to interstate crude oil pipelines to be a common purchaser, along the lines that I've described, but it doesn't have any if, ands and buts about it. Its a duty of a person whose covered by this act. "Every person, association of persons or corporations who purchases crude oil or petroleum in this state which is affiliated through stock ownership, common control, contract or otherwise with a common carrier by pipeline or is itself such a common carrier, shall be a common purchaser of such crude petroleum." That's the one with respect to crude petroleum, and we have a similar one that applies to a similar situation with respect to natural gas. But it places the duty to be a common purchaser with respect to those covered by the bill and it isn't dependant upon an administrative agencies later determination about it. Its a harsher provision than was had in the Alaska Pipeline Right-of-Way Leasing Act, but it was felt that it was not appropriate, that the situation in Alaska should be studied first before you imposed this. That there should be the agreement that it should be imposed, pursuant to administrative determination.

One of the interesting things that I find in this statute beyond that point is this provision. I'm not sure I fully understand it. I must study more and I'll certainly report back to

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your chairman if he so wishes. A rather remarkable provision is the second page of Senate Bill 7, its Sec. 31.15.020(c): "A purchaser cannot be ordered to be a common purchaser on the basis of purchases of oil taken in kind by the United States of the State of Alaska." Now, let us go through and see what the draftsman has done. Let us assume that the State of Alaska under its leases obtained its royalty payment in kind. You will have done that because, of course, you have decided as a State that you're better off to take that in kind for some economic reason. It may be important to the economy or it may be important to the State treasury. So you've taken the oil, rather than the royalty payment in dollars and cents and you want to do something with it. You don't have a pipeline, you don't have even a portion of a pipeline; that has been given up by this proposal. You don't have a 20% interest--undivided interest--in the pipeline. You're not about to build a pipeline to carry that oil. There's no other pipeline. Suppose the lessee says that we're not going to build anymore pipelines, we're not going to loop it, we're not going to expand it--it may not even connect up to take your oil. What do you do with your oil. You're not going to build storage tanks to keep it there; and I suggest to you that this means--I don't know what it means with respect to the State--they don't say that they won't buy from the State, it doesn't say that here, so I suppose they would buy from the State.

Perhaps thats the answer, I don't know. I have a question. Would they refuse to buy from the State if you take in kind under the leases? It doesn't say one way or the other. It's only implied, and maybe if its implied I would surely hope they would honor your taking it in kind and then purchase from you, the state. Suppose you sell to someone else? And someone else sees a value in that oil. Usually it will not be the State itself that sees a value but in its selling to someone else. The purchaser from the State of Alaska doesn't have any __ _____, that's the way I read it. I will study it more carefully. It just simply means that he doesn't get anywhere. I hope I'm wrong when I raise that question.

Then it goes on to say "or on the basis of the payment of royalties, overriding royalties, net profits, interests or _____ ___ __ interests, whether in kind in value, or on the basis of a producer taking his own production. A very unusual provision. Maybe it has a __ _____. I would certainly want to study it for you and report back what it means as its likely to be in litigation.

Moving on to other parts of the required covenants. Its unusual to see something go out of the act with respect to exchange of crude oil and natural gas. This is number six of the Pipeline Leasing Act. This goes out and even five goes out--Sec. 38.35.120 at page seven. These two go out. One wonders why the lessee would not agree to accept convey and transport or purchase crude

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oil or natural gas without unjust or unreasonable discrimination. Suppose there was no obligation to transport or to purchase but still if there weren't actual transportation or purchasing, one would think that the State would be able to require that it be done without injustice and without unreasonable discrimination. So that could at least have stayed, it seems to me, even with the typing out of the assumption--the covenant with respect to assumption of the common purchaser or common carrier provision.

Six refers to a covenant to exchange crude oil or natural gas, depending on the kind of pipeline involved, with each like common carrier in providing connections and facilities. This has been replaced in part, modified by, as I see it, the section ten. At least its connected with it. I really don't see the counterpart, Mr. Chairman, of six anywhere. It could only possibly by some kind of implication be included in the new modified ten. My judgment is that the required convenant to exchange crude oil and natural gas with each like common carrier has gone by the board. Again, . . .(background conversation inaudible on tape) Well, ten of course, is not a covenant to actually exchange. Its a covenant to make connections and facilities on the pipeline subject to the lease.

Q. Am I to understand then sir that if the pipeline is built, for a non-producer to buy it, then the producer is not required to sell?

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A. Let me be sure I understand you. If a non-producer. . .

Q. Let's go back. Build the pipeline--they do not produce gas, they carry it--they buy it and they carry it. Am I to understand then, that under this new bill, they will not be able to get the gas?

A. I'm still not sure I understand fully the implications of your question. This act is not speaking to what a lessee may not do by way of obtaining gas. There's nothing in it which speaks of that.

Q. I know but of course, by an exchange--you go to common carriers, but the exchange with the common carrier has been taken out.

A. Thats right.

Q. Therefore there's no exchange with common carrier. . .

A. I see your point. This, so far as a lessee-carrier here who takes out the duty , they required duty that has to be filled out in a covenant. It takes that out of the lease that is there by the present act and El Paso Gas in the situation that you have posed, would not be able to take advantage of such a covenant, because its no longer there; and the exchange could not be compelled under this express provision of the lease. Of course, it might be very important for El Paso to be able to effectuate that, and it might be in the State interest in many instances to facilitate that exchange. And that was the purpose of this provision.

The connection, of course, this is something that probably was handled in the Alaska Pipeline Commission Act. That is, you do have a provision there which does state for the problem of connection. It may be that this is something that you could handle by the regulatory approach. But, of course, you can always hope to obtain more by bargaining with people than you might be able to do by regulation. That was the idea of this provision ten in this same section; that we see in the original act. It provides, as it currently is in the law, that the lessee carrier covenants it will provide, where economically feasible and consistent with the primary function of the line, connections and facilities on the pipeline subject to the lease--both on state land and other land in the State for the purpose of delivering crude oil or natural gas, depending on the kind of pipeline involved. The persons desiring to purchase who are located in municipalities in the vicinity. The change is that the word "land" is substituted for the word "pipeline" in the sentence I've just read. So that covenant only relates to connectio.s to the pipeline on state owned lands, in light of other portions of the revisions of the statute proposed. So that is a very limiting factor. It would not anymore require that, as it presently does, that the connection be made with respect to the portion of the pipeline that happened to be on fedeally owned lands. Or that might be approrpiate to some municipality in the vicinity of the pipeline in the State.

The new language is added in the proposed Section 10, that the expressed covenant is that if the lessee carrier will provide. . .and so forth. . .a connection on the land subject to the lease for the purpose of delivering crude oil or natural gas, depending on the kind of pipeline involved, to persons contracting for the purchase at wholesale of crude oil or natrual gas transported by the pipeline. In order to meet the requirements of this covenant, the lessee shall not be required to enlarge the pipeline system and extend the pipeline, acquire additional right-of-way, or incur additional obligation or incur any cost or liability associated with the connection or connected facilities or assuming obligation inconsistent with that federal law. This is in line with the earlier deletion that there is no ability in the Commissioner anymore to seek after a covenant for increasing the facilities, increasing the size of the pipeline. Of course, it is limiting still further this provision and its effectiveness.

Finally, I'd like to point out with respect to covenants that Sec. 38.35.130 of the original Act is also dealt w' h in the proposal and I'm going to skip for the moment some ·rtions in the bill we're now considering to page eleven. The whole notion of Sec. 38.35.130 was that you couldn't spell out many of the provisions that might be appropriate for protecting the people of the State and the interests of the State; and that there should be an opportunity for the Commissioner to achieve

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these additional covenants. It might be as I mentioned earlier, a covenant with respect to the maximum rate for transportation that carrier would ask or file for with the applicable federal regulatory commission. It might be with respect to labor conditions, employment of employees that a covenant might be on. Excuse me, I should be referring to .150--that's the one that I want to refer to now--38.35.150, it is the provision that is most intimately related to the required covenant section. It is the optional covenant section, and that is repealed. Its all done for. And certainly the joint impact pipeline committee contemplated that there would be some very important valuable convenants that could be gotten at the bargaining table by hard bargaining, by collaboration between the parties at the bargaining table and that it might be as vital as anything that would be placed in the lease. It would not be a required provision, it would be an optional provision and it might become very important say five years from today, or ten years from today. Now authority is completely and totally wiped out. We have instead of a flexible instrument a very inflexible one. That device was conceived by the joint pipeline impact committee to be a very vital feature.

The point about the rentals I think perhaps needs to be mentioned next and then I will be through, its been a long session I know for all of you. This is Sec. 38.35.140, which is set out

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on page twelve. The--You do have a provision for the payment of the higher of two rentals. Essentially, one of them--and the second one is related to the annual net earnings of the lessee carrier. The whole problem here is one of whether the State as a lessor is entitled as a lessor to do what any lessor in the private sector is l'kely to do and certainly can do in leasing his, her or its land. And that is to realize the value of the productivity of the land in light of its use while its being rented. This is the very notion of the commercial percentage lease. That's why it was developed. Land is not just worth what it is when it isn't used. Its worth what its worth when its used. This is a concept that is not new, its notradical, its a very conservative notion. If you're the owner of the land and someone wants your land for a valuable use, which you typically do if you're in the private sector and you're a cattle businessman, business person, business entity, you try to capture in your rental, whatever the form of rental, you try to capture the value of the productivity of that land in the hands of the lessee. In The Alaska Right-of-Way Leasing Act that precisely what the joint impact pipeline committee was trying to do, what it proposed for the legislature and what the legislature adopted. It provided for a formula here which would bring to the State, like it does to any owner of land the rental value in light of the productivity of the land in the hands of the lessee. And you can talk about shopping centers if you want to, you can talk about leases

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of the land for the production of minerals. This is what you think about. And that's what was done. Now, what is a good way of capturing the productivity of the land in the _____ - of a lessee who is going to put it to a new use, that perhaps the lessor knows nothing about whatsoever. This is the position of many lessors in commercial percentage leases. The best example is a widow whose husband ran a grocery store or a business in a small building. Some business house comes to her and says we'd like to rent your premises. One of the best leases that the widow can make often is a commercial percentage lease which will tie her rental to the business done, the gross receipts taken in by a business that has leased her premises, a certain fair proportion of those gross receipts and added to her rental. Perhaps there are other provisions that you would put in there because of special circumstance of who the lessor is to protect her, if you were her lawyer. And your percentage rental would not be something that would be arbitrary, yo would take it light of other percentage rentals that are charged for that type of operation. This would vary depending upon the business that was to be operated--a parking lot, it would be very high, if it were some other kind of operation it might be relatively low.

In the case of the State, why is it not entitled to base a rental upon the productivity of the land in the hands of the

lessee pipeline. This is not _____ that lessee pipeline may be a wholly owned subsidiary of the producer company, its accepted operation. Its a separate business. Indeed, the oil industry has told us its a separate business. It is incorporated separately. Wouldn't you have separate pipeline companies that are not operated by a producer company. So we're justified in _____ ____ is a separate oppration. Its different from leasing the land for producing the minerals in it. Its another business. Its true that some companies integrate and they have both operations and its true that sometimes that incorporate two different entities to handle one business, to handle both businesses separately. So, this doesn't represent a reason for treating the State any differently from any other owner of land where that land is going to be devoted to a profitable use. So this is an answer here to measure the kind of rental that the State is entitled to obtain in light of the productivity of the land in the hands of the lessee for the use that the lessee is going to make of it. And it is tied to annual net earnings and to a percentage of them.

Of course, Alaska had a special problem and that was that this could not be so high as to affect adversely other _____, that the State had in mind. And this was a central factor in the discussion. This was cut down, not once, but as I recall, several times in the discussion of this committee and the committee

of the legislature that processed the bill.

What we have substituted for it in the bill that you have before you is a notion that is called the annual fair market value. You have in here _____ that this is a departure from the usual principle _____ all local owners of land including the State as a kind of a second class citizen in the economic world. It says this--the appraised fair market value of the land leased for right-of-way shall be determined "without regard to any enhancement in value attributable solely to the pipeline facilities on the land or the use of the land for pipeline purposes." Here you have a fundamental difference in philosophy. Is the State entitled to operate like any entrepeneur in the market place for the rental of land or is it not. The legislature decided in Sec. 38.35.140 that it was entitled so to do, and this is an effort to calculate some kind of minimal rental on th bases of that philosophy.

A final thing I guess I should mention. This is the provision that you see Sec. 38.35.160 on page twelve of this act that is proposed. This provision states that no lessee may

(tape recorder unplugged for awhile here)

I think that concludes my presentation, Mr. Chairman.

MR. CHAIRMAN: Thank you. Are there any questions? Yes, Senator Groh:

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Q. Professor Witherspoon, I'm trying to establish in my own mind, the _____ here so we can deal with them rather than with what I call the peripheral issues. Insofar as the gut issues are concerned, you are the main draftsman, wouldn't you say, of the right-of-way leasing act of 1972.

A. Under the direction of the joint pipeline impact committee which made many many fundamental changes.

Q. And which changes, as a practical matter, the 1973 amendment that is SB 3 as produced here by the Administration is substantially changes the philosophy and content of that act.

A. Yes, its essentially gone, I think.

Q. Is it--or I assume its essentially gone because the administration and/or of course the administration's advisors, experts and in the litigation, there's some question in their minds as to whether they're going to be able to sustain it. Would you say that that's a fair conclusion?

A. I have been not that privileged to them. But I would imagine having them come to some negotiated settlement with the plaintiff's through challenging it that that's a fair conclusion to draw.

Q. It seems to me that the State thinks they're not going to win the litigation, and that they think the legislation ought to be changed. And their most expert advice, the administration, the Attorney General, whoever's working for him, the Profs.

Williams & Meyers, and whoever else they've hired indicate that they're not sure they're going to win and they therefore want to change it. But they also had participated in the litigation so they know whats transpired in that and you haven't. . .it just seems to me that we'd get the balance--you know if we put it on scale that I've got to tilt in their favor just a little bit. Would you agree with that--that it would be a reasonable conclusion?

A. No sir, I would not.

Q. I see. Can you tell me on what basis you make that statement.

A. On the same basis that we once had a Dred Scott decision which said that a Negro with a piece of property in a free state and it took a Civil War to correct it. And for the same reason that the Supreme Court in the case back in 1964 decided that the ___ ___ ___ state doctrine prevented an American citizen from doing something about property that was confiscated under the Castro regime. Just recently the Supreme Court turned completely around. Justice While the sole dissenter. In 1964 and 1972 the Court turned around.

Q. As a matter of fact, many of us are worried about the Supreme Court of the United States, those of us who, like myself, have been pretty active in the field of civil rights. One decision rendered this year, for example, a person who agreed to do an

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article saying that this is just not the way constitutional law is to be administered by the Court. So I'm just simply saying to you that if the Court can go one way or a judgment of lawyers can go one way, but it can be very very wrong.

A/ After all, I think the ingredient that we have to face here is, that we have substantially this act on the books--the principle of the act on the books at the federal level since 1920 even with respect to pipelines. There hasn't been a hint that its unconstitutional, its true its the federal government not the State government. But the __ _____ we have indicates that the power of state goverament _____ ___ be the first to agree. But the decisions we have indicate that the power of the state is similarly broad and you won't find many decisions, I know of only one, and this could be a faulty analysis. . .I know of only one that has said to a state your exercise of state contract powers is unconstitutional and that was because Texas discriminated. They discriminated and they discriminated obviously, overtly and unfairly. And they should have been held unconstitutional. We've tried to hold back in this provision from discriminating in any way is possible. Maybe there is a discrimination. If so, it should be struck down, but the basic power is an extraordinary power. I would suggest Senator that this is perhaps something that has been on the books to be done by State's since the Supreme Court decided the case of

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United States vs. Lee Butler, when it recognized that the power to control and this ___ ___ _____ power of government is a totally different kind of power from the regulatory power of government. And that it opens a new way in which we can begin to cooperate instead of making an industry almost an outcast, sometimes to regulation we can sit down and bargain, maybe you can bargain with people and get them to do more.

Q. So you're best judgment, you're best advice to us is that so far as you're concerned we should continue to litigate, is that right?

A. Yes, that is right.

Q. And if our own experts tell us that that is not appropriate you iddicate, as I understand you, that we should not listen to them and make our own judgment and go ahead and litigate.

A. No sir, you asked me my own question--I think you asked the only one person who can make up the mind of the--or the one group of persons who can make up the minds for people in Alaska, and those are the people & their decision makers like yourself. And I think you just have to make a judgment. Whether the merits of this notion, this concept, both on the Alaska Right-of-Way Leasing Act brings so many benefits and potential benefits to this State and solves so many problems down the line, that its worthwhile trying.

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And perhaps there are other expedients that remain possible, raising the funds that are needed by Alaska apparently. I for one, if you don't mind my speaking in a kind of side response, I would wonder why you need the consent of the oil companies to tax them, for example.

Q. Well, we're not going to get into that. We don't as a matter of fact. I agree with you.

A. Then, secondly I would wonder why the Governor's proposal does not assume new importance--his original proposal does not assume new importance--if you have a problem of constitutionality. And I would wonder why if _____ might be innovated and created by a way of setting up a task force to find the business people who will do this without litigation. And to enact the special legislation that would be appropriate to admit them to put this together, perhaps to _____ from these oil companies and pipeline companies that part in their investment, take them out from under so that their expenses are taken care of to the extent that there are things here that can be utilized--there are studies, there are material, and so on--and take people who are really expert in constructing pipelines and perhaps they would be willing to help Alaska here to do this.

Q. Well, I know that we could intellectualize on it and perhaps devise other schemes, but I think that you will have to concede with me that it is pretty tough to go on ahead to litigate if your own experts and your own administration indicate to you that it's their best judgment that you are going to lose that litigation.

A. I can understand that.

Chairman Q. Since we have to be the judges, we have to look in depth as to how they litigate it with what type of experts, and the periphery of your comments on this bill, I think are just as important as the total policy contents, because it shows the negotiations that went on and the specific small items that may either have been negotiated for or given up.

Prof. Witherspoon: Also this was, generally speaking, a legislative creation, not an administrative. Administrative independently now seeks to change legislative creation. This is important, but it is a side comment.

Chair: Are there any further questions for Prof. Witherspoon? Senator Rader.

Q. Professor, insofar as our regulatory bill is concerned, we are exercising sovereign powers of the state which are not subject to negotiation, property rights or anything else. If we repealed that portion today, it wouldn't make any difference. We could re-enact it next week or next month or years from now and still be in the same standing we would, if we had it on the books today. Is that correct?

A. As I understand your question, yes.

Q. Now, the only parts of this then that are critical, where we are at critical decision making process, is that portion which depends upon our rights as a land owner?

A. I would think so, Senator.

Q. Right now those portions are: No. 1, the option to purchase 20%.

A. Yes sir.

Q. And the fee that we are going to charge, the commission -- What did you call it?

A. Percentage rental.

Q. Percentage rental. Now, is there anything else. Let's see, a common carrier status.

A. I would think the common carrier/common purchaser status, at least in future in the sense that right now they agree that when the commissioner makes determination,in the case of a gas company, that should be done. It's automatic in the case of a crude oil company with respect to common carrier.

Q. It's your thought that we will not be able to get a handle on that through our sovereign powers? That the best way to get a handle--or is it the only way, or the best way, or what is your judment?

A. My judgment is that for many of these the only way that you can hope to get it is by bargaining and by exchange of goods between the lessee and the lessor.

Q. Now, insofar as the accelerated rental is concerned, you don't really see that as a revenue measure as much as you do an incentive to hold down the tariff?

A. As a matter of fact I had even at one point argued for it being more flexible than it is. That is, it would be a bargaining tool that you would cut down on it if you got a _____ that was of value to the state, but here is a case just where I had a view that was not accepted by the committee. I think the committee was probably correct and I was probably wrong.

Q. Now, are there any other items than these three that you think they are inherently based upon our contract right? Of course a contract right is necessary now because once we issue the permit it's either in the contract or it's not.

A. That's right, that's right.

Q. And if we don't do it now, it's forever lost.

A. I would at least retain the ability in your commissioner, who's had long experience and a very able administrator, to be able to include other convenants that here today you and I, as we talk and we calculate what should be in there, might in this lease be very important because of knowledge he has that he gains after the act is passed, and I think your 150 option as it is now, is a very excellent thing. It's essentially what's in the federal act. We hope you would keep that.

Q. We're dealing with some oil companies that are maybe skittish about what we might require in that regard and perhaps we are hopefully only months or weeks away from dealing with this. What kind of an optional convenant do you think would be reasonable for him to put in, let's say within the next three or four months, that we don't know about today or that he can't tell us about today?

A. I would certainly hope that he would be able to bargain for providing education and on-the-job training for residents of Alaska - native of Alaska - and to employ even a percentage. If this were done regulatorily, you have serious constitutional questions. Done by the contract power and the property power I don't think it's any serious problem at all.

Q. Well, is that something we should write in there today as we are with these others? Again, we are talking about a industry which for either good reason or bad reason is skittish about the imposition of optional demand type of things - and I

would like to see it stated and I frankly would like to consider it if we knew it.

A. Yes sir. Here, again, myself and the committee disagree and they may have been correct. I think they didn't necessarily disagree as it was a question that they knew a lot more about that than I did--what could you get the legislature to accept. What was an acceptable package that would make sense to a majority, and one of the things that seems worthy to be considered as a mandatory requirement was a covenant with respect to the rate that was proposed to the Federal Regulatory Commission--transportation of either crude oil or natural gas by the common carrier. It would seem to me that it is very difficult to make a mandatory provision about it because again you need to have a formula there and we felt that the best place to keep that was 150. 150 as it now stands would permit the commissioner in bargaining to work out a formula that would be good throughout the history or period of the lease with respect to this.

Q. That would be submitting to our rate regulation then, would it?

A. It would be submitting not to rate regulation.

Q. Well, if you submit, you submit to only one rate tariff, then we decide what that is.

A. Yes, but it still remains possible for the federal government to say we disagree and then its decision is final with respect to that rate. If this is a common carrier, if it is subject to the jurisdiction, let's say the ICC with respect to the transportation of crude oil, then the ICC has the

power to speak to this rate for transportation of crude oil in this interstate crude oil pipeline, and it would have the final power to disagree with the agreement between the pipeline company and the commissioner. And if so, it would control, but by and large it might agree--it's not been an active commission--so this represents a tremendous opportunity for the state to be able to go to the pipeline company and get this agreement with respect to a rate at a little lower level than they might get as a maximum under the present guidelines administered by the ICC.

Q. What is the property right of the state to, in effect, build a wall around the state and to defeat the ICC clause of the constitution? For instance, and I know there must be some reasonable point here, but could the state of Kansas condemn in the public interest a strip of land around its borders a mile wide and then require any interstate activity to cross its right-of-way? Not on a highway. I understand that if it's a highway they can't contract with passage and the rest of it, but anything that wasn't on a highway, then it holds the contractual relationship which would in effect change the United States of America from a broad tree-frayed area just to defeat the ICC. I wonder at what point does that sort of thing obviously become a fraud and a hoax that would not be permitted to stand. At what point would you say the state of Alaska as a property owner then, with that very substantial right, is more substantial than Interstate Commerce Commission clause?

A. The only judicious and prudent answer I can give for that question is that we haven't reached that point yet. I think if you are discriminating and its clear that your are discriminating, that's wrong. I think the Supreme Court would probably uphold that to be discrimination under the thesis of the

recalls something like this the

discrimination, and in the case

I have those case citations here for you today.

Q. The argument would be -we're not going to discriminate against one pipeline - any pipeline it crosses would have to be

A. It's an evil that the state is accomplishing there. I think we have the decisions that would say that you cannot

interstate commerce, and that isn't what this act does. This act facilitates and it clearly is a decision that interstate commerce or foreign commerce of the United States and this wonderful product is of

and its selecting who and if this isn't the group that is willing to do it then either the state can do it itself or find other willing people to do this. No one person, no one industry can claim special privilege relative to what is owned by the state. The state can't block it but the state can certainly select and establish reasonable conditions which seems to me what have been set up so far.

Q. As I understand it - you do agree though that we using this property right to place a burden on interstate commerce which if you place it on interstate commerce without a property could be considered improper?

A. If you did it by a rule of law which said that someone violated would go to jail or would have to be _____ a criminal or a civil penalty would be assessed against them for not obeying the law, you could not do it. But this is not a rule of law, it's not a statutory rule of law, it's not a criminal sanction, it's not a civil sanction, it's a contract between two parts.

Q. Do you agree or do you not agree that we are imposing a burden on interstate commerce by virtue of our property ownership which would not be permitted except as a contractual agreement?

A. No, I do not agree. There are many of these burdens that can be imposed without them being. Now we distinguish between burdens. I have cited two cases early which show that even today under regulatory authority in the 60's the Supreme Court has held in one case that the only test to apply with respect to the negative implications to the commerce clause is the state power to regulate interstate commerce, is that it not discriminate against it and that the state be pursuing in the legitimate end of local government--like safety--like welfare of its people.

Q. Our right-of-way leasing which is intended to be an _____ to reduce a tariff below what is permitted by the federal agency--would not that be considered an unreasonable burden on interstate commerce were it not connected to our property right here?

A. No, I think not, because of nature of the federal regulation and the federal regulation is not a regulation which tells

the interstate pipeline this is what you shall charge. It puts the burden on the carrier to make its choice to what it wants to charge and that can stand and often does stand throughout the life of that tariff as the legal rate. It is called a kind of a private law. The only time the administrative agency may get into the picture is when there is a complaint about it being unreasonably high and then it would investigate this - hold a hearing perhaps and if it made a decision and then reduced it to what it deemed to be a reasonable rate. So we are dealing with a method of federal regulation from the beginning which is not imposing upon the entity in the private sector regulated. The duty to charge this rate in this fact or that is positively determined by the agency. So this leaves an option - it was built that way to leave an option of choice in the _____ as to what it was going to charge but having left it with that option this is something that it can make an arrangement with respect to. We have three states today that have essentially the concept of the Alaska Pipeline Right of Way Leasing Act. These are as I recall, Connecticut, New York and New Jersey. They face the problem of commuter passenger traffic. The federal congress gave the right to interstate railroads to withdraw completely from interstate passenger traffic. This would have been catastrophic for your large metropolitan cities in those three states. An so, they passed an act -- I didn't know about it when I proposed this idea to the joint pipeline impact committee I found it out later. They essentially did the same thing. They simply utilized the contract power and in one instance

they even utilized the lease notion by which they contracted or dealt with an interstate railroad and said 'give up your right to go out of interstate transportion of commuters for a period of five years.' Frequently it was funds that they appropriated to make up the deficit in operation. Now you may want to distinguish that and there are ways that you can. I won't argue with you on that. But the point is, it was the use of the contract power in one instance -- two instances -- and another two instances it was the utilization of the property control and disposition, and bargaining at the table, something that was satisfactory to the government and to the interstate transportation agency and profession and they went further. They really had them forego a privilege which they had but the reason I think it was obviously constitutional is— the reason I think this statute is obviously constitutional in this respect that we're now discussing. They can elect the level of the rate they want to suggest. The only time you'd come to the problem of collision would be if the ICC said after a rate was filed 'thats unreasonable'. Now how is that likely to happen. Well, I don't think its very likely to happen, because its lower than what the statutes requires and the ICC is not in the business somehow of protecting companies against going bankrupt. It just really isn't that kind of an agency.

Q. Professor, I know you don't hold yourself out to be an economist. We had some suggestion that the right-of-way leasing formula might not work as a deterrent for the reason that taxes or fees paid for rental of the right-of-way will be a legitimate part of the rate base and that therefore no matter what the fee charged, that the owners of the pipeline would go to the ICC, if that were the regulatory agency, and get the allowable eight percent on capital committed to the project with the allowable expense of the fee. Have you any comment on that?

A. Sir, this is why the dollar that you have focused upon is probably the most central point in the entire act and it also illustrates why I felt there should be a required covenant in addition to those that were listed, and here the committee, as I say again, disagreed with me and felt it was not something that would probably _____

can agree with respect to the rate they are going to propose you have a lid on the problem. Without it you don't have a lid. That's why what you've said is absolutely correct and why it is a problem and it should be some kind of provision that allows the commissioner to address himself to it. I couldn't agree with you more. But it can be handled and under section 150 of the act as it now stands, the commissioner can deal with that and he is very familiar with that--our original memoradum.

Q. The optional covenant you mean?

A. Yes sir. And that's why I'm almost pleading with you not to throw that out, because not only can you not now foresee

the problems that will be there down the line you can and all too readily foresee like you've just indicated in this verbal presentation, a problem that is there right now and there is not a required covenant. I think the pipeline impact committee was correct in its judgment even though we disagreed. I agree with the committee--it was too difficult a provision to write. I don't think I can write that provision in a statute except in part of it tied down and part of it you're going to have to leave to the judgment and discretion and good sense and prudence of your commissioner. And little more thinking has to be done about that. I think it can be done and one way would be periodical renegotiation--seems to me that perhaps you could talk in terms of a (as we do in some commercial leases) that given this rate it can't be in dollar and cents more than, say 15 percent, beyond what it was in a five year period. Something like that.

Q. The problem of periodic renegotiation appears several times through here and you usually refer to it as making flexibility to the instrument and to the regulatory scheme. The problem of renegotiation here is from the point of view of those being regulated. I don't know what you mean by periodic renegotiations. Does that mean that if they don't agree with the state do we force them out? What does the right to periodic renegotiation mean? They can always turn you down?

A. I would think that there should be some kind of formula worked out which would enable the commissioner to determine, say every five years, how well that formula has been

realized in light of experience of that five years. This is something where I think the economists have something to offer--a concept for inlining a rate charge for interstate transportation of gas or oil with some kind of a reasonable return vis-a-vis the people that are having to pay for it. We've done a lot of complex things in regulation. This would not be regulation. This would be a provision in a lease but certainly what we have done with respect to analagous problems would be useful to an economist and a lawyer sitting down together with the commissioner. I have no doubt it could be solved by some kind of formula that would be applied, say, once every five years. It would be fixed for five years and you would come back and reexamine in light of that formula what would need to be done, let's say for the next five year period. But it would have to be a formula. It would have to be some kind of formula that we could say in the long run for the usual life of the lease and could be defended.

Q. If we were talking about public utility type of regulation, where there's almost a body of common law as to what's an appropriate return and what isn't, we define our public utility law very briefly (the statutory end of it) and we depend upon a long custom usage as to what can be deducted, what can't and what the regulatory body can do. And I can see why, if you're undertaking a major project with that body of common law behind you that an investor or a pipeline company or a utility company would be able to invest, but I'm not sure that without that body of law behind you to tell you what's reasonable and what isn't reasonable that you

would be able to finance something as unusual as this pipeline--or not finance but even want to undertake it if there were something in the middle of it that said that a state official had a right to _____ the pipe to disagree with you and forfeit out your position in effect.

A. I agree with you. It has to be an original lease, Senator, and to that extent I don't have any disagreement with what you are saying.

Q. I am skeptical of turning over to the commissioner the obligation of drawing a formula three months from now if he can't tell me now what it is now so that I can sit here now and agree or disagree with him, and I am skeptical of his ability to do it then with the lawyers or the economists if you can't do it today, and I think it would be less unreasonable with the oil people here if you didn't say that we shouldn't submit them to that, that if there is such a thing that should be done that it should be done now, with this legislature disagreeing so much with what our administrators have proposed to us. Now with something that is this important, maybe it is a good thing that we do it here and now sitting across the table with everybody around instead of secretly handling these things, reaching a package and then coming out with a misunderstanding on it.

A. This might well be something that you would want to go into session with your commissioner. He is not here. Perhaps he has been thinking about this. I am sure that he has been aware of the problem from the original memoranda and possibly others have talked with him orally and have

communicated with him in writing and I would think that in addition economists with this problem, with this type of problem, I would put it that way, would sit down. I think we deserve their expertise. I think honestly, Senator, it was not focused upon because it was a complex act to write. It was written within a certain time frame, and I know you recall what happened, and this was one of those things that we thought it would be capable to be dealt with and it's something that the legislature itself could speak to. I don't see any reason why you can't limit this commissioner by subsequent act to pick the principle that you put out before. You were speaking then in a regulatory context, but I think that you can speak about this act too. If you are dissatisfied with the administration of that formula that you worked out you may work out, correct it, or you may cut it down. And that is the direction it seems to me that it is likely to go. That you would be worrying about the pyramiding, in effect. And I don't see any reason why the legislature can't sit in review on the Alaska pipeline Right-of-Way Leasing Act and reconsider this. I don't think that one problem that seems insoluble at all, I mean you might have a less good judgment than a better judgment but I would be willing for all the good that is here to go forward and see what he does. Maybe you would want to give him special economists or make sure he has an economist there and perhaps others to help him. This is not an easy task. I don't know what the appropriation situation is. But I just feel that there is enough good here. There is so much that will stand

scrutiny that perhaps this we should see what he could do. That the legislature can make its adjustment. It can simply say, this is too much--let's adjust it downward over the agreement, and this will be, I would think, so long as it is within the limits that the Interstate Commerce Act spells out, perfectly acceptable from the federal government.

Q. Mr. Chairman, I want to ask about the state's option to purchase again. This is one of the big objections that Mr. Spahr brought forth the other day. Mr. Lipton suggested yesterday, if I understood him correctly, that we might want to consider putting in conditions in terms under which the state would pick up that option in such a way that we would still have an honest-to-goodness option, and yet they could not feel or say anyway that we were taking advantage of or waiting for a moment when financing was easy, and all that sort of thing. But it seems to me that the important thing, if we felt that we needed to pick up an interest, we should be able to do it even if we pay a little premium.

A. Yes.

Q. Do you think we could write in something?

A. I would think so, Senator. That is certainly something that can be done. I think there is no intention here in any sense to take advantage of the company. I think while you could possibly agree to a formula that the House has set that would be reasonable at that time, that the state would not want to be unreasonable. And again, here is this value of the suggestion that you have made, Senator, which is that you could speak to this either specifically by later legislation and say this is to be added, and if there isn't enough

authority in the commissioner to give what seems to be fair and I think originally you could write in there what is the measure you want--the industry has used fair market value, and I would not feel at all adverse to putting that in. As a matter of fact, I think that is appropriate. That's a simple way--fair market value of this interest. Then you would probably have to have a board of arbitration. We all know the problems with a board of arbitration, selecting the people to sit on a board of arbitration, but it seems to me that the state ought to pay what it is worth. And it is getting something that is of great value at that point is what we would have said earlier in the joint pipeline committee is correct.

Q. On this leasing business, I was just thinking that assuming that sometime after a right-of-way is granted and an oil line is constructed it is bound to be feasible to construct a natural gas line from the fields to the market. And assuming that it would be compatible to use the same right-of-way for a gas line for ecological reasons and all of the reasons that make it difficult to obtain a right-of-way in the first place, would the state have any handle on that or would that be a question where the original lessee would be dealing with the gas company for example? Is there anything in this legislation that would give the state a handle on this?

A. At one time, Senator, there was in this legislation something that would have done it. I don't have, nor do I imagine the committee have, the original draft of this

legislation but it gave the commissioner authority to construct and operate any pipeline when the carrier is unwilling to undertake and complete such action within a reasonable time. Addressed to the very situation that you have just talked about. I think we were thinking more about another crude oil pipeline being essential. An additional line that they couldn't negotiate sufficiently with the lessee carrier to get them to undertake to build this, yet it needed to be built. There was at one time in the draft legislation this provision, and I felt very strongly that it was needed, but I think that this committee felt that this was something that could be addressed by subsequent legislation also. And I think it is something that you could do, but again I think that we could say secondly that under section 150 you could negotiate about this and it is possible that a lessee carrier would be willing to undertake some kind of obligation. Maybe not a fairly precise one, but some obligation with respect to building a natural gas pipeline. If I understand your question.

Q. No, you don't. I am assuming someone completely unrelated to the original lessee is interested in constructing a gas line from the oil fields, and because of environmentalists and ecology people and those who object to highways and going across country, if you will, that it is feasible to use a right-of-way that has been previously granted to an oil line.

A. Yes, yes.

Q. It might be just as valuable as the original right-of-way.

A. Exactly, Senator. This would be something, Senator, that would have to be spoken to under the statute as it is now stated through the optional covenants provision. You would simply reserve to the state in an explicit expressed covenant the authority of the state to deal with another outfit for a natural gas pipeline. Something similar to this has been done.

Q. Yes, but it might be going across, then paralleling the original lease and I wondered in that case if the state would have any handle on it.

A. Well, it wouldn't unless it reserved the right to do it.

Q. Well, has it done it in any of this legislation?

A. It has in this federal regulations and the regulation implements the federal pipeline right-of-way act.

Q. I'm speaking of the proposed legislation.

A. No, I don't see it, Senator.

Q. Is there any place there where we give that right away?

A. It seems to me it is given away by the repeal of section 150. I think that's right, Senator, it is given away. That's a very good point. It is given away along with other optional covenants. This goes back to your point too, Senator, how important it is. There are things that are either difficult to spell out or unforeseeable or something that you can foresee but it isn't presently on the table so you don't need to speak to it this year. This optional covenant provision is just, it seems to me, an utter essential and it would speak to Senator Butrovich's point--a very valid and important point. We had an example of what he's talking about, you know of a

major oil line,crude oil line, that was converted over to a natural gas line. Now that isn't going to be in the lower forty-eight. Now that isn't going to be feasible here so the only solution would be in all probability to have a natural gas line on the same right-of-way. And your optional covenants provision allows your commissioner to make that reservation.

Q. Would it be wise irrespective of that in the optional covenants to put i in there as a standard covenant? Giving them the first right but for a non-interfering use?

A. I would prefer it, Senator.

Q. We certainly don't want to do this twice.

A. Providing that we don't allow giving away on the rights of transit to begin with, which is what happens ... It seems to me while we've got thorny problems Senator Groh has mentioned one of them. I'd just like to see a district court decisions, I'd like to see a federal court.... It just might clarify a lot of the air about how constitutional this thing is. And then secondly we need some experience under this act. The opportunity gives you later on to substitute lessees if you have to, and maybe get to a point where the people would like to get out from under, and they want to sign, maybe you would be better at a point down the line to have this lease assigned to other people - might be agreeable to all three parties, a new party and the two old parties that you have a substitute lessee carrier come into the picture. The point is it's very important to have this optional convenants and devices

as a way as best you can for anticipating the things and for dealing with things you can't anticipate. And then putting into the required covenant those things that you now determine should be there - and to keep them there.

Q. It seemed to me one of the overriding statements by Standard of Ohio was that if we don't pursue with this package and negotiate, move on rather quickly, they may well lose some of their people involved in the pipeline package because then they would be subject to consideration of anti-trust, more subject to it, a big concern that would delay everything. Do you feel inclined to comment on this?

A. I think again when Mr. Lipton was here maybe...I know he felt that a qualified answer most of question. I would just talk from one standpoint that perhaps I have a little qualification to speak from and that is in terms of opportunities that this general device gives the state, if that were to happen this just might make very important this provision about the state exercising it's option to acquire and suppose you do have six percent or eight percent pull out and the state might want to acquire it at that time--that would not disturb any of the interest would it? And you certainly would want to have it not in the sole discretion of the other members of the joint venture whether the state could buy it up. You want this line to go ahead, and after all the federal government once owned eight percent of the Bank of the United States, you know back there in Jackson's day, and before and after. It's nothing unusual for a certain percentage of interest in a private concern to be owned by the U.S. government and I would certainly hope, in fact this I think highlights the

importance of having the Right-of-Way Leasing Act, so you can buy up as a state and take up the slack.

Q. That would alleviate the possibility of anti-trust action?

A. I suspect it would. The case of Parker vs Brown is a case where this kind of question came up. California was trying to prorate the selling of raisins(and that seems a long way from what you're talking about) but it decided the principle that you could not, although the producers came to the state and got them to impose this arrangement. The fact that the state did impose this arrangement through law was said to immunize it from anti-trust prosecution and I think we actually discussed this on the joint pipeline impact committee for a little time that some of you can perhaps recall better than I do, that the state being in here might make the federal government a lot more willing to accept this under certain circumstances than others.

Q. Mr. Witherspoon, I think we all recognize that if an individual believes he cannot do something it's highly probably that he cannot do it. The mental attitude is more important than you think. I've been told by what I thought were reliable sources that the expectations and probabilities as far as the state winning its case on different points--in some cases the probability was as high as 70 percent and in no case was it less than 50 percent on any of these points--let's assume that that was not correct and that the state attorneys were convinced that they would lose. Whether they are right or not I would suspect then that they would lose. As far as probability is concerned.

A. Excuse me, Senator, that's what we call a self-fulfilling prophesy.

Q. There are two differing assumptions. One is our attorneys feel that we have had a reasonable _____ and another is that they do not. Let's take the second one and assume that it is case and then what suggestions do you have to offer.

A. It seems to me some radical surgery is necessary.

Q. Is it reasonable to go outside of the subsistence the legislature is convinced that we do need to conclude this litigation or that we need to carry it forward in the courts to a conclusion in court and that our own attorneys would not be affected _____ points of the law. Is it reasonable to go outside of the attorneys office?

A. Typically this question arises. I am arguing a case on the 5th of November in Boston in the first circuit of appeals for the Attorney General of Rhode Island. It's a state--it's a very small state and involves a law that was enacted March 13th of this year and there's a real question about its constitutionality. I will say that it ought to be held to be constitutional. I lost at the District Court level, I expect to lose before the Court of Appeals, and maybe the reason you take it to the Supreme Court of the United States is that you may pick up one judge or two judges. It's just essential litigation in terms of getting the country to face up to a major civil rights issue in protection of the human person and the life of the human person--it's gotten down to that unfortunately--I mean that we are really having to litigate

whether a human being has its life and protect it. Many of us have been in the civil rights battle fight now for a good many years and it's never been felt that we would be fighting that battle before the Supreme Court to protect the human being and the life of the human being, but that's where we are. But I'm just saying that this was a cooperative arrangement; the attorney general called you in and he's on the briefs and he's there at the trial but private attorneys conduct litigation for the state. The firm of _____ of Rhode Island conducted that trial for the attorney general with the assistance of the attorney general sitting there and then with myself assisting the firm, and I wrote the briefs and this is not unusual in our state--we call in people by consent and agreement of the attorney general to handle the litigation, and that's one way to get people in who believe we can win and to work for it, and I'm sure your attorney general is working to win. I don't have any doubt about that and I'm sure every effort in his command, as a professional lawyer, is being directed toward doing that. I'm just saying this is an arrangement which can be worked out and which has worked out. I'm just simply saying that Rhode Island has too small a staff to do the work in this kind of complex case. I've had to study your problem here in the state and I'm sure your attorney general could advise you quickly about any constitutional law problems that could be presented--a separation of powers provision--I'm just not confident at this point to fully answer.

Q. Your recommendation is then that we should continue this litigation to a conclusion.

A. Yes sir.

Q. And that's both in a regulatory measure as well as the right-of-way leasing?

A. Yes sir - I would so recommend.

Q. Do you make this recommendation with the knowledge of the states pending financial crises?

A. No I can't say Senator that I honestly do. That was one question which I asked. I asked of someone just in ordinary conversation - in no kind of formal conversation whether there was a financial emergency upon the border or the horizon now that we are all talking about and seen. I just don't know the answer to that and you would know that far better than I but I could see if it is then this would be a new dimension.

Now I don't know how much of a dimension and how you would work from it but I would have to be quite honest and respond to you - Yes, it could make a difference.

Q. In your best judgment how long would it take to carry this to a conclusion - say to the Supreme Court?

A. I would at least want a Court of Appeals decision just simply because it could perhaps give you at least a regional response of judges drawn from over a region as to the validity of this legislation. I don't really think there is a problem with your regulatory act - in fact, I just don't see any problem at all. My honest opinion is that there can be no serious question about its constitutionality.

I don't want to be unkind but I think it's hardly arguable. But on your Alaska right-of-way leasing Act there's a resonable argument on the other side. In the sense, and please understand me - I'm stating that people are not being unreasonable and saying that there's a question, but then again, you have the strength, and it seems that the strength is very strongly in favor of its constitutionality.

Q. If the federal right-of-way permit is issued, say as early as January, and it's our decision to reject the governor's proposals and continue litigation - do you think we would be permitted to continue that experiment in the light of the national energy crisis?

A. I'm not sure that my focus and concentration was adequate to capture your question perfectly - would you restate your question, please.

Q. If the federal permit is issued at an early date, say January or February and in the meantime we choose the course that you recommend - recognizing it's going to take awhile to get to the court, do you believe that we would be permitted to continue this exercise to its conclusion - recognizing the national interest involved as far as energy is concerned?

A. Yes, I think I understand better your question - it's the latter part of it that worries me in giving you a good answer in light of the energy crisis. Are you asking what would be the weight in the judicial decision making? I'm not sure this is what you are asking.

A. No. Wouldn't in fact the energy crisis be at such a point that the whole process would be taken out of our hands?

A. You mean by the federal legislature?

Q. Right. We are advised that there is interest in our litigation on the part of Congress.

A. Senator, I think that this has so many imponderables that it is very difficult to answer - so my answer would be a guess, and I'm far from being an expert.

Q. Thank you. That's all.

Chrmn: Before we wind up for the day, would you comment on Senate Bill No. 8? Lease and sale of state lands for pipeline purposes.

A. Yes, I did look at that and I just really have one reaction. It's a piece that I would want to study further, but I wondered whether or not having committed yourselves as a state to the Alaska Pipeline Leasing Act, whether in moving along this line the lease device ought not to be utilized? I can understand the problem which is here and I don't think this as really undercutting the Alaska Pipeline Leasing Act principle but I do think and do suggest that it would be preferable to utilize the leasing device, the more typical leasing device for this purpose, simply because it would be closer to the Alaska Pipeline Leasing Act. It might permit a latter judgment of bringing the two kinds of leasing together. This might be made for a limited time. I am not familiar with the context in which this is set with respect to time. If you have a limit on time provided for - the commissioner might in his discretion make this for a limited time. It seems to me you would have a better chance of getting this Act and the Alaska Pipeline Right-of-Way Leasing Act together at a later time. I certainly do not feel stronglyagainst this at all.

If there is a special legitimate reason, local reason, for this it makes sense to both the state and the industry and I could certainly see that that could exist without having investigated the facts-this represents an option which might make very good sense.

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10/20/1973

STATE OF ALASKA
THE LEGISLATURE
LEGISLATIVE AFFAIRS AGENCY

POUCH Y - STATE CAPITOL
JUNEAU, ALASKA 99801

October 31, 1973

The attached transcript contains the remarks made by Mr. Milton Lipton on October 20, 1973 before the Senate Resources Committee. It is a verbatim transcript of Mr. Lipton's remarks. There is occasionally a word missing or other minor gaps in certain places, which are due to the speaker's testimony being indecipherable at that point. However, it is believed that these occasions are rare and the transcript presents a fair picture of the thoughts expressed by the witness before the committee.

Senator John Sackett
Chairman
Resources Committee

AGO 533600

SENATE RESOURCES COMMITTEE

Special Legislative Session

October 20, 1973

Mr. Lipton

I'll try to get my introductory remarks to the point of the issues which you are considering here with respect to the legislation submitted by the Governor. First of all it is very obvious that there is considerable urgency in getting on with the construction of the pipeline. This is clearly evidenced by Congressional action to authorize construction. And I think the action by Congress implies not only an appreciation of the hightened concern by the nation as a whole for the potential contribution of North Slope oil to the nation's precarious balance in essential energy supplies, but also a feeling that it is imperative at this stage to avoid further unecessary delays on account of litigation in the courts. And I think that the same spirit, the desire to avoid unecessary delays, is reflected in the negotiations between the Governor and the companies. There is no doubt but that the State and the companies have a very common interest at least in getting on with the job.

You must independently review the proposed legislation in the light of the many issues involved so in my introductory remarks I would like to address myself to the question - what have been the major concerns which have impelled past legislation, to what extent are these concerns still relevant to the State of Alaska, and to what extent do the proposed changes in the legislation adequately take care of the concerns of the State and to what extent may you want to consider variations, deviations, or at least review what is being proposed.

The first thing that I would like to stress is the public interest that is inevitably and irrevocably involved in the pipeline. This is a circumstance which is unique to Alaska, it is of tremendous importance to Alaska and it just does not obtain elsewhere. This is one of the reasons why in your legislation you must be circumspect to a degree that perhaps other states need not be. The contrast between the pipeline that is proposed to be built along a corridor from the North Slope to Valdez contrasts with any other transportation circumstances in the lower 48 states. There was never a time when it was not possible, quickly and expeditiously, for any crude oil producer having a significant flow of crude oil without access to pipeline capacity to undertake to build a new pipeline. Or for any refinery without access to pipeline that would bring crude oil to

his refinery not to undertake the construction of a pipeline. There is today for example a very serious shortage of pipeline capacity into the Midwest area. CAP line, which until Alyeska was the largest undivided interest crude oil pipeline in the United States is expanding its capacity under different investments by the various companies participating. Its not a proportional expansion of capacity but to reflect their several needs. There are refineries located in the mid-continent area of the United States that have historically drawn their crude supplies from Oklahoma and Kansas where crude production is going down that are prepared to build their own pipeline from the U.S. Gulf area into the mid-continent area. There was a new fairly large capacity pipeline just completed to carry products from the gulf coast area to new consumer markets in the mid-west. So that although individual pipelines have, in a sense, a monopoly over their own rights-of-way and are regulated, the circumstances of investment construction in the lower 48 make it possible for competing or alternative forms of transportation to be provided. This is simply not the case with respect to the crude oil resources of the North Slope and the access to export markets in southern Alaska. That pipeline corridor will convey to whatever company builds that pipeline an

an irrevocable right for the transportation of crude oil. The state has tremendous interest in this pipeline. It has interest in seeing that the facilities are operated in the most economical, efficient fashion. That the facilities, whatever their capacity, may in due course be expanded to meet the needs either of incoming production or facilities provided to expand the delivery of crude oil, for example, to intermediate points within the State, such as Fairbanks. My point simply is that company interests may not always correspond in toto, or at a moment in time to the concerns that are of primary interest to the State.

I had the privelege of listening to Mr. Spahr's testimony before this Committee yesterday afternoon and I was quite impressed with his very careful and precise statement of how a company balances all of its investment decisions against their many alternatives, which means in effect that the economic interests of the State, from time to time and in various respects may not coincide with the inclinations of the individual companies who are participants in the pipeline.

There is no way in which the State, through its regulatory machinery, can impose arbitrary or capricious demands upon the pipeline, either to deny them the right to do things or to compel them to do things, because the pipleline always has recourse to the state courts, under the due process of law, against capricious, arbitrary or confiscatory demands

made by a regulatory authority. There is likely to be a wide range of business transacted by that pipeline which involves intra-state commerce and which involves State interest in the totality of its commerce. And, to the extent that the State has an interest and can exercise jurisdiction, it would seem to us that the legislation enacted by this legislature should claim for the State such jurisdiction, subject both to the prior jurisdiction that the ICC may have, and subject also to court review of how the State exercises such jurisdiction as is available to it. But, I would not think that the claim by the State, in its legislation, to exercise regulatory jurisdiction, should be such a disabling factor that in advance they would say that we will not submit to the legislative exercise of this power and go ahead with the construction of our pipeline unless it has been previously reviewed in the courts. The exercise of the State regulatory authority is always available to them subject to judicial review. I would not think that this one, among the many issues would be the one that would be such a stickler that it would involve prior litigation and unecessary delays on the subject of the construction of the pipeline. This bears upon aspects both in the proposed amendments to the Pipeline Commission Act and certain proposed amendments in the Right-Of-Way Act.

The second overwhelming interest of the State I think is in the tariff which the pipeline will eventually establish.

The estimated costs of the pipeline goes up by leaps and bounds. The figure that is now being used in the range of 4 - 4 1/2 billion dollars which makes it both an incredible industrial undertaking and private investment. But it ought to be seen in context. There has been over the past three years, according to estimates, an increase of 3 billion dollars in the construction costs of the pipeline. On the other hand, the increase in wellhead values in Alaska, as measured only by the increase in postings already put into effect in California, are on the order of 60¢ a barrel, and 60¢ a barrel on 10 billion barrels of recoverable oil, means at least that the capital assets which underlie all of the incentives to construct this pipeline have gone up by about 6 billion dollars in the same period of time. Insofar as the economics of the pipeline are irrevocably tied in with the economics of crude oil production, the increase in the construction costs of the pipeline, occasioned by inflation, environmental considerations, regulation, etc. are not disproportionate to the tremendous increases in the value of Alaskan oil, which have already obtained by virtue of the run up in energy prices and crude oil values in California, and also with respect to foreign oil at the price which it can be

brought into the United States.

These higher wellhead values, reflecting world oil prices, are no reason for the legislature to have less concern than before about the relationship between a pipeline tariff and a wellhead price at which their severance tax and royalties are assessed. The mere fact that the oil is worth more is no reason for you not to insist that the maximum worth accrues to the State, and that it not be unecessarily depressed, even if its depressed from an unexpectedly high level by virtue of the tariff which is established on the pipeline.

It is not the issue that one questions the good will or the economics of the company. The real question has to do with how the State, given its economic interest, exercises its responsible legislative authority to protect the interests of the State in the event that company interests, for one reason or another, are found in such a way that the State feels its own interests are being bypassed. It is for that reason that we have felt very strongly that the State should be looking at a package of legislative means that not necessarily by themselves but together, would always conduce to the most favorable tariff, in light of the States economic interest.

One of the specific issues involved is one that came to the fore in the Right-Of-Way Leasing Act of 1972 was the percentage lease rental and the many provisions associated with it. If you recall our testimony last year, this was

one area in which we had certain reservations. It certainly was, to our mind, an imaginative approach on the part of the State, since the main intent and purpose of the percentage lease rental formula was not to raise revenue for the State. Quite the contrary, the intent and purpose was to hold out an alternative of pains or rewards to the pipeline participating companies. Pains in the form of a very high lease rental if they set too high a tariff, and rewards in the form of an appreciably lower lease rental if they set the lower tariff. We had however, considerable uncertainty as to what the company response would be to it. It was then very, very difficult and it remains very, very difficult to compute, company by company, the way in which the impact of the percentage lease rental would fall upon the company, not knowing in advance what the ultimate proportions would be between a company's equity in the pipeline and a company's equity in the crude oil, that is whether they were a net buyer or a net seller. And not knowing what the tax exposure was of individual companies with respect to income earned on production, which has the advantage of depletion allowance and the disadvantage of severance tax royalty, or what their income tax exposure might be on pipeline operations given accelerated amortization, investment tax credits, etc. This is a very difficult corporate computation. So there was considerable uncertainty as to whether the incentive that was intended in the percentage lease rental would actually

work.

Then there was the second problem about the pyramiding of lease rentals. Any rental payment that a pipeline company makes, insofar as it is subject to ICC jurisdiction and insofar as it sets its tariffs subject to the Icc rate making rule, if it pays a rental it is in effect able to recover that rental payment through the tariff. So that the higher the rentals are the higher the tariff would have to be.

Third there was the legal issue, and I think that, under the circumstances, where this has been made by the industry, one of the pivotal issues in their litigation I suspect that the legislature would want to consider very. very carefully the extent to which the percentage lease rental formula and all the provisions associated with it are essential to the interests of the State or whether there are other alternatives.

The second innovation that was introduced in the legislature last year and is now subject for your review, is the option of the State to buy up to 20% equity in the pipeline. Last year we were rather negative on the subject of 100% state ownership for reason which we would still enunciate. But we did feel that there was a very cogent reason for the State to have an option to buy a participation in the pipeline. in due course. What we had recommended, and what was enacted into your legislation last year, was an option to acquire up

to a 20% undivided interest in the pipeline. The reasons for that were, if the State exercised its option, it could use its ownership of some percentage, and it does not have to be a very large percentage, it could be less than 20%, to utilize its ownership of transportation facilities to leverage all tariffs downward. The State could set a tariff and say that this is an appropriate yardstick that others can follow. Or the State could set a tariff and if the tariff were lower than the company's tariff presumably all shippers would elect first to move their oil where the transportation charge is least, and on that basis the State would be in a position, with its relatively lower tariffs, to say that this is what determines the value of oil on the North Slope, and use that as the basis for its severance tax and royalty calculations, with the onus being on the company to prove that a higher tariff is necessary. Or if all else fail alternatively for the State to say we too will charge a high tariff and in effect we will recover in the profit on the oil that we move through our share of the pipeline what we may have lost through severance tax and royalty revenues because a high tariff depresses the value of the oil on the North Slope.

The attractiveness of the option provision was that having the option it would not have to be exercised.

That what the State could do by its option, plus what it might do through its taxing authority, that all of these would be conducive to a reasonable agreement between the companies and the State as to what a reasonable tariff would be, which might very well be at an ICC rate, depending on what ICC rate making policy is in 1977 and 1978. Or it might be somewhat lower, but at least it provides the State with a negotiating leverage and it would be one of those tools which hopefully the State would never have to exercise. The negotiations between the Governor and the industry have changes quite substantially the whole concept of the State's right to acquire an interest in the pipeline. Last year the company representatives were absolutely adamant that State ownership or State participation or State option were absolutely unacceptable and this was very largely couched in terms of the financing problems that would be posed.

I would like to call attention to arrangements that have been made elsewhere which involve government participation in a pipeline and a government option to buy. I'm referring now to an arrangement which has been made between a consortium of oil companies called SINCRUDE and the Province of Alberta in Canada having to do with the right to produce and transport a synthetic oil processed from the tar sands of the Athabascan tar belt. Will have to be a pipeline which connects the Athabascan Tar Sands Development

Project with the City of Edmonton where the oil will then move into other pipelines. The Province of Alberta is given, de nova, from start, an 80% equity in the pipeline. The companies which are participants in SINCRUDE commit their shares of the oil to that pipeline, without reservation. Secondly, and this does not have to do with pipeline but it has to do with an option, the Province of Alberta has an option to acquire, after the start of production, an undivided interest in the production itself, of not less than 5% and not more than 20%, with a formula that determines in advance what price will be paid by the Province of Alberta for the acquiring of that option.

I must be very careful to distinguish between the magnitude of what is involved here. The Alyeska Pipeline with an investment of some 4 - 4 1/2 billion dollars is a much larger pipeline facility than either the Athabascan pipeline or even the producing operations. There are differences in the magnitudes and degrees, but surely the principle of a definite participation in the pipeline, or the option to acquire a participation is not without precedent. If there are problems involved in the financing of the pipeline because there is an outstanding option for the State to acquire it, I would believe that those financing problems could be resolved if the terms and conditions of acquisition

under the option were spelled out. That is to say their investment, their costs, plus interest on their investment up to the time of the States taking over the pipeline, will be paid to them, and that the State thereafter undertakes commensurate obligations for whatever the outstanding debt may be.

The principle of an option to buy is not without precedent. This consortium of oil companies, who together constitute the SINCRUDE group, contains within their membership of four, two; the Exxon Corporation, through Imperial Oil in Canada, and Atlantic Richfield, who are major participants in the Alyeska Pipeline. So that insofar as the purpose of an option still commends itself to the Legislature as a significant factor in the protection of the State interest, which probably may never be exercised but which nonetheless represents a prudent approach by the Legislature. I think it may also be considered that the precedents which have been transpired, and if necessary, agreement by the State in advance on what the formula for payment will be, so that it is carefully spelled out, I would think that at that stage of the game it should not be a completely inhibiting factor with respect to the financing of the pipeline.

The third broad area at issues has to do with taxation. Obviously the taxing power of the State is the ultimate power that the Legislature exercises with respect to any of the

issues which may be involved with respect to Alaskan oil.

There is now tabled before you two major tax measures, an ad valorem property tax and an amendment to the severance tax. No legislature can bind itself through its term of office, let alone bind future legislatures, so whatever is enacted in terms of tax legislation is susceptible to amendment at any time. Certainly an oil company, more than any company in the world, is aware of the taxing power of sovereign states or States. In the context of the package of legislation that is submitted to you, it would appear that any tax legislation that you enact in this Special Session of the Legislature, implies some kind of a commitment. Here there have been negotiations, tax proposals have been made, in a special session of the Legislature you are being asked to amend or pass legislation which seems to be part and parcel of a whole package of legislative items, and certainly the industry, no matter how much it feels is subject to amendment in the future, will not be remiss is recalling to this or subsequent legislatures, that what you enact today was part of a package.

Therefore it seems to me that this particular legislature ought to be especially careful in what it does in terms of their tax decisions, and certainly the legislative record ought to show that a present enactment represents the sense of the Legislature to the extent that it is able to look ahead and see the circumstances under which the tax will be

operative. From the visibility of today, I submit that 1977 and 1978 might not look at all the way you or I think its going to look with respect to the economics of North Slope production or the economics of exploration and development elsewhere in the State. So in a sense, if you are enacting tax legislation today, you must also be alert to the fact that the interests that the State will be looking at 3 - 4 - 5 years hence may appear very differently than the best perspective any of us can hope to have on the future from today. So that the tax legislation will be subject to review, no only as a matter of legislative perogative, but also as a matter of very basic equity as circumstances may be changing.

There are three categories of taxation which are relevant to your Legislature.

(1) The first is a severance tax with amendments set before you. We have always looked on the severance tax as a tax which captures for the State a portion of the economic interest in its natural resource, and which was sufficiently broad guaged so that it really wasn't directed to the production of one specific company or the production of any specific _____. Two to three years ago we felt that what the legislature did ought not to be constrained by the particular circumstances of Cook Inlet at that time, nor ought to be so flamboyant that it was directed entirely to the hectic

expectations of North Slope development, but that in a sense it represented a fair and equitible tax given the circumstances of current, prospective and future production out of Alaska. Out of that came your tax which was the percentage of wellhead value and which contained four different brackets which related to average wellhead activity.

Last year your severance tax underwent substantial change with the introduction of cents per barrel which was designed as a floor below which the State's revenue would not fall whatever transpired with respect to wellhead value of the oil.

There are two different ways of looking at the cents per barrel aspect of the severance tax. One is as a means of offsetting depressed wellhead values. That is to say, if the pipeline tariff is high and the wellhead value is depressed, then if you can't get it as a percentage of wellhead value then you get it as cents per barrel. It is a response to what you might have considered an unjustifiably high tariff which depressed wellhead value and hence your severance tax. Of course you can get that also by changing your schedule in percentage of wellhead values. But as an offset to cents per barrel, or the severance tax however its enacted, as an offset to the lowering of wellhead values through the high tariff, it is a blunt instrument because it affects every producer in the State with higher severance tax obligations irrespective of whether or not that producer is a member of the pipeline or not.

As a revenue measure, every severance tax bears on producing profits. But it bears on it indirectly, that is to say it is a percentage of gross value. And as a revenue measure it comes out of producing profits, but it can be a different proportion of producing profits depending upon the relationship for individual fields and individual companies and individual circumstances, of the relationship between gross value and net value of the oil. Therefore it is not an income tax though it does fall upon it. It is a revenue raising measure that is always available to the State and is susceptible to whatever rates the State may want to impose, which the State can adjust whenever it chooses if it is dissatisfied with wellhead values. But this is an economic judgement.

The royalty offset feature in the last amendment of the severance tax was obviously a legal issue of considerable general concern to the industry. Because what it implied to the industry was that here in Alaska, and potentially elsewhere, royalty payments which they entered upon by virtue of contractual lease arrangements, might in effect be changed by the State enactment of severance tax legislation.

You can of course achieve whatever level of tax income from the State directly for severance tax or even higher severance tax to offset what you consider to be a loss of royalty income, not by a royalty offset but simply by a high

severance tax.

The legal attack upon your last severance tax enactment could be voided by a very simple amendment, that is to simply eliminate the royalty offset and leave all the old schedule, in which case the industry would be paying a very considerably higher severance tax than they paid under their old tax or they are paying under the governments proposed legislation. To avoid the legal issue of the royalty offset is something I think well worth considering, because you can exercise your severance taxing power at any time.

(2) The ad valorem tax is very clearly to raise revenue for the State and particularly as an interim source of revenue and is one among various ones that you might consider. The only thing that I would like to mention about it is the observation that an ad valorem tax imposed upon a pipeline is recoverable by its tariff. It is a cost of doing business by the pipeline and under ICC regulations, and I suspect under your own State of Alaska Public Utility regulations, an ad valorem tax becomes a cost of doing business and therefore can be added onto the tariff.

By way of rough calculation, on a 4 1/2 billion barrel pipeline a 20 mill rate would yield about 90 million dollars per year in tax revenue ad valorem tax on the pipeline itself, which in effect would mean about 20¢ per barrel addition to the tariff. The ad valorem tax would be passed on to someone else in the tariff of the pipeline. Insofar as the pipeline

tariff is higher and the wellhead values are lower, the State itself would bear 20% of the burden of the tax because it would reduce the royalty severance tax income. The tax would become a burden on those producers on the North Slope who are not participants in the pipeline but who have to transport oil because the tariffs to them will be higher. They would bear a portion of the burden in proportion to the amount of oil that they produce and ship relative to the amount of oil that is produced and shipped by companies who are also participants in the pipeline. The rest of it would be borne by the pipeline companies themselves as its passed back to the cost of transportation of their own crude oil.

The same holds true not only for the ad valorem taxes that the pipeline will pay in 1978 when the pipeline is in operation, but I suspect that the same thing holds true for all the cumulative ad valorem taxes that the pipeline will be paying between 1974 and the start up of operations, because those taxes are also recoverable costs of doing business and in due course will have to the companies as pipeline operators in their tariff.

All of which is not a reason in and of itself for you to say no more ad valorem tax. This all depends on when you want your revenues and how you best decide the State can raise its revenues.

(3) Finally, a few words about what I think is the most important aspect of taxation which is available to the State, that is your State income tax.

I think the Legislature, in due course, its certainly not required at this Special Session of the Legislature, must review its legislation to insure that incomes earned in the State are within reach of the State's income taxing power. This does not imply anything about the way you levy income tax, or whether there are any changes, but it does imply that you will scrutinize your income tax legislation very carefully.

In the end the income taxing power of the State is the means by which the State can insure that there is in the future a reasonable partition, or sharing, of what are the ultimate economic benefits of resource production in the State. I'm not only talking about crude oil but I'm talking about what hopefully will be a major exploratory and development program now that lands are beginning to be available for the reopening of leasing operations. Through your income taxing power you have the final means by which the State can decide, but not arbitrarily, never by itself, because its all subject to the essential incentives of investment by private companies in exploration and development. But within these limits the State has a means to participate in a reasonable and equitable way in the benefits that will come from Alaskan resource development.

MILTON
LIPTON
10/22/1973

STATE OF ALASKA
THE LEGISLATURE
LEGISLATIVE AFFAIRS AGENCY

POUCH Y - STATE CAPITOL
JUNEAU, ALASKA 99801

October 31, 1973

The attached transcript contains the remarks made by Mr. Milton Lipton on October 22, 1973 before the Senate Resources Committee. It is a verbatim transcript of Mr. Lipton's remarks. There is occasionally a word missing or other minor gaps in certain places, which are due to the speaker's testimony being indecipherable at that point. However, it is believed that these occasions are rare and the transcript presents a fair picture of the thoughts expressed by the witness before the committee.

Senator John Sackett
Chairman
Resources Committee

AGO 533625

SENATE RESOURCES COMMITTEE

October 22, 1973 Hearing

TESTIMONY OF MR. MILTON LIPTON

The legislation that's directly before you is the Right of Way Leasing Act but before I address myself to that specifically, I would like to say something about the entire package of legislation. It has been stated by industry, of course, that it is a package and they will review whatever decisions come out of the Legislature as a whole. I think it's true even more so for the state than for industry that the whole complex of oil legislation that's before you determines the extent to which the interests of the state are protected or the extent to which the interests of the state are yielded.

I don't want to take too much time on other aspects of it and get to the Right of Way Leasing Act as quickly as possible. So let me start out by saying that, in our opinion, having looked at all the legislation carefully, having listened to a great deal of the testimony that was made before the various committees, we now feel that the pivotal piece of legislation which determines the extent to which any compromise is satisfactory to the interest of the state, is the Alaska Pipeline Commission Act. This is your regulatory bill, a strong bill that was enacted in the 1972 session of the legislature, a bill for which the government and industry have submitted proposed amendments which largely convert what had been intended by the legislature in the first instance as a regulatory bill into an entirely different instrument for

the state, namely a device whereby a commission of the state simply represents the state in hearings before the Interstate Commerce Commission. The amendment to the bill as proposed and as pointed out by Professor Witherspoon yesterday afternoon, in effect, specifically denies (if the amendment is passed) by act of the Alaska legislature any and all jurisdiction which the state of Alaska might in the normal course of events, exercise over pipeline activities in this state, if only a pipeline such as transAlaska subjects itself to or is subjected to the jurisdiction of the ICC.

Now let me explain the reasons for our thinking that this particular act, as it now stands, the Alaska Pipeline Commission, is one of the most important tools available to the state of Alaska in protecting its interest. First of all, the act that's on the books claims very extensive jurisdiction for the pipeline commission which is being established. The jurisdiction extends to various aspects of regulation extensions of services, connections, expansion of capacity, potential abandonments --- so that with respect to these various aspects of pipeline operations the state of Alaska claims jurisdiction for its pipeline commission. Secondly, it vests in this pipeline commission wide authority to pass upon the validity of tariffs which are set by the pipeline. There is no claim made in the existing act, which is on your books, that the state of Alaska can regulate tariffs for the movement of oil in interstate commerce. This falls within the jurisdiction of the ICC. But there will undoubtedly be movement of oil in intrastate commerce, as for example from the northslope

to Fairbanks. There will probably be movement of oil in intrastate commerce from the north slope to Valdez which will remain within the state, for example, if the state should contract to take royalty oil and sell it for a year or two years or five years to the Tesoro Refinery or any other refinery which may be then or in the future be constructed within the state. So the state need only claim jurisdiction over the operations of the pipeline which affect intrastate commerce and jurisdiction over tariffs which involve the movement of oil in intrastate commerce.

Now what's the value of this? Insofar as there may be in the future an issue over the tariff set by the pipeline and this has been pivotal to your deliberations for two years now, insofar as there should be an issue over the tariff, there has really to be two things -- one, a determination as to what the appropriate tariff is, and secondly, a decision by the state as to what it will do to try to enforce what it believes is an appropriate tariff. How does one go about determining what is an appropriate tariff for the pipeline? I don't believe that the legislature in its deliberation is going to want to tackle the job -- that fantastically difficult and complicated job -- of determining what is fair value on a pipeline -- what goes into the capital base and what is not allowed in the capital base, and of what rate of depreciation is appropriate, and everything else --. Or what is a fair return -- this is an incredibly involved problem which the ICC struggles with or avoids by not doing anything about it,

as the case may be. In any case this is really not a problem of the legislature.

But you have established in the existing legislation a pipeline commission which has jurisdiction to determine the fairness and adequacy of tariffs insofar as it involves intrastate commerce. It would do so by holding hearings. If a rate is filed for the intrastate movement of oil, your pipeline commission may accept that rate as it's filed, or it may protest that rate in which case it has administrative processes by which it holds hearings, by which if it renders a decision it must support and justify why that particular decision was issued. And it provides opportunity for the pipeline companies to protest any tariff decision, or any other decision of the pipeline commission, insofar as the pipeline companies believe that it runs counter to due process of law, which means that the administrative decision of your pipeline commission will be tested in your state courts, or if necessary in a federal court.

But if in fact, your own adminitrative and judicial process has come up with a tariff which is lower than the tariff set by the pipeline companies it can be then enforced upon the intrastate movements, and the legislature and the state of Alaska is in a position to expect that the companies will apply an equivalent tariff to interstate movements also. Now that may not be enforced but I put it to you that on the day that it is determined by the state of Alaska, through its administrative and judicial processes, that a tariff is appropriate

for the intrastate movement of oil from the north slope to Valdez -- if on that day the companies refuse to reduce the tariff, which means to increase the well head value on all the oil that moves in interstate commerce, then the problem of the legislature in recapturing the interest of the state is a simple one, at that point you have the taxing power and know exactly at what level and what rate to exercise it, because you have through the instrumentalities of your own legislation already created the means and device by which an appropriate tariff can be determined; by which your own courts will reject the findings of the pipeline commission if they are arbitrary, confiscatory o. capricious, but if administratively and judiciously that tariff is upheld, then the legislature has the guidelines precisely how to go about recapturing the interest in the state through its incontrovertible sovereign powers - that is to say the power of taxation.

It's for this reason that we feel the regulatory bill is absolutely the heart of the entire package. Furthermore, it is our feeling, and here of course it's difficult to speak for companies because, as they said, they would go back and review the whole package, but insofar as the companies feel that there is a claim of jurisdiction by the state which is unconstitutional because it involves interstate commerce or insofar as they feel that there's a decision by your pipeline commission in an area where it has jurisdiction but which decision goes against the law because it violates due process, they always have recourse to the courts. They need not litigate this issue in

advance because the mere fact that this law is on your statute books and I'm referring to the 1972 pipeline commission act, the mere fact that this law is on the statute books does not impose in advance the kind of disabilities upon their intentions to construct the pipeline that will require extensive litigation at this state of the game. Furthermore, as we have pointed out at the previous sessions of the legislature where regulatory bills were before you, there is legislation to this effect on the books of other major producing states and these have never involved extensive constitutional issues so far as we know. Well then, this pipeline commission act we feel is the guts of any compromise which the legislature may wish to substitute in lieu of the compromise package which has been put before you by the executive department.

Now let me pass on then to the Right of Way, but before I do, let me say a few words about the other bills and then come to the guts of the legislation which is before you which is the Right of Way Leasing Act. There are three different tax measures before you and I don't believe that any of them are in any respect crucial to the willingness of the companies to abandoning litigation or to going ahead with the construction of the pipeline. The severance tax, of course is in the course of litigation and it's in course of litigation because the 1972 amendment to your severance tax law contains a royalty credit feature which the companies feel would establish a very unacceptable precedent if it were, first of all applied here, and secondly if it were emulated in other states. I think they're misguided in their concerns; I think the state of Alaska has very little interest, really, in maintaining the

royalty offset provision. It's applied actually by the state of Alaska in a very generous way so that the relatively high cents per barrel tax, which was imposed in your 72 legislation is evaded and reduced by virtue of the royalty credit. You could settle the legal issue in five minutes by repealing the royalty credit and leaving everything else stand, in which case the companies would be subjected to considerably higher taxation than they were previously and that they are in the governor's proposal. So that the removal of the royalty credit feature in your severance tax which the companies are so eager to obtain, we would surely recommend that the legislature give to them. Perhaps the easiest way of doing it is to give it to them by accepting the severance tax amendment which is before you. But I caution one thing: I don't believe that this is the time for the Alaskan legislature to enact a severance tax schedule, whether it's a percent of value at the wellhead or cents per barrel or a combination of both with the idea that what is enacted today is going to be appropriate to whatever the volumes and values of oil may be that are going to be produced in 1977 and 1978. So if you prepare to accept the proposed severance tax amendment as part of a compromise package, I would strongly suggest that it is part of the legislative record in your committee hearings and in your debate that in no sense does this represent a commitment on the part of the legislature that these particular tax rates are the rates which will obtain five and six and seven and eight years from today. We will have time to review that. So that in a sense what you are giving by accepting the proposed amendment to the severance tax is a willingness

on the part of the legislature to avoid extensive litigation on the royalty offset feature which we think is of very little interest to the state of Alaska, in any case.

Now, the severance tax of course is one of your important weapons. I mentioned in previous hearings before this committee and elsewhere, that eventually your income tax is an important thing but that's not up for discussion. It's not an appropriate time for the legislature to review your state income tax legislation although I strongly urge that at one of your sessions you review with your commissioner of revenue your entire concept of corporate income taxation here in the state. The conservation tax bill which is before you, I think is unncessary. We had recommended that the conservation tax which had been on your statute books in the past be eliminated and simply subsumed within your severance tax. It's an added piece of legislation that we don't feel strongly about one way or the other, but it complicates the whole process of paying and collecting monies as between the state and the industry. On the ad valorem tax, as we see it, this is a revenue measure designed largely to yield income to the state over interim years before Prudhoe Bay production begins, before the pipeline is completed. It falls within the province of the legislature to decide how, when and under what conditions it wants to raise that amount of money.

It's the combination then of a strong regulatory bill and the fact that you have continuing flexibility and authority

to tax via your severance tax or eventually through your income tax that we believe yields the greatest control by the state over the operations and the tariff determinations of the pipeline so as to protect the interest of the state.

Now let me get on the Right-of-Way Leasing Bill. We have gone through this bill chapter, book and verse, section, sub-section and paragraph and I think we are prepared to sit down with this committee and other committees of the legislature to discuss it in detail. I don't believe we have time to go through each and every aspect of this here, but I will report on those which we feel are most critical to whatever compromise package comes out. The first issue, as we see it, involving any amendments to the Right-of-Way Leasing Act is how much of the regulatory power that the state wants to exercise shall be done by indirection in the form of stipulations and agreements as conditions of leasing. The industry is challenging the 1972 Right-of-Way Leasing Act in the courts on constitutional grounds, claiming that in effect regulation achieved by indirection which cannot be exercised by the state directly is an illegal exercise of the leasing powers of the state of Alaska. This is one of the major issues under litigation. We obviously are not in a position to pass any judgment whatsoever on the merits of the case in litigation. I think there is a spirit of compromise abroad, I see it very much in the proposals of the Governor's Office, I'm not quite sure I see that much spirit of compromise

in what the companies are proposing in their package, but nevertheless, there is a spirit of compromise abroad and certainly we would feel strongly, and I hope the legislature does also, that it is desirable to avoid unnecessary prolongation of litigation, and the possibility that such continuing litigation may delay the start of construction. So if it is possible to avoid litigation without unduly sapping the legislative enactments that are vital to the state interest, we would feel that there is some merit in the legislature going ahead with the executive departments decision that a compromise is now in order. So on then to the question of the regulatory items which are introduced into the Right-of-Way Leasing Act by virtue of stipulations as a conditions of lease. One, the most important one in our opinion, which is largely eliminated is in section 120 (a) (3) that's the common carrier section. For many reasons it is of importance to this state that it is understood beyond any doubt that the transAlaska pipeline is a common carrier; a common carrier not only for purposes of regulation of interstate oil movements by ICC but a common carrier also for purposes of regulation by your pipeline commission. There is merit, that as a condition of the lease the pipeline stipulates that it is a common carrier period --without reservations, without qualifications, or anything else. Now this is so common, this is so common in state and federal regulation, that it is really surprising to me that any amendment to the existing Right-of-Way Leasing Act should in effect qualify the common carrier status here. It says first of all, that there will be common carrier if the

the commission so determines at the time the lease is issued. I don't think this should require a determination by the commissioner. Under these circumstances the pipeline is a common carrier -- without hearing, without determination, or anything else. Secondly, I don't think it is necessary in the Right-of-Way Leasing Act to stipulate what obligations fall upon a common carrier and certainly not to qualify the obligations incumbent upon a common carrier. 120 (a) (3) says that it will accept, convey, transport without discrimination, crude oil. This is something which will be covered by your pipeline commission in the course of regulation if it is a common carrier. Certainly not in advance to limit the jurisdiction over a common carrier by your own pipeline commission by saying that the imposition of common carrier status does not require the lessee to accept tenders of crude oil, except at points where there exists public, etc. etc. Do not c 'y the obligations of a common carrier. This is a function of your regulatory agency and insofar as your regulatory agency in its individual decision from month to month or year to year may either deny rights to a common carrier or impose obligations upon a common carrier which the pipeline owning companies feel are unduly onerous, they have recourse to the courts. So I don't think that one should qualify the obligations of a common carrier. I think that your 120 (a) (3) should simply stipulate that as a condition of obtaining a right-of-way over state lands, the lease for the right-of-way over state lands, the pipeline carrier itself, submits itself as a common carrier. Not only for the ICC

jurisdictional purposes but for the purposes of the exercise of jurisdiction by your pipeline commission.

120 (a) (4) in the recommended legislation removes the common purchaser provision from your 1972 legislation. At that time it was a permissible feature of your law. In place of the removal of the common purchaser status as a condition of leasing, the Governor has sent down a special bill that would make it possible to establish under certain conditions and subject to certain provisos, common purchaser status for companies owning the transAlaska pipeline. We do not feel now and we felt for a long time that there is real doubt as to how important common purchaser provision is in the state of Alaska, under the conditions where your oil is being produced and transported. Common carrier, yes, because it provides access to transportation and an equitable basis for everybody who is able to achieve production in the new state. Common purchaser for many reasons we have reservations about whether to leave it or not. The bill which is proposed to you we think is a weak and rather attenuated version of a common purchaser act, as it is applied in other states in the United States. Our recommendation at this stage of the game would be that you can afford and should yield the common purchaser provision as a condition of right-of-way leasing and probably simply pass over this special piece of legislation which establishes a common purchaser provision and hold that over to future sessions of the legislature as not being important at this time. When and as common purchaser provisions become meaningful in the conditions of the state of Alaska, at that

time to enact not the legislation that's proposed by the Governor, but a strong common purchaser act which is appropriate to the circumstances at such time. You will have ability and time to do that in the future. I don't think it's an essential point of the compromise, either from the companies' standpoint or from the State's standpoint.

I'm bringing before you here only major things or illustrative aspects of it. 030 - 040 -- these are repealed in the proposed amendment. In the proposed amendment to the Right of Way Leasing Act 1972, section 2 repeals 030-040. Now, 030-040 in the act that is now on the books governs the abandonment of or reduction or impairment of service and temporary emergencies services, and so on. It has to do with the authority that the state claims for itself and buttresses that authority by virtue of this being a condition of the lease. I would think that it might be appropriate, again in the spirit of compromise, that 030 and 040 be retained but that the language be rewritten to say that insofar as these are imposed upon the carrier, that they are in accordance with the jurisdiction and orders of the Interstate Commerce Commission or the Alaska Pipeline Commission, as is appropriate to the case. Which means in effect that the companies, although they are governed by these two clauses, nonetheless know that these two clauses are in accordance -- what is obligatory upon them is in accordance with the regulations that may be promulgated, either by the ICC if it involves interstate commerce or by the Alaska Pipeline Commission if it involves intrastate commerce. I put these out only as illustrative of the

aspects of regulation within the Right of Way Leasing Act which is at issue in the courts -- where we think either the state should stand firm, such as in the matter of common carrier, or where we think the state may very well yield. In general I would think that insofar as the state can achieve a right of way leasing act which avoids litigation but does not give up essential rights which the state still retains through, and I repeat, the combination of a strong regulatory bill and the ultimate enforcement of state regulation through its taxing power, that the legislature can yield on certain of these items in the Right of Way Leasing Act.

This by no means exhausts the regulatory aspects, but in the interest of time I want to move on to other things and as I said we're prepared to go through section by section with our specific recommendations to you.

The second major issue in the Right of Way Leasing Act is the percentage lease rental formula. There are two different impressions abroad as to the purpose of the percentage lease rental formula. Prof. Witherspoon yesterday afternoon suggested that he looked upon it as a revenue measure for the state. That if, in fact, the value of state lands were to be appreciated by the construction of the pipeline then the state like any other owner of land should be in a position to bargain for a fair share of the value of the land when it is being put to a superior use. I have no quarrel with this in principle; however, our position always has been that the leasing of state lands for pipeline right of way should not be regarded as a revenue device by the state of Alaska. We have always recommended that the interest of the state of Alaska is in the lowest possible cost transporta-

tion and the state of Alaska should not in and of itself undertake measures which inherently tend to increase costs of transportation, insofar as producing operation in the development of Alaska's resources provide the base for state taxation. It should be other than through the rentals of the right of way leasing of state land. So we have always urged the lowest reasonable rental for the commitment of state land to right of way. I would point out, for example, that even private property insofar as it's condemned by eminent domain for public utility or pipeline purposes does not convey even to a private owner any right or any entitlement to the enhanced value of land if it's put to other use. So we would recommend that however one looks at the rental for right of way lease that this not be regarded by the legislature as an aspect of its taxing power or as a means of gaining state revenues. That comes from other taxing devices in the state.

The other aspect of the percentage lease rental provision in the right of way leasing bill was that it was to be looked upon as an alternative -- either pain of paying or inducement to the companies to bring their tariffs down to a level which is compatible with the interests of the state; that is to say, a tariff that is lower than the maximum it might obtain under the ICC rate-making rule, certainly high enough to be rewarding for their investment and their risks but a level which is appropriate to the circumstances of pipeline operation in the state. And insofar as they increased their tariffs above a certain level, they were in effect subjecting themselves to the pains of progressively higher lease rental.

This was the percentage lease rental formula. This is one of the major items under litigation. For very obvious reasons the companies regard this as not only as something which is onerous to their circumstances in the state of Alaska but a precedent that if it were followed could lead to all kinds of things in their operation elsewhere. We have reservations about the effectiveness with which the percentage lease rental formula would operate for its major purpose, that is to say, in and of itself to induce the companies to bring the tariff down. It might for some companies, it might not for others. The extent to which it does for any of them would be largely contingent upon their respective equities in the pipeline as sellers of transportation services and in production as buyers of pipeline transportation services. There is an element of unpredictability in the operation of it. And while it was from the beginning, in our opinion, an imaginative and constructive approach and we're not saying even today that if properly effective it might not be a useful tool in right of way leasing legislation; but in the context of the violent litigation associated with this aspect of the right of way leasing bill, with the chances that continued litigation over this aspect of the bill may delay construction of the line, and on the presumption that what you have is not an emasculative regulatory bill but a strong regulatory bill, then we would feel that the legislature could give on the percentage lease rental and adopt the alternative to it as is proposed in the amendment to the Right of Way Leasing Act of 1972 by the Governor's amendments. Again, I say

that there are questions about how effectively it would operate in practice. Notwithstanding, there might be reasons for the state to hold to its case, to fight through the issue of litigation, if there weren't such a sense of urgency about getting the pipeline built, if there might not be such a large cost to the state in litigating. And whatever is done by way of amending the Right of Way Leasing Act in order to assuage the fears and concerns of the pipeline companies, either because of what it does or the precedent that it sets, I would say that what the legislature may do in terms of amending the Right of Way Leasing Act, in our opinion should be contingent first upon the retention of a strong and effective regulatory bill, that is to say Alaska Pipeline Commission Act. A strong regulatory bill which is backed then also by the state's taxing power and so that although you yield another tool in the entire package of legislation which was designed in 1972 to effect and enforce the state interest, really yielding to industry concerns, you do so here in the interest of avoiding undue litigation and the danger of delay on the pipeline.

The third aspect of the Right of Way Leasing Act to which I'd like to refer is the option to buy a percentage interest in the pipeline. The option to buy a percentage interest in the pipeline. I will not take time now to review the reasons why we have supported the insertion of the option to buy in the 1972 legislation. I think they're fairly familiar and

they've been reviewed I believe in previous sessions of this committee. We still feel that the option to buy a percentage interest is an important feature of right of way leasing. I think that insofar as the companies have allowed the purchase by the state of an interest in the pipeline to appear as a condition of the lease, even in the proposed amendment by the Governor, suggests that it is not a disabling aspect of the legislation from the standpoint of constitutionality of the legislation -- I don't know. But certainly the alternative which appears in the legislation which is section 120 (a) (7), the alternative which is substituted in the proposed legislation in our opinion represents nothing whatsoever for the state.

I think to amend the Right of Way Leasing Act to include the amended 120 (a) (7) would be to retain nothing for the state in this respect. I certainly would not recommend that part of the amendment. An opportunity to negotiate for an equity in the pipeline under highly qualified conditions, means that the state has an opportunity to negotiate when it serves the interests and purpose of the companies, which is really not what is intended in the option to buy as contained in the existing law. We do feel, however, that the legislature should give very serious consideration to the advice laid before it by Mr. Spahr of Standard of Ohio, that the option as it stands in the

legislation today may pose difficulty to the financing, or at least the financing at attractive terms, of the pipeline. Because of the uncertainty in the minds of prospective lenders as to what the capacity of the state as a possible future owner of a share of the pipeline may be to carry out obligations for the debt that is incurred at the time of construction which carries over and then may have to be shouldered by the state if the state buys the pipeline. I can appreciate that concern. But I would like to point out first of all -- and I have said this in general and I like to be very specific -- that there are precedents for this. The illustrations that I have made before various committees of this legislature the last two days, I would like to refer to very specifically here. There is the agreement between a consortium of oil companies called Syncrude and the province of Alberta in Canada which determines the basis upon which they get the lease to produce oil from the Athabasca tar sands and transport that oil via pipeline from Athabasca to Edmonton where the oil would enter into the major pipeline systems that traverse Canada and enter the United States. First of all, this has to do with ownership of the pipeline. This synthetic crude pipeline shall be constructed and owned as to an undivided 80 percent thereof by Her Majesty and/or an entity or entities hereafter formed by Her Majesty.

So that from the start, the province of Alberta is being given 80 percent participation in the pipeline. Now, an eighty percent participation in the pipeline--where is the oil going to come from? The province of Alberta is going to finance its 80 percent share of the pipeline just as a private company would. But how do you finance construction of a pipeline if you are not sure you are going to have the oil to put through? The lessees, and her Majesty, and the respective assignees of any interests in the Syncrude projects will dedicate their respective shares of the Syncrude oil recovered from the project to the Syncrude pipelines. That is to say, where the oil being produced by that project is committed to the pipeline irrespective of the fact that Her Majesty's government, that is to say in the province of Alberta, has 80 percent interest in the pipeline. So the percent of interest in the pipeline is there, the difference, of course, being that the state of Alaska in its Right-of-Way Leasing Act had wanted an option.

Now the issue of an option comes up. In this same agreement between the Syncrude consortium and the province of Alberta, the lessees, the Syncrude group including Exxon through Imperial Oil Canada, Atlantic Richfield (these are familiar names to you), Cities Service, and Gulf Oil--these lessees hereby grant Her Majesty an irrevocable option to acquire an interest in the Syncrude project. This is in the producing operation including the project sites, the leases and rights granted thereby, and all facilities acquired or constructed as part of the Syncrude project, which interest may equal undivided percentage interest of not less than 5 percent and up to and

including 20 percent. The option may be exercised at any time during the period from the date hereof and up to and including that date which is 6 months after the date of start of production or the 31st day of December 1982, whichever is the earliest.

Now as to how this is paid for, the payment by the government of Alberta to the members, the private companies, that make up Syncrude: Such costs shall be computed (in accordance with the accounting manual) on the basis of all of the costs which they, the companies, have incurred up to the date of the exercise of the option and shall include interest compounded annually at 8 percent. No portion of such costs shall be attributed to the reserves of leased substances. The province of Alberta could thus be buying in at what is the investment costs of the company plus the payment of 8 percent interest for all time that is elapsed. An interest in the producing operation of between 5 and 20 percent.

Why do I introduce this? Simply because I'm trying to suggest that there is precedence where the companies are prepared to undertake both to accept government participation in the pipeline and whereby companies are prepared to accept an option for governments to participate in what is essentially private operation. That the financing of this project does not seem to be inhibited whether by the government's participation in the pipeline or by the government's option to acquire an interest even in producing operations. Now I grant you that there is a very significant difference in the capital costs of the two projects. The TransAlaska pipeline will probably involve an aggregate initial investment on the order of ten times as much as the Syncrude operation. But that doesn't mean that

individual bond holders are lending ten times as much money. The problem of the bondholder, whatever the number of dollars, always is what security lies behind; what security is there which insures that the viability of the operation will provide for interest and sinking fund contributions. To get back to the crucial point, if the option is retained in the Right-of Way Leasing Act, the existing legislation may be amended so as to stipulate in advance, first of all, what the basis of compensation will be so that there is clear protection that no member of the Trans Alaska group will in effect suffer deterioration of its capital position by virtue of the exercise of the option by the state. And that in negotiating that option, the commissioner shall be prepared to enter into such stipulations by the state as provides the assurance necessary for the indebtedness that bondholders will be entering into prior to any possible exercise of the state's option. We feel that the right of the option to obtain an equity is a useful aspect of the entire package of legislation which you enacted in 1972. We think there may be a question about the way it is now written, whether or not the companies have as much, what shall I say, protection for their borrowing capacity as they would like to have. This protection can probably be provided both in the legislation where it refers to the terms at which the price will be paid and in the lease negotiation itself where the commissioner is authorized to give certain commitments on the part of the state of Alaska. Existing legislation also requires considerable other steps before an option can ever be exercised, including the positive act by the legislature and a referendum by the people of the

state of Alaska if there is to be debt financing. So I think there can be fair protection all around.

This again, represents in our judgment an approach to the issues which confront the state of Alaska. The issues being, must you continue litigation and risk the fact that prolonged litigation may result in delay in the pipeline? Or must you accept a negotiated package of legislation such as submitted to the legislature by the Governor? Or is there an alternative package of legislation which in your judgment represents the protection of the vital interests of the state of Alaska insofar as resource development and pipeline development is concerned, and probably represents a package which the industry can accept? It may pose uncertainties for industry but insofar as they may be obliged or feel they want to litigate, they need not do it in advance but can start construction of the pipeline and be prepared to litigate specific aspects of it as they become relevant. For example, if your pipeline commission, sometime in the future, issues an order which is deemed to be an unreasonable, in violation of due process, the companies can protest such order in the courts, and upset it if their protest is upheld. I think that what we are suggesting here is in the spirit of the negotiations between the Governor and the companies. It certainly represents a yielding on the part of the legislature, if our recommendations are followed, which go a considerable way to meet the issues posed in litigation by the companies. But I do believe it retains for the state of Alaska in two critical areas--namely the regulatory bill and the ultimate ability to enforce the intentions of regulation by the state's taxing

powers. Plus the retention in the Right-of-Way Leasing Act of certain conditions including the common carrier provision. It means yielding on what had been one of the most provocative and imaginative aspects of the legislation which is percentage lease rental. It means compromise on the option to buy so as to provide certain added protection for the companies. In our judgment, I think that this combination of action by the legislature would secure the interests of the state, and in our judgment (of course we are not in a position to speak for the companies) might not be wholly attractive to the companies, but we would think that they would not litigate to the extent that it would involve delay in the construction of the pipeline.

AGO 533624

ARLO TUSSING
10/17/1973

STATE OF ALASKA
THE LEGISLATURE
LEGISLATIVE AFFAIRS AGENCY

POUCH Y STATE CAPITOL
JUNEAU, ALASKA 99801

October 31, 1973

The attached transcript contains the remarks made by Mr. Arlon Tussing on October 17, 1973 before the Senate Resources Committee. It is a verbatim transcript of Mr. Tussing's remarks. There is occasionally a word missing or other minor gaps in certain places, which are due to the speaker's testimony being indecipherable at that point. However, it is believed that these occasions are rare and the transcript presents a fair picture of the thoughts expressed by the witness before the committee.

Senator John Sackett
Chairman
Resources Committee

AGO 533646

Memorandum
October 17, 1973 CONFIDENTIAL

To: John Sackett

From: Arlon Tussing

These remarks are based upon a first reading of the pipeline legislation proposed by the Governor and do not reflect any presentation by the administration or other witnesses.

General Remarks

The Legislature should be aware that the Middle East fighting, together with the new price increase imposed by the Persian Gulf nations, have put the State of Alaska in an absolutely invincible bargaining position with respect to the oil companies. The expected profits of the companies from their North Slope holdings have probably doubled over the last year, and will continue to spiral upward as the domestic crude oil deficit grows and with the expected rise in prices of Middle East imports. There is not the slightest possibility that the companies would refuse to build the pipeline because of the State's failure to enact the Governor's legislative package or any part of it. You should also know that Senator Jackson has prepared, and has promised to introduce a bill to nationalize the Trans-Alaska pipeline if

AGO 533647

litigation between the State and the companies delays construction. There is no warrant for the State of Alaska to make any economic concessions to the companies at this time; indeed, an opposite approach might well be considered.

The emphasis on economic measures is an important one. Where there are legal flaws in the existing State statutes dealing with pipelines, they ought to be remedied. Where there is even a possibility that such flaws could stand in the way of early pipeline construction, amendments ought to be considered. If there is to be further bargaining between the State and the companies (economic, political or legal), it is important to put the full onus for any postponement of construction on the backs of the companies and not upon State law or upon that popular whipping boy, the courts.

The state stands in two rather distinct legal relationships to the companies which are operating on the North Slope and which propose to build the pipeline. The State is, firstly, the sovereign, with taxing authority and the police power. As such it can tax and regulate oil and gas production and pipelines (to the extent that the latter power over pipelines is not preempted by the federal government), whether they are on State lands, federal lands or private lands. Secondly, the State is the landlord and royalty owner with respect to the producing properties on the North Slope and

the landlord with respect to pipeline rights-of-way across State lands. Different principles govern what the State may and may not do in these two capacities. Although the State as landlord is not necessarily on an equal footing in every respect with (say) a private landlord, it is among other things bound by the sanctity of contracts, including that of oil and gas leases.

The existing right-of-way bill asks for trouble because it confuses the State's two roles and attempts to use the State's sovereign power to achieve for the State as landholder privileges which are not available to other landholders. I do not have the legal expertise to say whether or not the State would prevail in a court test of the existing right-of-way leasing act, but as long as there are more straightforward ways to achieve the State's economic ends - ways that clearly respect the distinction between the State's two kinds of legal personae - there is no reason to resort to complex and novel formulas as laden with legal controversy as is the current law.

An often expressed objective of the original pipeline package was for the State to maintain control of its own destiny and to limit the ability of the major oil companies to control the State's economy and (implicitly) its politics. Many Alaskans would be willing to sacrifice substantial oil and gas revenues to advance this objective. The most

important elements in preventing company domination, however, are (1) an informed population, (2) a high level of integrity and detachment on the part of the State's elected and appointed officials and (3) an expert, professional and well-funded Division of Oil and Gas. The third we now definitely have. The second - integrity and independence of public officials - is probably most important because the information received by the public and the maintenance of an independent analytical and regulatory capacity depend upon it. If the Legislature wants to guarantee its own political independence and that of the State government, it might consider some very tough public disclosure, conflict of interest, and campaign financing statutes.

The Ad Valorem Property Tax

I see no problem with the general principle of an ad valorem tax. The arguments for the State's preemption of taxing authority over this kind of property are compelling, and need not be repeated here. The division of tax revenues between the State and its subdivisions is a purely political question which is outside my terms of reference as a consultant.

One question that might be asked about this proposed legislation is the reason for exempting the so-called intangible drilling and development expenses. This item is made up primarily of the labor employed in drilling of wells and is not different in principle from the labor employed in

building a pipeline or any other structure. These outlays could be valued on a depreciated historical cost basis, on the same principles as other outlays for producing properties. Is the exemption proposed because the companies do not want to disclose their intangible expenses (which get special treatment under federal tax law), or are they just anxious that the principle of treating them like other investment costs never be established anywhere, lest the expensing of intangibles in federal income tax law be jeopardized? In either case the Legislature ought to know the reason and view it on its merits.

Right-of-Way Leasing

My preliminary remarks dealt with some of the objections to using right-of-way leases as a roundabout way --- a hostage, in effect --- to influence the State's combined royalty and tax revenues from oil and gas production. It confuses the State's roles as sovereign and as a quasi-private party to a commercial transaction - roles which ought to be kept distinct for a number of reasons. Whether or not the approach in the present Act would stand up in the courts, it is sufficiently questionable that it ought to be avoided if there are equally effective alternatives that are more conventional or more straightforward. The proposed amendment, however, goes out of its way to abdicate any authority of the State, in either its capacity as sovereign or as landowner, to regulate operation of the pipeline.

Page 4 of my copy of the Governor's proposal was missing, so I cannot refer accurately to sections and subsections on pages 5 to 11. The language of subsection (3) on page 5, which begins, "the imposition of common carrier status does not require . . . ", is not necessary to protect owners and operators from unreasonable and uneconomic demands by shippers, and appears to go far beyond the common law in permitting pipeline operators to evade their common carrier obligations.

Some modification of language or punctuation is necessary to make it clear that the word "which" at the beginning of line 7, page 6, refers to "pipeline" rather than to "lessee."

I shall comment on the common purchaser provisions, which the Governor proposes to remove from the right-of-way leasing act, separately under the heading of common purchasers.

The State's option in existing law to buy 20 percent of the pipeline is probably unworkable in view of the way in which the pipeline is to be organized, financed and owned. Once the line was built, transfer of a share to the State would be extremely complicated and would generate horrendous Lawsuits. The proposed substitute language (subsection 7 on page 7), however, is almost meaningless. Its only force is to establish instances in which the State would not have "an opportunity to negotiate." It is not clear what is the purpose of this provision.

There are still arguable grounds for the State to own a share of the pipeline, both (1) to protect its own royalty and tax interest against tariff manipulations, and (2) to provide a vehicle for shipment of oil by independent producers if the companies operating the pipeline are unwilling or unable to provide transportation on a nondiscriminatory basis. If this is the State's approach, however, the decision ought to be made positively now to buy into the pipeline on a specified proportion, before pipeline construction is started, and this decision ought to be coupled with the necessary organization, bonding authority, etc. to carry out the project. The option to buy in its present form is understandibly objectionable to the companies because of its potential use simply for harrassment.

It ought to be kept in mind that the State does have the ultimate power regardless of this legislation to condemn pipeline property for public purposes (provided it does so subject to law and pays the owners fair compensation), and to operate the pipeline as a state-owned public utility. It is not clear what benefits there would be in state ownership, but its possibility might be as much of a deterrent to abuse of private pipeline ownership as the option in statute to buy a part of the line. I am not sure that there is any point in raising the state ownership issue in any legislative form today, however, unless the State definitely intends to own

and/or operate all or part of the pipeline.

The Production Tax

Collection of a production tax, whether "cents per barrel" or a percentage of wellhead value is unquestionably within the authority of the State. There are no obvious legal difficulties in coupling a minimum cents-per-barrel tax with a proportional or graduated tax above this minimum.

Much higher prices can be expected for crude oil in the near future, and these prices will not be offset by higher development costs or additional exploration risks. The result will be vast windfalls for the operating companies. There is no economic reason the State could not levy a highly progressive severance tax --- one which takes 25, 40 or even 90 percent of wellhead revenues above a given level, for example $4.00 per barrel. I am not proposing such a tax, but in view of the quite successful demands of a similar magnitude by the OPEC countries, it would be surprising if Alaska did not reconsider its oil and gas taxation levels in the context of the new conditions.

One recurring problem with respect to severance taxes (or royalties) levied as a proportion of wellhead value is the valuation of oil or gas at the wellhead, where arms-length sales are lacking or rare. In general, the operators will be carrying their own oil through their own pipeline and selling it to their own refining divisions. In such a case the declared

wellhead value or transfer price is not a real price but is an accounting fiction chosen to minimize the company's consolidated liability for taxes and royalties. Where the sum of production tax and royalty rates is low at the margin, the depletion allowance (which is applicable only to income from production) encourages the integrated companies to take their profits in production rather than in transportation or refining. This tendency means that the companies will declare relatively high wellhead prices, which are in the State's interest.

It is not always in the companies' interest to maximize wellhead values, however. As the sum of royalties and production tax rates is increased, it is increasingly important that wellhead values not be unilaterally set by the companies and uncritically accepted by the State. Recognition of this problem was of course one rationale for the existing right of way leasing law. Some remedy to this situation seems to be available in existing and proposed state law, but the Administration ought to be able to explain carefully and completely how any remedies will or do work, and how the State expects to combat any unrealistically low transfer pricing.

One question that ought to be explored thoroughly is whether it is in the State's interest to imitate federal tax law in every respect --- particularly whether the percentage depletion allowance, the expensing of intangible drilling costs, etc. This Session is not the time for such a new and

complicated issue, but a study Senator Jackson has requested from the Library of Congress in behalf of the U.S. Senate's Energy Study will be the most complete consideration of the tax preferences for oil and gas yet published. This study will be available early in 1974, and will be of considerable value to Alaska's Legislature.

Conservation Tax

There are no apparent problems with the oil and gas regulation and conservation tax. Because its revenue would go into the general fund and is not earmarked for these specific activities, however, the segregation of this tax in a separate bill with a special name is just semantics.

Common Purchasers

The kindest thing to say about this bill is that its provisions will never be used. It does not cope with the problem that created the demand for common purchaser legislation in the first place, and addresses a problem which is unlikely ever to arise. The bill, in essence, forbids a petroleum purchaser to discriminate among sellers. The problem however, is that pipeline owners, by virtue of their monopoly over transportation, are alleged to compel independent producers to sell to them in the field at prices less than the value of their oil. The discrimination at issue is not among sellers, but between the oil of the pipeline owner's affiliate (which is not sold in the field), and that of independents (who must sell in order to dispose of their oil).

The existing law at least recognizes and addresses itself to the real problem though perhaps not effectively.

In any event, a civil penalty of $100 to $1,000 can simply be regarded as a cost of doing business. If the conduct in question would bring a disruptive outsider to heel, it could well be a rewarding investment. If either common carrier or common purchaser legislation is to have any effect, the Legislature ought to consider at least creating (1) a private cause of action for recovery of triple damages, and (2) the possibility of injunctive relief.

Perhaps the problem is one that can never really be solved under a regime of shipper-owned pipelines. Even if common carrier requirements are strictly complied with, it is always cheaper for the pipeline owner to ship an additional barrel of his own oil through his own pipeline than it is for an independent to ship his oil through a pipeline he does not own. The outsider pays the tariff (which is always higher than the cost of shipment) and the owner pays the cost (even though his books say he paid the tariff. He paid it to himself!) So, given equal prices at the downstream end of the pipeline, the pipeline owner can always offer to buy the independent's oil in the field for a better price than the owner can get by selling it at the other end of the pipeline and paying the transportation tariff. If the common carrier requirement can be evaded, of course, the pipeline owner can get by with a

lower price than the independent could have got by selling at the pipeline outlet.

Pipeline Commission Act

Whether the State has concurrent regulatory jurisdiction with the federal government over oil pipelines is a serious legal question, and I am at a loss to know why the Administration would not want this issue to be litigated. If the State lost the case, its remaining authority would be no less than provided in this bill, and might well be greater.

There is no way in which litigation over the regulatory authority of the Pipeline Commission could hold up pipeline construction; it is difficult to conceive of a cause of action the companies could advance until the Commission issued an order which conflicted with federal jurisdiction, and such orders would not commence until the pipeline began operation.

The assertion that new attention in Congress to anti-trust and common carrier problems assures an effective ICC surveillance of pipelines is at best naive.

Concluding Remarks

I want to reemphasize that these are first reactions upon a first reading of the proposed legislation. Despite occasional strong language, my remarks are provisional, and my conclusions may change as I am exposed to advocates of the legislation and have an opportunity to study the proposals

more carefully. There is one conclusion that I do not expect to change, however. These bills need not be considered as an inseparable package; they each ought to be examined on its own merits.

CHARLES SPAHR
10/19/1973

STATE OF ALASKA
THE LEGISLATURE

LEGISLATIVE AFFAIRS AGENCY

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JUNEAU, ALASKA 99801

October 31, 1973

The attached transcript contains the remarks made by Mr. Charles Spahr on October 19, 1973 before the Senate Resources Committee. It is a verbatim transcript of Mr. Spahr's remarks. There is occasionally a word missing or other minor gaps in certain places, which are due to the speaker's testimony being indecipherable at that point. However, it is believed that these occasions are rare and the transcript presents a fair picture of the thoughts expressed by the witness before the committee.

John O. Sackett

Senator John Sackett
Chairman
Resources Committee

AGO 533660

TRANSCRIPT OF SENATE RESOURCES HEARING

October 19, 1973

SPAHR: For the record I should identify myself. As most of you know, I am the Chairman of the Standard Oil Company of Ohio. I have been involved in the oil business all of my working, earning life and am getting to the point where my seniority might entitle me to some respect in my actions and correspondence--in other words, I am getting to feel rather old these days. I feel that in the Committee's best interests, it would behoove me to position myself in the very beginning to answer questions, since I did make a statement this morning of an all encompassing nature, which I believe all of you heard. I believe we can use that as a reference and begin in whatever way you gentlemen would prefer.

SACKETT: Very good. Are there any questions from Committee members? Senator Thomas?

THOMAS: I won't hesitate to jump in now, because I know if I don't it will be about two hours before I get a chance. Mr. Spahr, maybe if I could just preface it by saying that I, at least, and I know a few others also, several years ago were much persuaded by the arguments about the ICC being a paper-tiger really and would not, because of its past performance, really protect our best interests up here. And, what we were fearful of was that the wellhead value would go down to a point

that our taxes would not amount to what they otherwise would and that is one reason, I am sure, that the cents-per-barrel tax came through; but primarily that was my reason, at least, in voting for the right-of-way leasing act--to give us some kind of handle on this thing and hopefully to persuade the owner companies of the pipeline to not recoup their investment as quickly as they could legally under the ICC rulings. And, at the same time we had no assurance that a maximum take would not be made by the companies involved--no assurance that this would not happen--driving down the value of the wellhead. Out of this, I think you can see what my question is--how are we going to be protected against this sort of thing?

SPAHR: Senator Thomas, I will try to be responsive to your concern. At the time you considered these questions and expressed these concerns, all of which are related, circumstances were somewhat different than they are today. I really believe that the things that have happened are one of the bases for your concern of these matters being litigated somewhat. Let me proceed to explain. I refer mainly to the way things are going in the world of oil production and purchasing and the relationship of supply and demand and the effects of all these things on the value of oil. A very decided upward pressure on the price. That prospect was not apparent several years ago when first considering the measures that are now law and your calculations have indicated that then current prices, backing off transportation charges, terminaling charges and all those kinds

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of things, allowed for 7% return on the ICC evaluation on the pipeline on a low volume, that the value would be minimal, if existant at all. At that time we tried to point out that we were not interested in producing oil for no profit, just having all our profit given to a pipeline return, but I realize we just weren't very convincing. Let me proceed to the ICC. This morning in the House Resources Meeting, the question about the ICC arose and I think the implication was strong that there was still concern that there might be a paper-tiger. The question posed to me was--what has my company's experience been in working insofar as its transportation operations were concerned under ICC jurisdiction. And, I will give you the same kind of answer as I gave those gentlemen. My company, as far as operating pipelines in the Lower 48--we have one that we own entirely which is rather old now, which connects the tri-state, that is, the Illinois, Indiana and Kentucky oilfields, to our Ohio refinery--was built in 1939. It has connections to other carriers that serve it from more distant fields and it, in turn, has connections at this terminus that allow oil to be moved on to other carriers to destination. So, it is involved in both establishing rates and working out divisions of rate with other carriers, all of which have to be approved by the ICC. It has transported oil for other shippers who were the sole owner. At the same time, we have used pipelines operated by others that parallel and serve this line that I mentioned--Marathon's pipeline being one--various carriers who deliver into central

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Illinois being others. We also participate in the Capline Project through our ownership in the Mid-Valley Pipeline. This latter company, Mid-Valley, built a consortium in 1950, connecting the East Texas oil fields to the Ohio refineries and pipelines which originate there. This was owned by the Sun Oil Company and my company in the beginning--we originated the line as we are attempting to share in the origination of this one because we needed the new carrier and a capacity that would be sufficient, and at the right place to satisfy our needs. Later, Gulf became a partial owner. That line operated continuously since 1950--it has served other shippers such as Ashland, other companies that I could name--it goes through the same proceedings in filings its tariffs and getting approval of the ICC as SOHIO Pipe. I could name others--the Colonial Pipeline, a product carrier, is one in which we have an interest, and the Harbor Pipeline is another, on the East Coast, in which we have a small interest. We have other wholly owned interests and much more restricted--restricted in terms of volume--but in all instances we have to file and get approval on our terms--terms of receipt, minimum volumes, conditions under which we receive, we have to specify the carrier's responsibility, the custodial law, the obligation to return it in kind, or substantial kind--and in all these operations, to my recollection, while we have had inquiries for clarification and some suggestions on improvements of our tariffs from the ICC, we have really quite apparently done nothing to trigger their criticism in terms of penalities that might have been applied--in other words, I think

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we have conducted our operations well. Now I think our experience is typical of that in the Lower 48. We have used other people's pipelines before and they have used ours. We, or most major companies in the Lower 48, have operated for sometime and have been in transportation operations for sometime and parties to the rather well remembered Madison Consent Decree, which was the basis of establishing the limitatio.. on pipeline earnings and related earnings to a percentage of the valuation. So you have that restriction, and an effective one, to be concerned about in our operation, and, of course, we are subject to the Interstate Commerce Act, which Act carries some interesting penalties among other things, failing to observe the law. The potential difficulty that arises out of malfeasance or misfeasance, or plain bad operation, or illegal operations, are so potentially severe that the ICC, in my view--an operator that has had to work under the jurisdiction--is a very effective regulator. Now, I believe it is a very fair thing for me to add that their concern about their regulation varies almost directly in relation to the size of the facilities, complexity of facilities, they have to be concerned about. A small line operating for a long time with a reliable record of performance gets their attention, but very little concern, let us say. They can easily tell if the tariffs are being developed in accordance with their regulations and if there are differences of any substantial nature from what they expect. Larger lines, such as Capline, which is a still growing line, having capacity added

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almost every year, and which has an ultimate potential capacity of around 900,000 barrels a day, being in the state of development and growth, gets more of their attention than do the older, smaller lines. Thus, the operators get more inquiries; but again, the performance requirements have been so well established and the availability of the systems have been so general that the ICC's requirement to police and penalize is not great. Now I have the firm impression, however, that comments about ICC being a paper-tiger, concerns expressed in this State, general concerns expressed in Washington and elsewhere about the possible need of making sure that regulatory effort is good--all are going to have the result of making the Interstate Commerce Commission very, very aware of this pipeline and of the need to inspect, to study, to regulate, and to be sure that we don't do anything that we should not do. That's all a very lengthy way of saying--my own experience with them is that they will do an effective job. And, my belief is that this likelihood, coupled with the provision that we are going to keep our records for Alaskan operations separate from all of our other records--coupled with the willingness I expressed this morning to have our records--my own company's records with respect to Alaska--independently audited, with the auditor one that would be acceptable to the State--ought to give you some substantial assurance that we are going to operate within the law rather than outside it. Now, with respect to costs and tariffs and the value of Prudhoe Bay oil. We now expect to schedule our construction in such a way that the second increment of volume capacity will be available

as soon as the pipeline is done. In other words, we expect to install the stations needed to operate at 1,200,000 barrels a day and have them ready as soon as the line is commissioned. We will have to undergo a short period of commissioning time--it's variously estimated at four to six months, depending upon the weather prevailing at the time we are doing this--when we have to test everything, make sure it works right, fill the line, make sure we have vessels scheduled in Vald to take the oil away, make sure we don't encounter difficulty that would cause the pipeline to shut down and allow the jelling of the oil in severe winter--during which time the--according to Alyeska's operating people, we'll be operating at rates varying from 200,000 to 1,200,000 barrels per day. During that period of commissioning, the average rate's going to be less than 1,200,000, but as soon as it is over, there is nothing that we can visualize that would prevent us from operating practically at the 1,200,000 barrel per day rate. So, we no longer visualize the possibility of an extended period of time going by, like a year, during which low rates where, if the choice were calculated on the basis of a 7% return of low rate, it would go sky-high. We do want to have the privilege and we are counting on having the privilege of establishing our rates in accordance with the ICC limits, but we believe and we think it can be demonstrated by our people, as well as by the State Administration, that the use of tariffs that will allow a return on investment approximating 7% of valuation will not result in a valued oil at the wellhead that would be anywhere close to nothing or nominal. So, the combination of

expected initial volume at a high rate, with the advances and prices of world oil which will effect the value of Alaskan oil are the principal things that I see that tend to completely eliminate the concern that you have. I will try to be more brief on other answers.

SACKETT: Are there other questions? Senator Rader.

RADER: I am interested in the nature of the understanding that you have with the Governor. If we pass a 20 mil tax this session--ad valorem tax--and an additional 5 mils next session, would that be a violation of your understanding with the Governor?

SPAHR: We have absolutely no understanding what the Legislature should, could, or would do in the future. I didn't presume to try and establish that. I feel if I had, the Governor would probably have kicked me out of his office. We simply tried to develop together--after listening to one another, a set of revised laws that would eliminate our concerns by being able to finance and really operate without undue restrictions and regulation. Now we recognize that the State must have revenues to meet its budgetary requirements and it has that power to do this at any time it wishes to, but as I said to the Governor in the very beginning--I believe that a philosophy we could use as a foundation for our discussion which would lead to a negotiation would be this--we recognize that with the State's power, and the realism of its working out tax laws that would provide it with the revenue it needs to do the jobs it wants to do for the State of Alaska. On the other hand, we hope that we can convince the

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State as to the needs we must have for relief in the regulatory and financing areas that will allow us to do this job the way the State really wants us to do it with minimal cost and, you might say, with maximum speed. And, if this can be the basis of examination for changes that could be made to the laws about which we have been so concerned, it would seem to us that we should find a way for us to solve our problems, accomplish our objectives, and eliminate the waste of time that is bound to continue to occur by pleading the process through the courts.

RADER: Now if the imposition of a 25 mil ad valorem tax in January would not be a violation of your understanding, would the imposition of that tax now be a violation of your understanding with the Governor?

SPAHR: Well, sir, I really think the imposition of such a tax by you couldn't be conceived to be a violation of the understanding that I have with the Governor; however, the understanding I believe I have with the Governor is that the total content, including the tax amounts of these legislative proposals that are before you now, represents in combine a solution to the problems that we have. And, my understanding is that it represents an adequate taxation base and contemplated take for the part of the State. The Governor understands, and I want to be sure you do too, that if you decide to change this now, then I have the problem of going back to all of the companies involved, whom I have represented here as a spokesman, as well as the obligation of

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re-examining from our own point of view, any changes that you make in order to determine whether we want to accept them, or whether we feel it would be best to go ahead and use the facilities of the court. My point is that if you do not choose now to approve what has been put before you, substantially in the way it has been put to you, then we just simply have to take the risk of use of time to find out who wants to do what--whether the lawsuit stays in effect, or whether we can accept what you do. Now, insofar as January is concerned, while it is only a few months away, I think you are no more restricted there than you would be at any other legislative session, which is to say you are not restricted at all; however, I would feel that, frankly, you would be taking advantage of a technicality to move that fast on a change in the tax base--I wouldn't really understand it.

RADER: Our standard maximum in the State is 30% on ad valorem for our subdivisions at this time. If we went to 30 mils right now, you state the reason for the negotiations is so you would not have to go to court and have protracted hearings or for financing. Of course, there would be no court hearing involved in that--nor would that affect your financing, would it? If it was just a matter of our judgment what the fair tax would be?

SPAHR: It's a matter of your judgment, but here you begin to affect the economic considerations of the people involved in this pipeline project, and you bring me to the point where I would like to expand a little bit on what I said in the general

session this morning. While you have a right to do this, it changes our economics. Every participant in TAPS could evaluate it again. Some might conclude that, well--if the tax burdens are going to be this way--they are going to apply to the pipeline this heavily--maybe there is no real incentive to us anymore --they might reason-- to participate in the line so we would like to get out. My conjecture is that this kind of reasoning is very likely to arise among the small owners. Thus, we would be involved in TAPS in a reorganization--a rearrangement of ownership. I think it is fair to say that nobody wants to take any more of this ownership burden, in spite of your thoughts, that you may have had in the past, about the lucrative ownership of the pipeline--nobody wants any more of the burden than they have to take proportionately to the utilization made and so there will have to be some time spent in working out the rearrangement of ownership and investment responsibility and then there would be, as a consequence of that, the disappearance of some if it should take place, a going concern that I would have, and I think would be shared by others, that the elimination of small owners would serve to enhance the curiosity of the Department of Justice about whether or not we are getting involved in something that is a violation of anti-trust laws. We wouldn't be, but it is one thing to feel, you might say honest and pure, and another thing to convince those who might be inclined to think just the opposite of you. So these are the kinds of things that I think would arise out of such an action.

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PADER: As I understand it, you are saying that some of the owners, if you raise the tax, might consider it so unprofitable that they would not any longer be interested in participating?

SPAHR: Undesirable--I don't think I said unprofitable. Maybe I did, and if I did I want to correct that.

RADER: Undesirable--unprofitable--aren't you talking about profitability?

SPAHR: Profitability is always related, but you see, every company involved, I think, has the theoretical choice at least, and I think it's a practical choice, of deciding where he is going to put his money for investment. He doesn't have to put it in Alaska in a pipeline when he could put it in a chemical plant, or motel, or invest it at 10% in short-term governments, or there are a lot of things that would perhaps be attractive by comparison, so he might decide that he can rely upon somebody else taking care of his obligation in the pipeline, including perhaps the Federal Government, finally, as I mentioned this morning--let them do it, produce his oil, he won't have to worry about the risk of the pipeline, he won't have to hire lawyers to take care of his obligations, he won't have to do a lot of things that are involved here--he can do the simpler job of making money elsewhere, and rely upon a service provided by somebody else.

RADER: Let me preface my next question with a statement. A lot of us are concerned about the ICC matter, because we view the pipeline as being in the nature of a public utility--a

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monopoly, which is different than in the Lower 48. Pipelines have other competive methods, but we have only one exit from the North Slope. It has to go through this pipeline, and if we did consider it in the nature of a public utility, then you would be assured as a public utility is, with a certificate of convenience and necessity, and the rest of it, and under ordinary and standard public utility law, a reasonable return on your investment, and bankers are accustomed to lending money under those circumstances. Don't you think they would finance you if you were under the same constraints?

SPAHR: I doubt it, but let me answer you in a broader context than you posed the question to me--I want to refer to some of your observations. You apparently think there is a difference in the situation you are involved in because there aren't other transportation facilities available to compete with the pipeline. As a practical matter, in the Lower 48 states there are no other transportation facilities that are available to compete either. It is not physically attractive, desirable, or economically feasible to transport oil by truck or by railroad, or by anything other than by pipelines down there. In the normal course of development of pipelines, there aren't duplicate facilities that serve the same source, the same destination, so while this is the first development up here--and it is the biggest one ever--it seems to me that the situation is relatively the same as those operating in the Lower 48--your State situation as well as Texas or anywhere else, so I really don't understand the concern. Now it really isn't a public utility--as public

utilities are defined as I understand them--it's a private business, regulated, serving a limited amount of interested shippers and those who at destination would like to have the oil. And the public as such isn't involved at all, so to regulate us and restrict us and require certificates of convenience and necessity to get in and out, as I see it, would serve no purpose except to be restrictive and ready to provide jobs for others--it wouldn't protect the public--it would severly limit us in the flexibility we would like to exercise as time goes by, but none of us present in the room, for example, may be in the same position to be influenced as we are now. So, that's the objectionable feature to me.

RADER: Of course, you say it is not a public utility, but that may be a question. If we have only one, it's a monopoly situation--everybody has to use it. It has all the earmarks of a public utility where you want only one waterworks, one telephone system, or one power company; we don't want two pipelines, and we don't want alternate methods for economic reasons, ecological reasons, and other reasons, and it's hard for me--and I think others have the same problem here--to think that the public doesn't have an interest in that rate, and what the rates are that other corporate citizens, who are not owners of the pipeline, have to pay to get their oil to market. It is because of our concern in that sense--and again, assuring to you--what if we put you under our Public Service Commission, no owner's forfeiture provisions or anything else--you would be under the same provisions as the Alaska Juneau Light Company or Alaska Pipeline from Kenai on up to Anchorage up north--the same position, same

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control, same regulation--that will guarantee a rate of return. They have no trouble financing themselves, its a method of financing that is well known throughout the country--a certificate of convenience of necessity enhances the financability of most utility projects--why wouldn't it operate in the same way for you?

SPAHR: I repeat, this is not a utility project, so I can't see that it would enhance our capabilities at all--I see that I haven't been convincing to you, although I still contend with great conviction, that it would hamper us. I have complete difficulty in understanding your concern since we are regulated by the Interstate Commerce Commission on the one hand, by the Madison Consent Decree on the other, which limits how we can establish our tariffs. We have to make the pipeline available to any and all who meet the tariff requirements--we have to be reasonable in the first place and satisfy the ICC as to the reasonablness. It seems to me that all you are suggesting, frankly, is double regulation which requires more attention to detail, more expense, and in the end less profit, and it seems to me it's less rewarding to you.

RADER: But that's not a reason for not building the pipeline--for double regulation, is it? Isn't there a lot more involved in this than that? Isn't there a great difference in the type of regulation I am talking about and what you are talking about?

SPAHR: Would you mind telling me specifically what you think might be involved? Are you concerned about the profits we will make on the pipeline?

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RADER: I think you must make a profit. I want you to make a profit, but I think the public has an interest, aside from that profit, in the same way they have an interest in the profit of the local utility company here. They have a monopoly situation. They are serving the greatest resource we have--there is no other way to extract the resource.

SPAHR: Do you think a return of 7% on the approximate investment involved in the pipeline is unreasonable?

RADER: As I understand it, that could be a 50 or 100% return on your invested equity. We have had testimony from others that that could well be a 100% return on your invested equity.

SPAHR: Alright, now we are getting very much to the point. Our borrowing capacity--anybody's borrowing capacity--is limited finitely, dependent upon the resources we have available to cover the borrowing. If we are going to remain in business, then every investment we make has to be a reasonably constructive one or we ought to take the alternates that are available to us. Therefore, if we are going to be limited severly on the return on the borrowed capital we have to employ up here, we are employing the capital and withdrawing the ability to use it elsewhere for a better rate of return with the rest of our capital employed. If we only use 15% equity up here, we will probably use more elsewhere. We can take advantage of the high borrowing ability up here to finance a project that is very, very costly, which couldn't be financed otherwise if we had to use more equity. This particularly applies to my company and it has very similar appeal to all the rest, so when you are looking at our problems and our finan-

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cing and our returns on investment, you have to consider our whole company and its problems. We have to--just to talk about my company a bit more--in addition to building our share of the pipeline, comparing our share of the North Slope, which is rather substantial, we have to buy ships for the Valdez operation --a 120,000 ton ship costs $50 million each at this time-- in order to meet all the requirements and specifications that are designed into it now--we have to revise our refineries in the mid-continent so that they can run Slope crude, whereas they have been running Mid-East crude before--this takes millions of dollars; we have investments in expansion in the market place to make, as well as refining facilities to support them. Because of the very rapid shifting and supply situation in the world we have to commit ourselves to the financing of large capacity tankers of foreign flag nature to bring oil from the foreign lands to this land of ours--we have many, many things to do-- this is multiplied many times by the total industry. It is not remotely possible that we can do all these things with our own funds, and the problems facing the oil companies, as well as other industries in raising adequate amounts of money to do the kinds of things that are projected that we are going to need to do in this country, are nothing short of appaling, so we have to look at what we do in Alaska as part of the total, realizing that we have choices to make if the opportunities in one place aren't as good as in another, and this is why I have said, as strongly as I could say--hopefully without appearing to be combative or unreasonable--that if we cannot have the opportunity to work under ICC regulations with the realibility that I think

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they provide for everybody--if we have to be restricted substantially in our earning capacity here--I am one who would much prefer to see somebody else do it. And, I am...

PALMER: You have just said we have to consider the entire situation, not as an isolated case. I think we do, so I think we have to figure the pipeline and its profit--not in its own relationship, but also in relationto the fact that it provides you a means of extracting and marketing the North Slope oil and, therefore, should be a much higher profit than might be gained in many other places, so it is not an end result, but only a means to an end, and can't be considered by itself in isolation.

SPAHR: It's a component of a total and I don't think you can necessarily conclude that its going to enable us to make an unconscionable profit on the oil that would not otherwise be moved. This oil is going to be moved anyway. If we don't build the pipeline, somebody else will. I am confident we will get that oil out of there--sometime.

KERTTULA: John's question wasn't entirely answered...

RADER: I have a couple more if I could follow for just a minute here...

KERTTULA: The answer is you can't earn over 7%--you can earn over 7% on your equity, that is....

SPAHR: Well, you can earn 7% on the evaluation which, in the very beginning, would be an approximation of the total investment

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involved. Borrowed money, as well as equity money.

RADER: It is my understanding that it is your position that the TAPS consortium cannot finance this pipeline on a public utility basis--would not want to--is that what you are telling me?

SPAHR: I did not say that it could not be done. I do want you to understand that I think it would be more difficult. I do want you to understand it would be far less attractive to me--I am not talking now about the consortium of the other oil companies because I haven't discussed this problem you are raising with them. We have only discussed feasible solutions we felt we could accept.

RADER: Now if you feel you would not want to build it on a utility basis, with a utility profitability, and if we felt we had to have that sort of a show, would your position then be to favor a Federal line?

SPAHR: My position would be that we would have to go home and re-examine the whole problem by ourselves and with our associates and reach a conclusion and my position is that that will take time. If we have to do it, we will have to do it, but I do feel it is not in the interests of anybody involved to spend time unnecessarily. This may be necessary as a consequence of what you do, but I am trying to say that it poses enough of a different question from any that we have considered that I do not have an answer.

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SACKETT: Before anyone asks a question--while we are still on the same subject--I kind of like your idea of a Federal pipeline, built by the Federal government.

SPAHR: That's not my idea! It is a suggestion of a way to solve the problem.

SACKETT: Well, I like the suggestion you made this morning, as another alternative. I would assume that under Federal ownership the regulation would be with the Federal government and that regulation might take care of the same problem we have now, which is the concern over tariffs being charged at the wellhead value. Would you care to comment more on this concept?

SPAHR: The Federal government is another business--the Tennessee Valley Authority being a prime example--anyone who wishes to can evaluate that operation to their full satisfaction and speculate on this one. I don't think it would be a very good solution to ask the Federal government to build the line. I start from the premise that I simply can't accept your concern about the possibility that we are going to milk everybody in sight out of all the money they have for our pipeline service. I am concerned that Federal building of the pipeline would probably be the most expensive way to build it, and that it won't necessarily be the quickest way either, because the profit motive is not there, as it is with us. The desire to minimize the cost is not there, as it is with us. I could cite many, many instances on this latter business. For example, we attempted to persuade the Conference Committee that just brought out the pipeline bill to insert the

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word "reasonable" in the phrase that requires us to compensate the government for all its expense in the past, now, or in the future, for investigating the line, inspecting during construction and during operation. We wanted "reasonable" in there so that we would only have to reimburse for reasonable expenses and that the charges might be subject to some examination. We didn't succeed in getting it in there and we have no control over what will be done. And, I don't think--and this is a personal opinion--that those who were responsible for putting that in there in the first place have much concern over what those costs will be. Now I want the pipeline inspected. I want it built well. I don't want trouble out of it, and we are determined we won't have it, but I do think that we need to do just as good a job on planning how to insure its inspection will get the job done well as by the kinds of materials we select. So, I think if the Federal government builds the line it will be more expensive, it will take longer and maybe the problems arising out of operation will be more difficult and time consuming to solve. That's it.

BUTROVICH: Mr. Spahr, you and Senator Rader had quite an exchange on whether the pipeline should be a public utility. Are pipelines public utilities anywhere? Are they handled as public utilities anywhere to your knowledge?

SPAHR: To my knowledge, no crude oil carrier or oil product carrier is treated as a public utility anywhere in the United States, I am not knowledgable about the European countries, although I believe the same to be true over there.

BUTROVICH: If they are not a public utility, then as far as earnings are concerned, if they are not treated as a public utility, you agree then they should not be treated as a public utility for any other reason? Would that be a fair statement?

SPAHR: I think that would be a fair statement. In other words, they shouldn't be protected from competition or anything like that? Yes, that's correct.

BUTROVICH: All embracing--anything--they should not be considered a public utility for...

SPAHR: With a very important exception which I wish to make. The right of eminent domain is an important thing.

BUTROVICH: That is what I was thinking about.

SPAHR: I thought you might be. Railroads have had that right in the past. The pipeline has to -- the pipelines are already regulated in a very effective way, but if they don't have the right of eminent domain, perhaps then they can't be built.

BUTROVICH: Is that inherent or by a specific law?

SPAHR: I am not---is it inherent? I think you will have to ask Mr. Heard, who will be up here soon and who is a lawyer, to comment upon that.

SACKETT: Senator Palmer.

PALMER: Mr. Spahr, you talked earlier about your pipeline operations in the lower states---mentioning some of those. What is the percent profit earned at this time, or for the

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recent past years, as calculated under the ICC? We hear about 5% and wondered if that was correct.

SPAHR: Depending upon the abilities to operate at the volumes that were contemplated when the tariff was set, theyhave ranged from 5 to 5-1/2, up to 7 at times.

PALMER: Well, if there is no competition down there, and I felt that was what you said awhile ago, then why are the tariffs....

TAPE TURNED OVER--SOME TESTIMONY MISSED.

SPAHR: ....their geology and the rest of their exploration indicates is available. That's been proven time and again.

PALMER: But given that geology, they can only bid what their economic....(couldn't hear rest of his sentence.)

SPAHR: That's right, but think of the differences that sometimes exist on the bids on the same tract of land because of differing evaluation in any circumstance---they are far more important, I think, than the cost of transportation.

PALMER: If production capacity increases, as we hope it will, markedly, with some of thenew lands up there, a market of course exists, what plans do you have for looping the line?

SPAHR: The plans have not been developed yet. They will be, I think, when it becomes apparent that they are getting close to the time. For example, once the line is built, and operating

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at 1,200,000, it will be time, if not before then, to start developing, perfecting the plans for looping. There has been some projecting of looping plans already so that we are aware of what can generally be done, but nothing has been finalized in detail. I don't--I plead with you really to be somewhat confident that the companies are going to be quite timely in planning for that kind of thing.

PALMER: Even if it's not your own oil--even if it is someone else's oil that you will be carrying?

SPAHR: Yes, because among other things, you know, if somebody else discovers oil and puts it to us, and we don't have the capacity, everybody gets prorated and our oil gets backed up, and that gets pretty costly, so we will make the investments alright.

SACKETT: Are there other questions of committee members? Senator Rader.

RADER: On this problem of public utility regulation type of thing. We regulate as a public utility a gas line that exists --a single gas line that crosses the Inlet and serves Anchorage from the Kenai Peninsula--limiting their rate of return. Is that an unusual situation, or an unfair situation in your view?

SPAHR: I am really not competent to talk about that. The Natural Gas Act is quite an act in itself and has quite a lot of influence upon thinking pertaining to gas matters, and I am not as knowledgable about those things as many others are. We are not gas producers in any substantial degree, nor are we gas

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transmission operators.

RADER: Part of your pipeline package here is the sale to you of lands with the dock in Valdez and for other facilities, not at a competitive sale. And, of course, we would have to justify that because there was a very substantial broad public interest in the pipeline and in your expeditiously getting that land--that it not be handled with somebody in between, making a very large profit or something like that. It seems to me that if we were to consider you in the light of a public utility; if you had a guaranteed rate of return, and a certificate of public convenience and necessity where you couldn't be competed with by any other consumer facility that it would make it much easier for us to make that land available to you.

SPAHR: Well, let me...I think it has been pointed out up here that we have offered to pay the appraised value of the lands. All those lands we specified that we want, for $10 million or whatever is higher. I think that is public knowledge up here. Our own appraisals of the land indicate that that $10 million is better than twice a realistic appraisal at the present time. So, we felt that we had demonstrated a considerable responsibility in assuring you that even with this deviation from your normal procedure of selling land, that we assured you of substantially more than might otherwise come out of a sale, even with public bidding. So, I think we have handled the problem really.

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RADER: I think you are right, but we have the philosophical thing and it's really the public interest in this pipeline is different than other bidders of land and other people we are dealing with. Let me ask you this. We have attempted through our right-of-way leasing thing to increase the right-of-way fees, as your profits increase--as a contractual matter--that is the theory we have proceeded on there. Would it be totally unacceptable to you, or your people, if we entered into an agreement with you as a contractual matter, and instead of that fee schedule that we have in the right-of-way lease, merely that you agreed to submit to public utility--standard public utility--type of regulation with a standard return on invested capital? I mean the whole public utility thing--get away from all this forfeiture stuff.

SPAHR: I dislike it myself. I don't know...I dislike it myself because of the things I have already said and because I don't think it is necessary to protect your interests; however, I cannot speak for the other oil companies involved. This would have to be put to them and they would have to consider it and answer for themselves, either directly or through me. I would be willing to be a conveyor, but that's not a question that is going to be answered in a few hours.

RADER: Let me carry it a little further--you don't really have to worry about ad valorem taxes of 30 mils if you are a public utility and have a guaranteed rate of return which is going to let you pay that 30 mil tax. You have, in a lot of ways, the things you are objecting too and the things you are concerned

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participation, much as I dislike some of the features of it, and so on.

CROFT: You indicated that you might encourage others to take a percentage of the present participation. Are there arrangements between the owner companies at this time regarding that?

SPAHR: There is a provision in an agreement that exists among the owner companies that provides for a means of reallocating ownership as the pipeline capacity is enlarged, that provides for their nominating capacity for determination of what the new capacity allocations will be up to 100% and that's all that we have. But this provision was put into the contract because the contract was prepared at a time when the potential of Prudhoe Bay wasn't very definite. People thought they had certain interest in the field, but they weren't sure, and, of course, as it has turned out, there have been differences from expectations.

CROFT: Is SOHIO free to sell its interest in the pipeline to anybody without obtaining approval of any of the TAPS.....

END OF TAPE.

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END OF TAPE.

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MILLER: My impression from your talk this morning was that basically the eight bills, substantially as written, which would indicate to me that that would include the distribution of the tax within the State of Alaska to local governments and this type of thing, also perhaps may have been part of your agreement with the Governor.

SPAHR: No, that was the Governor's determination. I am only--we agreed we wouldn't fight a 20 mil tax--an all inclusive tax--now by some formula (there is one in there) which would allow for distribution. We are not concerned about that. I don't see how we could possibly be, or should be. I didn't mean to imply that at all.

MILLER: With that particular bill then, perhaps we have more leeway than your talk indicated, and perhaps maybe some of the other bills could be construed the same way.

SPAHR: No, I think you have more leeway than you might have assumed this morning on that 20 mil bill, but I don't think my talk indicated that you would have less than I am indicating to you now. I was talking about the total amount of the tax this morning--if it were changed upward, then the total combination of things which we view as all inter-related would have to be reviewed because the cost would be higher.

MILLER: But I assume...

SPAHR: But, the distribution of the 20 mils, or of any figure, the distribution would be of no concern to us. It is the total that matters.

MILLER: But, that is a rather major portion of that bill that could be altered from the way it was written as far as you are concerned?

SPAHR: Distribution?

MILLER: Yes.

SPAHR: As long as the total doesn't change.

MILLER: Thank you, Mr. Chairman.

SACKETT: Mr. Spahr, Senator Silides has to leave for another meeting and has a question for you.

SILIDES: Mr. Spahr, there seems to be some difference of opinion as to whether you will be required to purchase oil which is brought to you. I was under the impression that you would have the option of buying it and that the prorating would begin only if you did indeed begin, or commence buying such oil.

SPAHR: I think I can straighten that out. I think there is a little confusion on several different facts. If the pipeline is full with oil from Prudhoe Bay put to it by all of the producers up there, including us, and some other oil field is developed and connected to the pipeline, then those producers--let's say they exclude us--have the right to make tenders in accordance with the tariffs. If the pipeline does not have the capacity for handling everything, oil from Prudhoe Bay is going to have to be backed down so that the new producers and the old producers get transportation prorata to their total needs equitably.

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SILIDES: Then ycu are indeed a common purchaser?

SPAHR: No, there is no purchasing involved here at all. Now if in this---you see, we are only producers here along with other producers, so we are an owner of oil that we want to ship, along with others who might have bought it or who produced it and, because of a restriction in transportation capacity, we are all restricted from moving all the oil we would like--it's a pro-rata restriction--nobody gets favored. Now, however, if in this field (we are talking about this second field) we choose to go in as a buyer from one producer there; then this proposal requires us to become a common purchaser in that field and to take prorata from everybody, as I understand it. We still could then turn around and find we are restricted as an owner of that purchased oil from moving all that we want to move, because the pipeline doesn't have the capacity.

SILIDES: My basic concern, which I think you have answered, but I want to be sure I understand---if someone connects with you, then you do have to back up the Prudhoe Oil and take oil....

SPAHR: Or provide the additional capacity so that nobody gets on the prorata purchase.

TUSSING: Both this morning and this afternoon you have said that the company could, or would not, go on with construction unless the proposed legislation were adopted, substantially as is. Now these bills contain a very large and complicated selection of propositions, some of which are considerably more important than others to the State and some which are considerably more important than others to the companies. We realize

AGO 533691

that you are privileged to speak for the other companies. I think it would be useful to go through the bills and their main disposition and indicate some order of priority; that is, which of these things do you think are really indispensable. Specifically, which of them are things without which you would not go on with construction. Secondly, which are things which would not necessarily be an obstacle to initiating construction, but in the absence of which you would continue to litigate. And, then thirdly, those things which you think would be wise for the State to do and you would urge the State to do, but might not be either an obstacle to construction or a cause of action in a law suit.

SPAHR: If I might respond to you for the moment...this morning I indicated not that the pipeline companies or the oil companies could not or would not proceed with pipeline construction if you alter the legislation. What I tried to say was that if you do alter it substantially, then there will be an element of delay, compared with the situation that will prevail if you do not alter it substantially, because new evaluations of the total affect of the altered legislation will have to be made by everybody concerned, so that each person will be able to make his own individual decision as to whether the changes are acceptable or not. That takes time and the point was that the risk we face, therefore, was time in the very beginning. And the secondary risk, of course, is whether or not the changes made will result in any alteration of the TAPS consortium, etc. I pose those to you as possibilities that I think are real and should not be overlooked. Now, in response to your suggestion

A67 533692

that we ought to go through this legislation bit by bit--I'd like to repeat what I indicated this morning--that in our negotiations with the Governor, we made it clear--as we finally made clear by accepting the results--that we were looking at all of our problems and trying to solve them all as a package and that in our view, what has been presented to you will solve our problems in a way--and we believe from what the Governor said, would solve yours--in a way that would permit us to go ahead and permit you to let us go ahead. Now if you are going to examine these laws bit by bit--we have the people available who will do this with you--but I really don't propose to try to dismember or do surgery to all this stuff. What has been presented to you is something we can buy. If you choose to change it, that will be your decision and then we will look at it.

TUSSING: You are saying then, take it or leave it?

SPAHR: No, I am not really saying that. I am saying that a bit by bit examination with me of this legislation is not going to be productive because I am in no position to bargain with you at this time on alterations to this--speaking for seven oil companies--I do not have that commission and I don't presume to be presumptous about it.

TUSSING: On the same basis, I can't pretend to speak for the committee members, but it seems unrealistic to come in here and expect to get the entire package, every jot and tilt, passed in its form--it's proposed form--and I think it would be worthwhile to pick out some of these things and to ask questions. Which of these things from your own point of view you could not live with.

AGO 533693

SPAHR: Well, I have already said, this morning, and I will say it now voluntarily. Any very substantial change in taxes, in regulatory arrangements, is going to require a review on our part and on the part of the other oil companies. I had hoped when I came here that the Legislature would eventually conclude that the total content of the tax package was adequate. Now if you are going to raise some things and lower others so that the consequence for us is about the same, I'd have to predict that that would probably work out, but it would still have to be examined.

TUSSING: May I ask the Chairman here whether he wants to pursue this line of reasoning, because I do think it would be useful to ask specific questions about specific items, but I think that is up to you and whether the other members want to travel along that road.

SACKETT: Since we do have other people available who could probably answer these specific questions....

SPAHR: I doubt that they will be able to answer those...

SACKETT: The people tomorrow?

SPAHR: I doubt that.

SACKETT: Well, obviously they won't be answered, but then perhaps through the Attorney General's office and the Governor's office we may be able to determine exactly the priority....

AGO 533694

TUSSING: In that case, let me ask one other question. The circumstances of the world energy picture has changed very radically in the last two years, and particularly in the last two weeks, and one of the consequences of that change is the vastly increased urgency of delivery of Alaskan oil to the Lower 48 markets, and the vastly increased value for that oil to its owners, both the State of Alaska and the operating companies. As far as I know, nobody has done the calculations and revised revenue projections in view of developments in the past two weeks. Perhaps it would not be unreasonable to project dollar values at the wellhead--in fact, values two or three times those that were projected (noise on tape...missed next couple of words)....Interior Department's tax statement 2-1/2 years ago.

SPAHR: I do have reason to believe that your State Administration is diligently working, and constantly, to keep such information updated.

TUSSING: Well, that really is not the point. In view of the immensely greater value and greater urgency of Alaskan oil, doesn't it seem that whatever difficulties or complications, either in financing or in the overall attractiveness of the overall project would be created by existing...(noise on tape--missed next word or two)...difficulties and burdens would be substantially less burdensome and substantially more bearable than there were in the time when the companies initiated their litigation against the State's laws.

AGO 533695

SPAHR· I believe when you ask that question you are ignoring the realities of financing choices that holders of money and funds to invest have to make; particularly when those people can reason, as I believe they can, that they have a multiple of choices, all of which will be beneficial if chosen, to the country as well as to the owners of the money.

TUSSING: You think that this is one of the less desirable alternatives that is provided....

SPAHR: Would you say that again?

TUSSING: Well, I think you are implying that Alaska North Slope development and delivery of its oil to market would go down substantially...so substantially in the ranking of desirable investments that this project would no longer be of substantial interest to the government.

SPAHR: On the contrary....a different nuance...I want to remind you, for example, that one of the features of the present legislation is that the State has an option to buy 20% of the pipeline, at a time of its choosing under circumstances where it can negotiate. Now I submit that that option stays in there--in the first place the State is not going to exercise it except under what it considers to be the most opportune time. Now, I would like for this to be understood. When one goes to a prospective lender, and in this case it will be a substantial insurance institution or big pension fund, or something else similar, to propose that they lend us money---we are going to talk to people with substantial funds of knowledge in financing

AGO 533696

matters and choices, and they are going to see that of the bonds that they are considering, for us, that 20% of it is not going to have an assured base in terms of being outstanding or earning capacity, and very likely, some development that only the State will control, may find that they have the funds back on their hands to reinvest again. So this will have an effect upon their attitude about what the terms of their lending will be. It will have an effect upon their judgment as to whether this is a better issue than some other one where the same return is provided but where the risk is not there. Those are the kinds of things that will effect a lender's decisions in my view. And, in my view, which I had checked out with our financial advisor, Morgan Stanley, I feel I've got great support and confidence that with that kind of an option there, we're not going to get the pipeline financed on a reasonable basis, if at all. Now if we are also...

TUSSING: This is one of the things you can't live with?

SPAHR: That is one of the things we can't live with--one among many. I am trying to give you a picture of our financing story and I don't think I am getting in a position where you are getting me to say things I said I wouldn't say, but I do want you to understand the financing problem. That's one feature. If we are going to have a feature, such as the one you now have, on the pipeline leasing act, which puts a severe limitation on our retention of earnings as a pipeline company, when it gets beyond a certain percent, it has the automatic result of lowering the coverage of fixed charges and...(noise on tape--couldn't hear next two words)...and making it less attractive than would other-

AGO 533697

wise be the case if we can go to 7%. Again, this is going to have an effect on the bond raising and so on--even though, as you might suggest, we enjoy a quasi-public utility status. There is no question about it in my mind. The money is going to be lent at the best terms for the best possible conditions of coverage and recoupment and gain that are going to exist and to the extent that we are handicapped up here, we'll be hurt. Now the pipeline has to be financed separately from the North Slope. We have to watch our total corporate credit arrangements. If financing is going to have to be supported by through-put agreements, they are going to have to be noted on the balance sheets and so on, but there are differences in the way, as I am sure you know, analysts evaluate things that are on your direct balance statement and your footnotes, and they will look at the totals too, so this is a very important element along with others.

SACKETT: I would like to call a ten minute recess. (TAPE OFF AND THEN ON AGAIN.) Are there any further questions from Committee members? From Senators? Senator Hensley.

HENSLEY: Mr. Spahr, one of the pieces of legislation that has caused some dissention in the members of the legislature is the ad valorem tax, and I don't believe there are many that quarrel with the idea of the tax, but in my opinion, I don't think it is a major portion of the agreement--in terms of time, and inasmuch as we have several pieces of legislation that are going to take some time to work out, I would like to know whether it is of any difference to you whether or not we, the Legislature,

AGO 533698

enact the ad valorem tax now, or the next session.

SPAHR: Well, if you don't enact it now, we don't have to worry about paying it for awhile, I guess. If you enact it at the next session and the total amount isn't changed that soon, I don't think we would have a problem. We have no reason to interfere in, or suggest anything, with respect to how that tax is divided up, as I have previously siad, so I guess I would have to say that non-action on the ad valorem tax, insofar as we are concerned would not be a problem, but it could very well be a problem for the Administration of the State, I suppose, because it is an important element to them. You know, I should add here, I think, make it crystal clear that my own view, which I think is accurate, of the way this legislative package developed was that through our discussions, the Governor got a clear idea of our concerns and ideas and attitudes and from that he developed a series of proposed laws which we said, in effect, we can accept in their entirety, and so if I have sounded as if I have been defending what my presentation to you--I certainly want to correct that impression. It is a technicality, but I think it is an important one for all of us to understand.

HENSLEY: Your feeling is that that portion of the package is not such major concern to you as some other aspects of the package...

SPAHR: If you would never pass it, I would be delighted!

HENSLEY: Fine. Then if we can convince the Governor that it may not be worth the Legislator's time at the moment to go into

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a battle over the distribution of that and save that portion of it until such time as we can fully explore the impact on the State's communities between now and the next session.

SPAHR: It would be helpful, and I am sure that the answer to this will have to be, we can't do it -- it would be helpful if I were to know that even though you don't pass it, that your present intent isn't to delay and up it substantially.

PALMER: Why is that tax any different than any others? Well, in essence you are saying that if we pass it now at 30 mils, it might change things so much we can't build the pipeline. Isn't that what you are saying? That you would have to go back and look at the other things again and, therefore, cause a delay?

SPAHR: I have said that. Here you could put yourself in a position of giving us nothing to re-examine except the lack of a determination on your part and we would just have to decide on a hope that things wouldn't be greatly different. That could be done, I am sure. Some people might say we don't want to deal in a lack of security--we acted in good faith--at the present time it would appear that these taxes are adequate--we would expect in a passage of time, not necessarily just a few weeks, that you might find that you would have to do something else, but we wouldn't expect that you would have to do something more--and "you", I am speaking figuratively as if I were talking to the Governor again.

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SACKETT: Correct me if I am wrong--is not the tax at the present time at a rate of 30 mils? Was this not taken into consideration by the oil companies and did they not know that if the pipeline were constructed that Boroughs under the existing tax method would probably have come into existence?

SPAHR: I think you'd better enunciate that again so I make sure I answer you.

SACKETT: Isn't the tax millage now at 30 mils?

SPAHR: I thought the tax millage now -- limit was at 30 mils, and I didn't understand that that was being applied everywhere by any means.

SACKETT: Wasn't this taken into consideration though initially by the pipeline, the oil companies, that anyone could have charged up to 30 mils and that as soon as --- even though there aren't Boroughs created along the entire route, that as soon as the pipeline were constructed, that Boroughs would definitely have been created?

SPAHR: Well, I can assure you we didn't look at it that way. Our thought was more like this. We are bringing to the State a vast new asset that can be taxed and I don't recall -- I don't think I ever knew when legislation affecting the 30 mil limit was passed. But, we are bringing more assets under the taxation possibility and, therefore, the total amount of tax available with 20 mils would, in our view, exceed what might have been available under the old circumstances that prevailed when the

30 mil, or upper limit, was enacted, whenever that was.

SACKETT: That has been enacted for quite a few years. Yes, Senator Croft.

CROFT: As I understand your statement, if we were to change the mil levy or the severance tax rate and pass the Governor's package, you are not in a position to say then that the Trans-Alaska Pipeline could still be built?

SPAHR: Senator Croft, you put the question in a way that I dislike answering. I am not in a position to say if you change the total tax base in any substantial way---what the reactions of other parties will be. And, therefore, I have tried to say I feel that we automatically will be involved in the use of some time to ascertain that and to find out what the consequences would be in terms of participation by everybody, or fall-out of some kind or other, etc.

CROFT: Suppose we raise the mill rate from 20 to 30 mils--what would be the position of SOHIO?

SPAHR: We would be dismayed.

CROFT: Would you still build the line?

SPAHR: I don't know.

CROFT: You really don't know whether you would still participate?

SPAHR: I think we would want to examine very carefully whether we would want to opt for trying to encourage some others to take a different percentage, get relief for some, consider the Federal

AGO 533702

participation, much as I dislike some of the features of it, and so on.

CROFT: You indicated that you might encourage others to take a percentage of the present participation. Are there arrangements between the owner companies at this time regarding that?

SPAHR: There is a provision in an agreement that exists among the owner companies that provides for a means of reallocating ownership as the pipeline capacity is enlarged, that provides for their nominating capacity for determination of what the new capacity allocations will be up to 100% and that's all that we have. But this provision was put into the contract because the contract was prepared at a time when the potential of Prudhoe Bay wasn't very definite. People thought they had certain interest in the field, but they weren't sure, and, of course, as it has turned out, there have been differences from expectations.

CROFT: Is SOHIO free to sell its interest in the pipeline to anybody without obtaining approval of any of the TAPS.....

END OF TAPE.

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CROFT: The exact terms of the options of the companies to purchase has not been worked out yet?
SPAHR: Oh, yes. Its all by formula, the price is established. For example, if we were to increase or decrease our ownership the price involved would recompense us for the costs we've paid or we'd have to recompense the other fellow, plus interest, for the time he had had the ownership for our benefit.

CROFT: That hasn't caused any financing problems?
SPAHR: No, its all very finite. It hasn't caused financing problems because we haven't tried to finance. We have to settle the issue of rearranging ownership before we go to financing. I know we won't have to. We'll do it promptly. We haven't gone to any of the financing companies. We've had lots of talk based on supposition.

CROFT: If that same arrangement were worked out with the State, would you still anticipate that that would cause financing problems as far as the option was concerned?
SPAHR: That would require the State to get in a position of putting or taking without option. We all have the same privilege for opting for new proposals of ownership as the pipeline increases to fit the realities of the development of the North Slope. In order to do it though, we have to pick up a hundred _____ or none of it works. There is a great deal worked into this to guarantee 100% performance,

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unless there is unanimity on change.

CROFT: If the State had the same option, would that cause financing problems?

SPAHR: If the State had a similar option, I must qualify my words by deferring to lawyers who have read it more recently than I, then it would have to tie its obligation to its expected ownership of oil. It would have to expect that it would be forced to take 12 1/2% for example, or perhaps 20%, depending whether we are looking at royalty oil alone or the consequence of severance tax. And be prepared to take this base and pay for it and reimburse us for our expenses or pass the option up as soon as we decide what we are going to do. We are going to do this very quickly and before the construction starts I'm sure, or simultaneously with it as a practical matter. So the apparent options, we are probably using the term a little loosely, really are not going to exist.

CROFT: There will be an option as soon as you decide on the capacity and through put of 1.2, what happens when you get above 1.2, there will still be an option among the owner companies?

SPAHR: There will be another opportunity to determine whether we opt up to 1.2 or not, and as I recall, the full space has to be taken.

AGO 533705

CROFT: At the time you obtain financing there will be an option among all of the companies to participate under certain circumstances in an increased or decreased ownership, and you don't anticipate that will cause any financing problems?
SPAHR: No because ther will have to be complete coverage of it if its to happen.

CROFT: Do you believe that the only financing problems faced by the companies are the 1972 oil legislation that we passed?
SPAHR: I have no idea what the other companies financing problems are.

CROFT: What about SOHIO's.
SPAHR: We have a lot of difficulties that we have to manage in addition to this one.

CROFT: Of significant size?
SPAHR: Yes.

CROFT: You indicated that the public's attitude toward financing the line might cause financing problems. If the 1972 legislation is not resolved by adoption of the Governor's package you anticipate some financing problems, is that correct?
SPAHR: It would be more accurate to say that we would have to go ahead and ascertain what the results of the legal action

AGO 533706

would be to a finite conclusion before we can evaluate what we can or should do.

CROFT: I thought you said this morning that the 1972 legislation caused some financing difficulties with some of the smaller companies.

SPAHR: No, I tried to say that the 1972 legislation caused financing problems for all of us, in terms of the quality of the financing proposal we would be able to bring to prospective lenders. The degree of difficulty would vary from company to company depending upon a lot of things.

CROFT: I understood you to say that some of the smaller companies might be forced out of the line and that this would cause anti-trust problems.

SPAHR: No, I believe I indicated that if this legislation were substantially changed that it would cause the smaller companies to reconsider their interest in continuing to participate in the line. But I wasn't trying to make a point about financing problems there. These companies, particularly those with small interests would have an opportunity to compare their prospects and opportunities resulting from investment in this pipeline with those resulting from investing in something else and they might well conclude that the interest they've had in the pipeline up to now is something they no longer wish to maintain and opt to get out. It would be a question of alternates that each would make for himself,

and there would probably be a difference of conclusions.

CROFT: Would you feel that potential investors would be skeptical of investing in these companies that participate in the Alyeska project until the 1972 legislation is resolved?

SPAHR: I have felt that way, yes.

CROFT: How does that tie in with the fact that SOHIO stock is selling at an all time high for the past decade?

SPAHR: Oh no. That is not true. Its been selling at new highs for the past couple of weeks. But since we made our agreement with BP in June of 1969, the stock has fluctuated. It went up when the lease sale went on up here, it then went down because the stock market interpreted that we must have missed the boat somehow, it got down to some pretty low rates, then it went back up, it fluctuated quite a bit, then its risen rather steadily this year as the prospects for difficulty in the Middle East have developed, this is my opinion now, and as the prospective position of a fully integrated oil company as we can conjecturably sometime be seem to get better by comparison with the other oil companies. So there has been quite a deal of speculation in our stock.

CROFT: I noticed on Foster & Marshall's Stock Guide that between the years 1960 and 1972 the highest price SOHIO stock ever sold at was between 119 7/8 dollars a share.

AGO 533708

SPAHR: That 119 dollars was in August or September of 1969, wasn't that the year of last lease sale.

CROFT: Yes it was. And I noticed that the lowest it sold this year was 115 1/2 and that it closed at the end of September at 141.

SPAHR: That's right, but why don't you look at 1972 and 1971.

CROFT: My question had to do with whether investor confidence was shaken as far as SOHIO is concerned in the past year. Its selling at about 31 times earnings?

SPAHR: 31 times last years earnings. Its quite apparent that the investor who is buying that stock is either speculating in it on a prospect of making money buying selling, short or otherwise, probably not in this instance; or he's buying it for the long term because he feels our prospects for earnings are quite good. We haven't raised our dividends in four years, we just today lost 40 thousand barrels out of Libya, we arn't running our refineries to capacity. The stock price does not reflect current situation or any concern at all over how the management is going to solve its problems over the next several years. These factors will probably have some influence, but its based on the future and the speculations of different investors vary. Its wild.

AGO 533709

CROFT: I did also notice that over 10% of your common stock is owned by institutions.

SPAHR: Oh, yes. I think now that substantially more than 10% is now owned by institutions. But we still have a very substantial individual ownership, last time I looked at it, it was well over 40%.

CROFT: I understood in your remarks today that whether construction started today was contingent on a least five things: the final action by the U.S. Congress; the approval of the permit under that legislation by the Secretary of the Interior; the action of the Alaska Legislature; and then I think you added two more that I hadn't heard of: the Corps of Engineers and the EPA requirements on air and water emissions. What is the status of your application for a Corps Permit, and when do you anticipate that that might be approved. This is for the crossing of the rivers, is it not?

SPAHR: Yes. I can't answer you Senator. I'm sure the answers can be obtained from the Alyeska officials who are responsible for that and there are men in this room with me who can get that information.

CROFT: Have those permits been applied for?

SPAHR: I don't know. I am sure that all the things that have to be done for an application have been done to the extent that they could be. I have a sneaking recollection that the requirements that have to be met havn't been

clearly enunciated by the Corps yet so the application hasn't been totally presentable.

CROFT: So it may not have been applied for?

SPAHR: I don't think so. Not because of lack of diligence but because of lack of definition of what has to be contained in it.

CROFT: Have the EPA certificates been applied for?

SPAHR: I don't know.

CROFT: And those are essential before the pipeline construction can begin?

SPAHR: I think so. One of the things that concerns me is a matter that stems from a Supreme Court decision of earlier this year, as I recall, which made it clear that it was going to be non-permissable to indulge in industrial or other kinds of development in the undeveloped parts of our country in a way that would result in deterioration, of the atmosphere for example, from what it now is. The pressful problem that we face, other than during the construction phase which is temporary, and which concerns me in relation to this filing, is Valdez. Valdez is a high volume terminal, and the plans call for a sophisticated vapor recovery system and a lot of other things that are designed to minimize pollution of the atmosphere. I am no longer up to date as an engineer, but it is beyond by conception to visualise a possibility where there

will be no venting of any fuel, under any conditions, at Valdez. Without a lawyers advice, it is beyond my imagination to se how, technically, Valdez can conform to the apparent decision of the Supreme Court. Thus, I begin to worry, is Valdez a potential trouble source, with the trouble originating with those who do not want to see the trans-Alaska pipeline built. I think my concern is quite related to the EPA problem. What is their latitude in interpreting that Supreme Court decision? I don't know. Even though approaches have been made, I doubt, at the present time, that the applications have been put in to be formally acted upon. I expect that they have been very substantially prepared, and will be ready at the appropriate time. Now, I might find out that I'm wrong, and they've been submitted.

CROFT: Have you discussed with the various attorneys for SOHIO and Alyeska, whether or not there might be additional suits once those permits are applied for, under the Environmental Protection Act.

SPAHR: Oh, yes.

CROFT: Did they indicate that there is any possibility that that might happen?

SPAHR: For the most part and until recently, I think they had to hedge and say - well we have to be wary about what our predictions are. As I understand the content of the bill that's come out of the conference yesterday, which I have not seen, there

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is a provision in there that requires anyone who is going to oppose the pipeline, on grounds of the kind we are talking about, to file within 60 days, on either the issue of a permit or the passage of a law, I'm not sure what this says yet. And then there is a provision that such a suit will be heard by a U.S. District Court, and a further provision that any appeal therefrom will be directed to the Supreme Court. I don't think our lawyers could bring me any more up to date than that. With the passage of this law, presumably, we'll soon find out what our problems are.

CROFT: I would assume then that even if Congress approves the trans-Alaska pipeline bill as is indicated, and the President signs it, and the Secretary issues the permit, and the Alaska Legislature would concur in this package, that you could make no real assurance that construction could begin this spring because there are two essential permits that not only haven't been granted, but as far as you know haven't even been applied for?

SPAHR: You sound as if you might be trying to corner me. I believe I said that, with respect to timing, on those first three items: the Washington legislation, Alaskan legislation and the issue of the permit; in order that we might be assured of the best prospects of starting next spring, that the actions on those three things ought to be taken as soon as possible. I really believe that all three have to be taken, including the Interior permit, before we have any prospects of seeking

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and getting action from the Corps, or from EPA. We have nothing to apply for really, until we get a right-of-way permit from the Department of the Interior. We'd promptly follow through as soon as we had that permit, if the permit is one that we can accept and go to work on.

CROFT: I understood two years ago when we talked to the Department of Interior officials that even after the right-of-way permit is issued that no construction can begin until after a construction authorization certificate is issued. They told me at that time that it was their intention to require the final detailed engineering design and specifications to be submitted, and that they would have a period of 90 to 180 days after that before they would issue the certificate to proceed with construction, and that if there were any significant changes in the plans or specifications that the period of time would commence running again. Do you know if that is still their intention?

SPAHR: I have no reason to believe anything has substantially changed their intention, other than perhaps that they too will try to minimize the amount of time they need to review those kind of things in light of our country's . . .

CROFT: Have those detailed plans and specifications been submitted finally, complete.

SPAHR: That again I can't answer exactly because I don't keep that close watch on Alyeska, but I'm quite certain

that a very great part, if not all, of that has been done. There has been a process of submittal, suggested amendment, re-submittal going on for quite a long time. And I really believe the work is very largely all done, to the extent it can be already. There is still a question in our mind as to what the final stipulations attached to the basic permit will be.

CROFT: Regarding what?

SPAHR: All kinds of design requirements, regulations, liability provisions, things of that kind. The Department of Interior's administrative department has quite a lot of latitude under the law that will be passed I think to specify the requirements that we might want to debate with them.

CROFT: That might cause a delay in itself.

SPAHR: It might, but I think there would be a great compulsion on the part of both of us to get the debates over and done with and conclusions reached. I don't really think it will result in much delay, no.

ERICKSON: Did you say that the ownership interests in the line would be adjusted to equal the interests in the oil?

SPAHR: They may be adjusted at a time a nomination for

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capacity increase step is made. Then they will be adjusted only if the nominations for space total as much as 100% or more.

ERICKSON: There will be adjustments possibly made before you arrange financing though, as well. Is that a possibility or a certainty.
SPAHR: I think its a necessity.

ERICKSON: And this is to bring ownership interests into approximate line with what the companies think they have?
SPAHR: To illustrate, our present ownership is approximately 28% of the pipeline. Somebody might think that if that doesn't change we are getting a free ride on investment requirements and so on since our proportion of the oil field up there is substantially greater.

ERICKSON: So Humble, for instance, who might have an excess of pipeline capacity, wants you to take over some of that capacity.
SPAHR: Very likely. They would remind you that the name is now Exxon.

SACKETT: Would it be possible to make available to this Committee these agreements that you have on the option?

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SPAHR: I would want to refer that question for advice to our lawyers.

RADER: When I was talking about the utility regulation, I was thinking of whether on a contractual basis, instead of a fee, like we were talking about on our right-of-way, for the purchase of the land, that we would contract with you that instead of paying a fee or a scale or something like that our rental that you would agree that the rate would not exceed that of a normal utility, on a utility type of accounting. That was what I was suggesting.

SPAHR: Yes, and for such an agreement we would get permission to use the land.

RADER: We would also assure you that the taxes we'd impose or anything else would not jeopardize a fair rate of return.

TUSSING: Mr. Chairman, for a point of information, the bill reported out by the House Senate Conference Committee requires the parties who are applicants to a pipeline permit to disclose all these operating agreements and agreements for change in shares

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JOHN
FURMAN
10/24/1973

STATE OF ALASKA
THE LEGISLATURE
LEGISLATIVE AFFAIRS AGENCY

POUCH Y - STATE CAPITOL
JUNEAU, ALASKA 99801

October 31, 1973

The attached transcript contains the remarks made by Mr. John Furman on October 24, 1973 before the Senate Resources Committee. It is a verbatim transcript of Mr. Furman's remarks. There is occasionally a word missing or other minor gaps in certain places, which are due to the speaker's testimony being indecipherable at that point. However, it is believed that these occasions are rare and the transcript presents a fair picture of the thoughts expressed by the witness before the committee.

Senator John Sackett
Chairman
Resources Committee

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SENATE RESOURCES / COMMERCE

October 24, 1973

TESTIMONY OF MR. JOHN FURMAN

CHAIRMAN: As Senator Thomas indicated, many of us questioned the status of ICC and how far their regulations went and in what area. I asked Mr. John Furman of Washington D.C. to testify. Mr. Furman had previously under the governorship of Senator Miller did a memorandum for Arthur D. Little back in 1970 relative to ICC regulations. Mr. Furman is a member of the Bar of the United States Supreme Court, the District of Columbia and Maryland. He is a partner in Cox, Langford and Brown in Washington D.C. A Yale graduate of 1946, cum laude, he has served in the office of Price Administration, a department of State from 1956 to 1962 he was a consultant with Foster Associates, a firm with offices in Washington, Tulsa and Calgary Alberta specializing in problems of rate regulations. He is a member of the American Bar Association. At this time, I would like to turn over the floor to Mr. Furman.

MR. FURMAN: Thank you sir. I'm sorry to tell you the Chairman was reading from something I wrote, I think, three years ago, when I was asked to give my background. I want to make one change in it. I withdrew from the law firm of Cox, Langford & Brown in January of this year and now have my own office.

I assume that what I really am being asked to do here today is to say whether there have been any changes since I was here before and speak to the question of function and role and level

of activity of the ICC. First of all, I want to say that there has certainly been no changes which affect the right of Alaska to regulate intrastate pipelines or, and I think this is very important, intrastate activities on interstate pipelines. There is a tendency in the discussions and in the drafting of the House Bill No. 6 to support that there are two kinds of animals. Intrastate pipelines and interstate pipelines; and that while the State may have jurisdiction over the first, the ICC has jurisdiction over the latter and it therefore follows that the State has no jurisdiction over the latter. This is simply not the case, if only because of the responsibility of the State of Alaska to regulate intrastate pipelines and to regulate the intrastate activities of interstate pipelines. I feel very strongly that you need something like your existing Alaska Pipeline Commission Act. As I read the proposals for changing that act, I think the rate of escalation is not too strong. I think the consequences would be not only the limitation or your rights with reference to the intrastate activities of interstate pipelines, but to create a body with much less effectiveness in dealing with ___ __ problems which are clearly within the jurisdiction of the State.

Now, have there been any changes in the last three years to indicate that the ICC has some new conception of its role. The first point might be that there's certainly been no changes in any of the statutory authorizations under which the ICC operates.

I think we have to recognize that the ICC is the oldest regulatory commission in Washington. Its also the least respected regulatory commission in Washington. And its the least self-confident regulatory commission in Washington. There's even talk in this administration about abolishing the ICC. Not necessarily have to do with its regulations of pipelines because thats pretty inoffensive, but because of the philosophy of this administration that much of the regulation that has been built up over the last generation is unnecessary and anti-competitive. And this, in fact, is true. The ICC for years has sought to protect railroads from competition from other forms of transport, it has sought to regulate motor carriers in ways that this administration would say is better left to the competitive process. So that you're not talking about what I would call a vigorous and effective agency even within its own terms.

Furthermore, the system and authority of the ICC resulting from the Hepburn Act is very limited. There's been no change in that since three years ago and I want to endorse what Professor Witherspoon told you yesterday about the authority of the ICC. I won't go through that with you. I do want to make one point--and that is that the fault that the ICC has with reference to railroads and with reference to motor carriers is a fairly wide range of authority..For example, the case of _ ___ ___ ___ certificate authority does not mean that also it has the authority with reference to pipelines.

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I went through the Interstate Commerce Act once, and x'd out all those provisions which because of the definition or because of their terms were applicable only to railroads or motor carriers. I ended up x'ing out most of it. There was really very little that the ICC has authority to do. Furthermore, there is now pending before the Senate a proposal by Senator Stevenson connected with the problems of how do you regulate natural gas producers and to what extent do you exempt them from federal regulations in the interest of getting more gas to market. A proposal which would transfer the jurisdiction of the ICC over all pipelines, such as it is, to Federal Power Commission. And I think this again is a reflection of the general view in Washington as to the very limited function which the ICC has been performing in this area. What I do think it means is that Governor Egan is right when he says that there are clear indications that the ICC may _____ If I were the ICC I would be doing a lot of re-examining, if only because of this proposal for the transfer of authority of pipelines to some other agency. This is the quickest way to get an agency in Washington to re-examine something.

I don't know, however, what he means when he says that the ICC has been primed to begin responding in a new way. It takes staff, as well as interest, to accomplish anything. It takes Statutory authority, and I know with reference to the ICC that there is no effort by the ICC to seek more money for the staff

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it has working on pipelines and its hard for it to do it, because it doesn't have any staff that works on pipelines. Before I left Washington, I got ahold of a copy of the telephone directory of the Interstate Commerce Commission, which is arranged in functional order, with all the titles of the various offices and divisions and subsections and so forth. Now, you can go through that telephone directory and you can find that under the heading of ___ __ _ ___ _, sections having particular responsibility for railroads or for motor carriers. You can look at the Bureau of Operations and you can find a section of Motor Carriers and a section of railroads. But there isn't one single mention of the word pipeline in the whole bureaucratic structure of the ICC--and that's from 1970. and In anticipation of my testifying here today, I've made and I've had my office make several efforts to make sure that I'm right in believing that there just isn't anybody at the ICC, who really devotes his time and attention to the problems that you're wrestling with here.

Now, it is true that because the ICC has certain limited functions to perform, and because in particular it performs a function for the pipelines with reference to the--specifically--pipeline's final form _ ___ ___ _____ _____ ___ _ back in 1940, when he was pursuing the oil industry with a rather broad anti-trust action and the war came along and the oil industry said, "if you want us to help you in the war effort, then we better settle this." And he settled for a one provision, relating

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to the charges which oil pipelines make to their own affiliates in comparison to the charges they make to other parties for the transportation of oil. This has placed on the ICC the informal function of conducting evaluations to see whether the pipelines are making more than--I think the figure is 7%. It is also true that the ICC keeps house while by interstate pipelines, and that if a change is filed on a tariff, anyone who is interested has 15 days within which to make that interest known to try to persuade the ICC to prevent the change from going into effect. The ICC must be notified 30 days in advance of the proposed change in rate.

I know of no proceedings which has resulted from this particular procedure of the ICC, nor do I know of any effort the ICC since World War II, on its own initiative to investigate any of the aspects of a pipeline--of all pipelines--in the manner in which they are administered and their affect on the general public welfare. In an effort to confirm my impression, while I've been up here and in view of the statement of the Chairman of the ICC and the statements made by the Governor which have been circulating here, I asked my office to check around and see if they could find any basis for saying that the ICC is somehow taking on a new lease on life. They talked yesterday to the legislative counsel of ICC, Larry Reda, and we were told that the ICC is trying to see whether in fact it is using its power to the full. But I get the impression that again, that this is

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a by-product more of the proposal to transfer the functions of the overall pipelines to the Federal Power Commission than it is because of the special problems that relate to the TransAlaska pipeline.

This leads me to the conclusion that you certainly ought not, as is proposed in Bill No. 6, to adopt a provision which says that you will not exercise whatever power you have waiting to see or until the ICC affirmatively decides that it has no jurisdiction. Even if the ICC were to begin a proceeding today to decide whether or not they had jurisdiction; if it took as long as the rate case they ran before World War II, it would take them ten years to come to a concrete and affirmative decision that they have jurisdiction over this or that or whatever the issue might be. I would say that quite apart from the merits of that particular drafting device, its not well-suited to the problem.

Now, I think you have a special problem here, that as far as I know the ICC has never fully faced. And that is, how do you regulate an undivided interest pipeline? When I talked to some people in the ICC in 1970, one thing that they really threw up their hands on was a regulation of undivided interest pipelines. And I think its worth pausing on that for a minute. To the extent that the ICC has jurisdiction, to the extent that the ICC has an interest in regulation, its interest is focused on the pipeline companies as companies. Exxon Pipeline Company, for example, rather than Exxon's particular piece of the braided

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line, as its sometimes called, which is going to be the taps line. That means as to whether the Exxon pipeline is in a healthy condition or its rates are to high or too low, the ICC based on past cases is going to look at Exxon Pipeline Company as a whole. It has a national function to perform, and its not necessarily going to be raising the question as to the appropriateness of that portion of Exxon Pipelins Company's earnings which are attributable to the operation of Exxon's share in the taps line. For this reason, I like one proposal that I see in Senate Bill No. 6, and that's a sentence in Section 6 which proposes to add to your Sec. 42.06.430 (6), a sentence that would require a pipeline owning interest in an undivided interest pipeline to make reports to the commission on an individual pipeline basis, for any pipeline located wholly or in part in the State. I think as you go ahead into what I'm sure is going to be a very complicated and difficult problem, one of the things that you're going to need most desperately, are facts.--are going to be hard to come by and I think you have to rely on yourself to get those facts because I'm very doubtful of the extent to which you're going to be able to pick up the long distance phone and call an expert on oil pipelines in the ICC and get the facts from him.

I would leave, except for this one possible change, I would leave your existing pipeline Commission Act as it is.

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It's not my understanding that the lawsuits which have been filed and I have read the briefs of both Mobile and the other plaintiffs, its' not my understanding that it is Pipeline Commission Act that is their principle target. I do understand that they have a problem with the certification section, but their main focus, as I understand it, are on other pieces of legislation. Its therefore hard, frankly, for me to understand how a negotiation to settle the lawsuits could have wound up with the proposals to make the drastic changes in the Alaska Pipeline Commission Act, which are embodied in Senate Bill No. 6.

For anyone like myself who practices law in Washington before the regulatory commission, its always a little confusing to see a piece of legislation such as the one you have before it, that treats natural gas pipelines and oil pipelines as though they were similar in character and as though the regulatory problems were similar. The Federal Power Commission and the Natural Gas Act are both a different commission and a very different regulatory statute from the ICC and the Hepburn Act. The way in which gas is bought and sold and taken to market is very different from the way in which oil is bought and sold and taken to market. I do think that the Natural Gas Act provides an instructive lesson as it were, how in our federal system, state commissions and a federal commission can work together to accomplish effective regulations. I don't believe that the most regulation is the most effective regulations and it

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frequently is the worst. I think what you have to do in any case is to find some reasonable balance. Not only between how much regulation you need, but in our federal system between what the federal government is to do and what the state government is to do. And there is simply no constitutional black line that you can draw between the authority of the states and the authority of the federal government only because the facts are usually so complicated that you're dealing with. At the same time, both matters of federal interest and matters of state interest. The Federal Power Commission is a commission of limited jurisdiction in the sense that it was created in 1938, as to its jurisdiction over natural gas pipelines I should say, it was added in 1938, the Commission having existed since 1920 to regulate electric utilities. It was created to fill a gap between the state regulations at the production end of the pipeline and the state regulation at the distribution end of the pipeline, the consuming _____ end of the pipeline--the distribution end--and if you go through the Natural Gas Act, you will find, time and time again, conditions under which it is anticipated that the federal agency and the state commissions will work together. There areprovisions for joint hearings, for example, over problems that affect both. There are provisions for the Federal Power Commission to provide assistance to State commissions. So that to think of the problem as one in

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which it either belongs to the Alaska commission or it belongs to the ICC, I think, misses what is the real point. That what you need to do is to develop a method of regulation here in Alaska which would be appropriately complementary to whatever regulation exists in Washington, recognizing always that to the extent that Congress acts, and to the extent that the ICC acts, the action of the federal agencies will undoubtedly preempt the field. But until such action is taken by the federal government, and in areas where the federal government does not act, you're either going to have, as you did in the Natural gas pipeline field before 1938, a void where no regulations exist, or you're going to have state action.

I think this is not an easy line to draw, and I have no doubt that down the road in the process of drawing the line, there could very easily be situations in which the decision as to where to draw the line is one that everyone will _____ ___ ___ ___ _____. I'm not sure that need necessarily be the case. I'm not sure that its necessary that the Alaska Pipeline Commission must from the day it starts out, push its powers to the full possible limit until it meets the ICC coming the other way. But for the Pipeline Commission to be effective, I think you have to have a strong commission. And I must say the proposals to reduce the Commission to a situation in which you would really have only one full-time Commissioner, I personally believe would be a great mistake. The Alaska Pipeline Commission does no more in the next several years

than to gather information, to gain a better understanding of what does in fact go on in Washington with reference to the regulation of oil pipelines, it will certainly be earning what little amount from your treasury it will take to pay a few more full-time commissioners with adequate staff personnel. I just don't think you can hope to deal with this set of problems by having this legislature, as able as it is, assemble on an ad hoc basis, from time to time, experts to tell them what would be a wise thing to do. I think you've got to have some continuity of expertise and I think a strong pipeline commission is exactly the place in which to attempt to accomplish that. To the extent to which the existing pipeline commission act conflicts with federal jurisdiction, or is in some sense unconstitutional, I frankly don't see it. I agree with the question Senator Rader posed the other day to Mr. Heard, when he pointed to Sec. 150 which says that the provisions apply only to the extent no preempted in federal legislation. From the point of view of an attorney, I think that solves the problem. I think the problem is also solved in the particular case of the taps line and the possibility that it may be required to jump over the same hurdles here that it had to jump over in Washington, because although you now have a TransAlaska pipeline authorization act, or will soon have, and although in that act in Sec. 212 the Congress has made certain determinations to

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the effect that the taps line is in the national interest, that really accommodates itself very well to Sec. 240, where your existing legislation says that the requirements for a certificate shall not operate to impose state regulations which has been preempted under the Interstate Commerce Act of 1906, the Natural Gas Act of 1938. When federal law has preempted state regulation, the commission shall accept the finding made under the federal scheme of regulation. I can't imagine the Alaska Pipeline Commission not accepting the findings which Congress has now made to the effect that the taps line is in the national interest.

I agree with what Mr. Levy said a few moments ago. He is not award that the ICC has taken any steps in the recent past, to increase its sensitivity to oil pipeline problems. I do not agree with the next statement that he made, because I don't think it puts in quite right. He said I would not place my trust in princes, even if they are located in Washington. I think speaking to you as a friend of Alaskans, I would say I would not place my trust in princes, especially if they are located in Washington.

I would be glad to answer any question anyone would have:
SENATOR PALMER: The existing legislation specifically says then, that any certificate of authority that the state pipeline commission might have is null and void and preempted by the federal government in that respect. You're saying then that that really poses no

threat to Alyeska Pipeline companies, or should pose no threat but from the state standpoint might be quite important in the future when we do have intrastate pipelines not regulated by the federal government and this certificate of authority may be vital at that time. Is that what you're saying?

A. I quite agree with that, yes.

SENATOR KERTULLA: Once again,(rest of question unintelligible)

A. That's right.

SENATOR GROH: Mr. Furman, I really appreciate your comments and your help. Insofar as intrastate pipeline is concerned, there is no question is there, either about lines as to the effect of or existing regulatory legislation. It will work, won't it, in your opinion.

A. You're talking about the 1972 legislation--Yes I think it will.

Q. Senate Bill 6 has not endeavored to deal with that issue. That is the issue of intrastate pipeline.

A. Well, I'm in much the position that Mr. Levy is in, which is that I have not had time to take Senate Bill 6 and do what he recommended--that is to take all the existing legislation and lay it out then see exactly the way in which bill No. 6 would affect it.

Q. I might mention that Senator Lewis has done this; I don't know whether anybody shown where the changes are in the act. Now, for intrastate pipelines, the regulatory _____ ___ _____ _

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This is where I have a problem, and you're obviously an expert in this field. Would you say if the pipeline is interstate commerce and within the jurisdiction of the ICC, would you say that the State has the power to exercise concurrent regulatory jurisdiction?

A. I would, and I can illustrate that if you like most easily by reference to the way in which the federal-state system works with reference to natural gas pipelines. There's no question but what the Federal Power Commission has jurisdiction over natural gas companies, that is, those companies that transport gas in interstate commerce and __ ____ that gas for resale. But that doesn't mean that state commissions, who also have authority over exactly the same companies with reference to those activities, which don't come within the jurisdiction of the Federal Power Commission.

Q. Let's limit ourselves to oil pipelines, because that's our primary concern. Are you saying that in your view we have concurrent regulatory jurisdiction; then my question is, where does that concurrent regulatory jurisdiction end? Does it end as the courts have defined it at such point as that concurrent regulatory jurisdiction imposes a burden on interstate commerce--is that the cut-off point that we can go to?

A. No sir. There is such a cut-off point, but its not the cut-off point that I would refer to. In other words, whether or not the Congress had seen fit in 1906 to adopt the Hepburn Act,

I think the State of Alaska is barred from imposing any burden on interstate commerce. Thats a separate legal issue--an indepedent ground on which the State of Alaska operates subject to limitations. Before we go on from there, I would like to point out that the word concurrent was one of your choice, and not, I think, not _____. Because what I-- I think the way I would put it is this: that it may well be that Congress under the Constitution has the power to limit even more severely, then, as the case with natural gas pipelines, the power of the State of Alaska to regulate in particular areas. The fact is, as I read the Hepburn Act, it hasn't come close to doing that and I think it would be a gross mis-construction of Congressional intent to say that that also represented a decision by Congress that no one should perform the regulatory function that the ICC does not perform.

Q. I'm trying to reach the point beyond which __ _____ ___. I won't use the term concurrent regulatory. In case, it is established that we cannot go beyond the point, that is the decisions of the Supreme Court of the United States, that we cannot go beyond the point where we create a burden on Interstate Commerce, is that a valid statement of the law?

A. That is correct.

Q. So that is the limit to which we can go, as I understand the state of the existing law, in your view.

A. That is one test; what I'm also trying to say is that I think you have an independent problem arising from the fact that Congress has, in fact, acted with reference to interstate pipelines.

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But so much of this depends upon the particular fact situation. Let me suppose this fact situation: Suppose that for reasons of the economics of transporting oil products vs. crude oil that it is in the interest of the oil companies to build a highway at Valdez and to process all the oil coming down the taps line at Valdez. I think that would change the situation. I think there wouldn't be any question then, whether the oil was being transported from the North Slope to Valdez was all moving in interstate commerce in the sense that you would somehow be barred from regulating that commerce, quite apart from any other intrastate aspects of it. So that what you're doing here, as I see it is to try to create a structure of regulation _ ___ _____ and you're dealing not only with the particular fact situation that you've got in front of you now, but you're trying to set up a system into which you will be able to deal with a whole variety of fact situations which may arise down the road.

Q. Let me ask this question and maybe. . .Assuming an interstate pipeline which presumably we're all agreed its going to carry oil in interstate commerce, do you think that its within our regulatory powers under the existing state of the law involving interstate commerce to require a certificate of public convenience in the form in which it exists in our present regulatory law?

A. I think you can, subject to the qualification which the law already provides for. . .that to the extent that the Congress or

any other branch of the federal government has made findings with __ ___ _____ to this line as to its being in the public interest. I think that you are foreclosed from _ ___ __ those findings. And I think that your statute that contains the means of accommodation.

Q. I'm not sure I understand you. In fact, with the existing law the way it is and Congress acting on the pipeline bill, under our present regulatory bills, as I understand it, Sec. whatever it is--the one that sets up a certificate of public convenience and necessity and one that sets up the _____ ___ _____. Do you think that under your understanding, that the State of Alaska has the present power to require, considering what this line is and what has transpired, a certificate of public convenience and necessity?

A. Yes, I think you probably can. Let me also say that what has been referred to as certificate provisions, includes a lot more than just getting an initial certificate of public convenience and necessity. Now I'm not addressing myself as to whether, with reference to the particular case of the taps line, that this legislature should or should not do something like Congress is in the process of doing. We've discussed this thing about whether its going to influence the environment for so long that there's no point in discussing it any further. we will therefore, as a legislative act, decide that in this one case we're not going to go through the legal procedures. For this

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one case, because we've been discussing so long, because the Congress has acted in this unique and unusual fashion, we will make that effort as a legislative body, whatever determinations with reference to public convenience and necessity our statute requires. And thereby avoid, perhaps, an administrative proceeding which might otherwise be necessary.

SENATOR THOMAS: Is there anything at all in this new act that's coming out of Congress that tends to encourage cooperation between the state regulatory body and the ICC? Is there any language there at all to handle this?

A. I don't think there's anything off-hand. I think that certainly the Congress was looking at the problem of the taps line from a national point of view and the national shortage of oil, and its desparately needed. I think everyone in this room wants to see the taps line built as fast as possible.

Q. The reason I asked was that one of our senators back there had suggested that we could in fact do this very successfully to have a strong regulatory commission. . .(rest inaudible)

A. Yes, I certainly think so.

SENATOR KERTTULA: I'm not quite ready with my question.

SENATOR RETTIG: Mr. Furman, do you see any reason why, I think you made reference to_____ _____, (rest of question inaudible)

A. I certainly think you're free to amend, to the extent which you can strengthen--of course, the more history _ ___

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the less you can influence that _____.

Q. Do you see any area in regulations that we could adopt in the future?

A. I think a legislative body like this is always free to amend previous legislative enactments.

Q. Is there something we're doing in considering this--if we should adopt this, or we shouldn't--that there's something we can't act on in the regular session next month.

A. That's right--or I assume thats right. Although I would say that how you approach this problem this session will be taken by all parties involved to be of great significance.

A. The matter of convenience and necessity certificate--in the case of interstate commerce, wouldn't that statute required to issue a certificate be an exercise in complete futility. There could be no way that such a hearing or such an exercise could stop the construction of that pipeline.

A. First, the Interstate Commerce Commission has no authority to issue, and therefore has no authority to refuse the issuance of a certificate. At the federal level, that question doesn't even arise. Furthermore, I think Congress is in the process of speaking formally, certainly at least with reference to the exercise of federal power with reference to this particular pipeline.

Q. Can't we seek through this device to impose a burden on the ICC?

A. No, and I think you. . .

Q. So, the provision is really inoperative at this time.

A. I'm not sure which provision we're talking about. Are you talking about the provision in your own legislation which calls for the issuance of a certificate. . .Yes. Well, I have in front of me the Title 2 of the federal Leasing Act amendements and I would hesitate to preempt the function of your own Attorney General. . .

Q. Can we through this device of requiring a certificateof convenience and necessity stop the construction of the pipeline? So isn't that certificate an automatic thing, anyway?

A. I would suppose that it was.

SENATOR PALMER: Is there any reasonable way of assuming that requiring this certificate as we have our 1972 legislation, requiring it when applicable, when it has already been preempted by the federal government, that this can be construed legally to be an _____?

A. I'm not sure I understood the point of the question; but if you are saying that the provision already in the statute which says that these _____ will apply only if not preempted, could lead to the commission taking the position that it has no function to perform in the issuance of a certificate. I can well imagine that line of reasoning.

Q. It seems the point the Senator was driving at was this would cause an undue burden, and therefore was impossible for us

to do. My question was, does it really constitute unde burden?

A. Well, I think it depends on--to be frank with you, I don't consider myself as master of the certificate provisions of your existing law, and I hesitate to address myself to the specifics.

SENATOR RADER: Have you any views that you could give us as to the Right-of-Way Leasing Act. . .

A. No, sir.

Q. Whether or not that would be in your opinion an undue burden on ICC?

A. I prefer not to speak to that, I simply haven't--to be frank with you, I have read the briefs of the oil companies on these issues, I have not read the state's briefs and I would hesitate under those circumstances to issue a ruling.

MR. CHAIRMAN: Are there any additional questions? If not, then thank you, Mr. Furman, very much.

SENATOR RETTIG: Mr. Chairman, I have one more question. Mr. Furman, I'm concerned about the oil getting through the Valdez terminal, the docking facilities--how far does ICC regulate? Does it regulate until it gets on the vessel, and therefore will prove itself part of the common carrier. Or do we have to worry about that? Must we concern ourselves with being a public dock?

A. I think you better concern yourself with it, because I doubt if anybody at the ICC will.

AGO 533740

JOHN
LAMONT
10/25/1973

STATE OF ALASKA
THE LEGISLATURE
LEGISLATIVE AFFAIRS AGENCY

POUCH Y - STATE CAPITOL
JUNEAU, ALASKA 99801

October 31, 1973

The attached transcript contains the remarks made by Mr. John Lamont on October 25, 1973 before the Senate Resources Committee. It is a verbatim transcript of Mr. Lamont's remarks. There is occasionally a word missing or other minor gaps in certain places, which are due to the speaker's testimony being indecipherable at that point. However, it is believed that these occasions are rare and the transcript presents a fair picture of the thoughts expressed by the witness before the committee.

Senator John Sackett
Chairman
Resources Committee

AGO 533828

MR. LAMONT'S TESTIMONY

October 25, 1973

Good morning, gentlemen.

The old show business parlance that's not only a heck of an act to follow but it's even harder to compete against. But to begin you have a problem here which in its own way has enormous consequences that will run a very long time in the future. You're trying to _____ enable a pipeline to be built. A pipeline must be built. The country needs the energy source. This you know. It is a matter of _____importance not just to the state of Alaska but to the entire United States, but it is a matter of concern not just to have energy but to have energy under terms and conditions which will aid it to make our economy grow on fair and useful terms. I'm tired and retired Justice Department anti-trust lawyer. I spent many many years in this area working on the scene, as it were, between regulatory agencies and the anti-trust division. My particular specialty for the period from about 1955 until June 30, 1972 when I retired was pipelines. I speak then from the standpoint of someone who has had to consider what is the regulatory jurisdiction, how does it fit with the anti-trust laws which abhor regulation? In pretty much the same kind of way that you gentlemen have to consider the legislation that has been presented you. I might also add that after reviewing the testimony that I am about to give, Mr. Ralph Nader called this morning to say that with respect to my comments as to the ICC jurisdiction and the ICC

competance, he wishes to associate himself enthusiastically. In his terms, ICC is the classic case of regulatory abdication and within ICC pipeline regulation is the absolute quintessence of nonfeasance. What authority they have, they have not exercised. When they saw authority deficiences they did not request legislation. You're here to accept a quick settlement in a form deemed acceptable by the companies involved and the state. You would be very well advised to consider this settlement will create more trouble than it will avoid. For you may remove some of the questions from the Alaska arena and the legislature but you will almost certainly remove those questions that are "settled" to the court where you will find a great deal of difficulty with respect to their ultimate solution. Let's review the main elements of the settlement which are relevant to what I'm about to say. The most important point is this: the state in settling did not have before it involved in the "settlement" all of the possible parties in the interest. It is my purpose to review some of those parties and interests that were left outside the settlement. Let me in doing this preface my remarks with the example of the Interior Department. Very long time ago when the pipeline was first proposed and Prudhoe strike was first made public, Interior accepted a quick and ready settlement from the companies involved as to what it would do by way of impact statement. As you know that has been rather extensively litigated. The lawyers on the environmental side, which include some of my personal friends, nave told me that except for

except for Interior's eagerness to sweep all of the real issues under the rug by this quick settlement, they would never have had six months in court. They would barely have been able to get up the courthouse steps. This settlement, like that one, opens as many avenues of litigation as it closes. In fact, quite probably opens more. For it depends upon its validity entirely on the regulatory capability and competance of the ICC, a very weak reed, indeed. There are many other parties in interest who can litigate the TAPS issues in the anti-trust arena, and in litigating seek and possibly get injunction against the line. On this, I might add to those of you gentlemen who are practicing lawyers, I find myself in an extraordinarily uncomfortably objective position. I cannot represent either plaintiffs or defendants on any anti-trust suit respecting the pipeline. Quite simply, because for a matter of five years I was in charge of the anti-trust division extensive and still continuing investigation of the anti-trust issues that this tremendous combination of economic power represents.

Let me review quickly the possible interests who can seek litigation. Section 4 and 16 of the Clayton Act creates a wide area of private ability to sue for actual or prospective harm involved in violations of the anti-trust laws. Section 4 says in such instance that any person whose interests or property are harmed by a violation may sue to recover his damages trebled and his attorney's fees. Section 16 authorizes such private interests to sue for an injunction. Among the people who are still able, willing, possibly, to undertake

this kind of litigation we must place at the head of the class the federal government. Now I am aware of the fact that the companies here involved hope that by virtue of the emergency conditions of the energy crisis and the general political power which they enjoy that they will be able to stop the Justice Department in the initial phases, before any suit is ever brought. And in the ancient words of the courthouse lawyer to cop a plea that will leave them what they want. On this I would say it is entirely possible. It was my judgment that it was possible in June 1972, and it was the reason I left the Justice Department. Since June 1972 however, there has been quite a number of rather startling events with which you are as familiar as I, which have made the Justice Department rather considerably more independent than it has been for a number of years. Beyond the federal government, with its broad and sweeping powers to litigate to enforce the anti-trust laws, you have the states. Technically the states are private parties within the meaning of the anti-trust laws, although in truth to call a state a private corporation, as at least one of the TAPS members has done in other litigation, seems rather to derogate their standing as a public entity and a part of our federal system. The states, moreover, can sue as damage claimants but they can also sue _____ on behalf of all of their citizens for prospective damage to enjoin it. And so, if the state who has sought so hard to have this line go the MacKenzie Valley route rather than the TAPS route should actually undertake to do so, they may well be able to enjoin the line. Assuming that

the line is still an important part of the overall anti-trust case. You have also private interests who are suffering or anticipating damage. I think the liklihood of private interests suing under either section 4 or 16 is probably fairly remote, because until the line is operative, until the controlled market it involves has become a fact instead of a prospect, they will probably not feel quite so vigorous about the private enforcement. There is also however, a little known section or two little known sections of the Sherman Act which I think may well bode a great deal of trouble. Section 6 of the Sherman Act and Section 11 both passed in the 1890's - Section 6 applying to domestic commerce and Section 11 applying to foreign commerce - says in substance that any property owned under a contract or by any combination or pursuant to any conspiracy, and being the subject thereof, mentioned in Section 1 of this title, and being in the course of transportation from one state to another, or to a foreign country - shall be forfeited to the United States. What is very important here, however, are the further words - "and may be seized and condemned by like proceedings as those provided by law for the forfeiture, seizure and condemnation of property imported into the United States contrary to law." The only difference between Section 6 and Section 11 lies in the words describing the type, the status of the property involved. Section 11 simply says "imported into and being within the United States." What makes this so terribly important is that the customs laws as they are now on the books, give to the informer a fee for his information and gives him a standing to enforce that fee. I may here tell you that there are a number of risks - environmental groups among others - which are looking

at this particular section very, very intently. And in so doing, they are reading the ancient history of the Sherman Act where it made is clear it was the purpose of these sections to give to the individual who saw a violation, a standing to do something about it on his own if the government did not do so. I have even had several tentative requests to represent such groups in such a suit. For the reasons I have states before, I have turned them down.

This then is quite a roster of the possible people who will have some standing to question these matters on anti-trust grounds.

Let's then turn quickly to something of the anti-trust grounds that exist for a suit here. Understand, that basically anti-trust concerned with pipelines comes because it is a "national monopoly" or very nearly so. There are economies in scale in a pipeline so that any large line that is built to accomodate the existing traffic can always be more easily and cheaply expanded to accomodate new incruments of shipment than it would be to build a competing pipeline. For that reason, it has very much the same characteristics as a railroad. For as you know, there are many railroads in the states which parallel each other - which compete directly for traffic - that are considered within this general framework of national monopoly. Both the Interstate Commerce Act and the Sherman Act originated at much the same set of problems. The unrest over the railroads which hauled only from the elevators that held grain that they owned - that they had bought at favorable prices. And the result of the farmers against this strangle-hold

on their operation. The coal companies had a great deal of dissatisfaction with the roads which hauled only coal which they produced. The Sherman Act is a little more complex, but it was aimed at the same thing - the aggravations of monopoly power whether held by transportation which is the most convenient stranglehold on the market or by other means, could not only themselves control the profits that they made, but could exclude others from wide areas of competition within the economy.

In all of these however, both from the standpoint of the ICC and from the standpoint of the anti-trust laws consider transportation as the most vital factor in market entry. If you can control the highway to a market, selecting who may or who may not use it, you control that market. Perhaps the best summary of what this means comes from an old case, not so old - 1920, the Redding Case - by coincident ownership of the largest single coal company operating within the Skoykiell Anthracite fields and the railway over which that coal must find its access to interstate markets, the Redding, said the Supreme Court, had the power to increase or decrease the output of coal from very extensive mines, the supply of it in the market, the cost to the consumer, to increase or lower the charge for transporting such coal to market, and to regulate car supply and other shipping conveniences and thereby to help or hinder the operations of independent miners and shippers of coal. In that particular case, Although the railroads were rather at that time regulated by the ICC as they still are, the Sherman Act, Section 2 monopolization provision was applied to Redding and they were compelled to divest themselves of

the coal. To bring this thought of transportation control as market control, in about the same period of time in United States versus Ohio Oil Company otherwise known as "The Pipeline Cases" Justice Homes described the reasoning behind the declaration originally the pipeline could be common carriers and regulated. But it also describes a basis, the basis, on which anti-trust concern exists with pipelines. And the quote is on 234 US 546 at 560 it says - itself of this monopoly as a means of transportation, the Standard Oil Company refused through its subordinate to carry any oil less sold ,to it or to them, and through them to it. on terms more or less dictated by itself. In this way it made itself master of the fields without the necessity of owning them, and carried across half the continent a great subject of international commerce coming from many owners but by the durress which Standard Oil Company was master, carrying it all as its own. The situation that then existed has not significantly changed. Despite the fact that a great effort was made in 1906 by amendment of the Interstate Act to declare pipeline to be common carriers. They were made common carriers in name, but not common carriers in fact, and they have not, with very, very few exceptions - they have not functioned in the sense of common carriers as we lawyers would recognize the concept from its meaning in common law.

They are in terms common carriers as defined by the Interstate Commerce Act. The Interstate Commerce Act defines as common carriers a great number of different types of transportation modes. It then applies to each carrier, each type

of common carrier, the kind of regulation that the Congress at that time deemed appropriate for regulating that carrier. It applies to the pipeline carrier almost no regulation at all except that should a line permit you to ship, if in its excess of generosity it will give you a connection, then you may quarrel about the rate, if you do not care what happens to your connection afterward. On the basis of this, Justice Department over many, many years has been concerned with pipeline. The biggest case that was brought in this line after the temporary national economic hearings in the late 30's, the filed the Mother Hubbard case which was a monstrosity. It joined as defendants the Amercian Pretroleum Institute and every integrated company and its pipeline subsidiary. It was an untryable case, it was too large - and it was dropped. It was first postponed because of the war, then it was dropped totally because it was literally untryable. With that, and the fact that anti-trust division is a rather busy outfit with a rather large economy to police, there was no real concern with pipelines as such until the 60's. And we began a series of investigations in connection with the joint venture of pipeline cases. Now understand that when we are dealing with a single company line it is subject to a lot of different considerations under anti-trust than if you are dealing with a number of companies. The Colonial Pipeline Company, which came up in the course of Mr. Hurd's testimony the other day, was such a case. Nine large re-

finers on the gulf coast joined to build a 36 inch pipeline from Houston to Greensboro which was a 34 inch line from Greensboro to Dorsey, Maryland and a 32 inch line into the harbor. It carries a million-and-a-quarter barrels of light products a day and it dominates the Piedmont market of the United States to a dictatorial degree that is almost unimaginable. We began an investigation of that, recommendation was made, suit has never been brought. The reasons why have never been fully explained nor do I propose to explain them now. I will say this. Shortly before I retired in June 1972 the original recommendation to sue had by that time been given to various consultants outside the section in which I worked for an evaluation as to whether or not it represented a valid anti-trust case. The answer we had gotten in 23 separate instances was that it was. The case was still not brought.

We also investigated the Olympic Pipeline and presented recommendations. This is a line which runs from Ferndale, Anacortes, down the Cascade shelf to Portland. Again, the matter is still pending unresolved. They have never decided to go forward with it, they have never decided to drop it. The Explorer Pipeline, too, is still under investigation. There were two cases, however, in which we did have some success at the staff level. One was the Glacier Pipeline Company in which the predecessor of the - I hate to say predecessor, let's say Humble Oil and Refining Company and

Humble Pipe - proposed to join with Continental in a joint venture line covering all, or nearly all, the crude oil in Montana. They were told on Christmas Day in 1968 that if they proceeded with it the government would sue. The proposition was dropped. In the Gateway Product Line in which Humble, again, was a party, they were told that if they proceeded to complete the venture the government would sue. The case was dropped.

Among these pipeline cases that we have examined, however, none are of the undivided interest form that TAPS is constructed to be, or is organized to be. In this, Dr. Witherspoon makes a very serious error in his appraisal. That was not done because the Justice Department believed, or at least that the staff believed, that the undivided interest proposal was any different in its ultimate effect than the corporate proposal. It was just quite simply this: trying to dig the Panama Canal with one hand and clean the Aegean stables with the other, we were quite unable to take on a third variety of monstrosity and to explain to a court exactly what the undivided interest concept amounted to, as you gentlemen know it is a rather slippery concept and as a trial lawyer, the prospect of trying to explain that to a judge who didn't quite know what a pipeline was in the beginning, didn't seem like the most attractive prospect, at least until we had some solid litigation on the books with respect to corporate joint ventures.

This brings us then to the Alaska Pipeline investiga-

tion. I'm going to tell you only my own views as to the law. I do not intend to answer questions or give you information which has been supplied to the department under administrative subpoena or under other conditions of confidence. But let me explain to you in general the theory of violation on which this investigation was proceeding at the time that I left. It may have changed. First, the sheer size of the oil production held by three companies in very close joint venture. I do not just mean that they happen to have individual production within the same field. As was made very clear in litigation in California in 1969 Humble and Arco, Exxon and Arco were very close partners, sharing on a very detailed basis any activity that each took in an area north of the Brooks Range and east of Naval Petroleum Reserve No. 4. The Arctic slope agreement that was attached to the complaint filed in the middle district of California in 1969 is a most instructive document in terms of the closeness of the venture between these companies. The venture between BP and Arco, between BP and Sinclair originally, was acquired by Arco in its acquisition of Sinclair. And so you, therefore, have three companies with the overwhelming bulk of Prudhoe Bay which are involved in partnerships that are of a very, very close nature. The sheer size of the oil production which they will hold is something which anyone familiar in the remotest detail with the anti-trust laws must find of concern. They will have a

quarter of the U. S. proved reserves and presumably a corresponding producability in the years when TAPS is built and that field comes onto production.

They will have very nearly two-thirds of District 5 alone, which is a valid market within which to judge the impact of such a joint venture. Exxon alone, outside of the Prudhoe and its other joint venture operations in District 5, has long recorded in its stockholders reports a degree of--an amount of--production which corresponds somewhere between six and ten percent of the United States. But in addition to that, Exxon, with Arco, shares in the Wilmington field in Long Beach Harbor, on contract with the city and the state, a field which controls--which produces--150,000 barrels a day. A recent preliminary impact statement has been filed with respect to the Santa Anez unit, a large producing field in the deep water offshore Point Conception, inshore Santa Barbara, on an inshore Anacapa Island; which according to the statement, may be more than a 1 billion barrel field and which according to press rumors that have had some currency recently, may be two to three times that. That means these people in close concert will control a monopoly share of oil in District 5. They will control a share of the total oil production in the United States, which is considerably above any amount that would be permitted if the production were of a commodity other than oil. There is no

exception in the anti-trust laws for oil production.

Section 7 of the Clayton Act prohibits merger; and a joint venture is a merger. Section 1 and Section 2 Sherman prohibit mergers combinations which approach monopoly proportions. And these may well be so held. That was the basic theory of the case, which we were investigating. To this would be added the control of the pipeline. This was an important, but not a critical element in the basic suit. The dominance of these concerns on the North Slope would be greatly enhanced if they controlled the only practicable outlet. If you, as a possible producer, are looking at North Slope drilling, you are not going to go very independently if you can be seriously inconvenienced or excluded from the only practicable method of transportation to get your oil out. You do not produce if you cannot sell, you cannot sell if you cannot move. If you do go north then, you will go as a vassal or as a partner of these companies which control the line. In other words, we on staff, viewed the pipeline as a factor in the overall anti-trust action as an important part of our investigation, exactly to the extent that the producers could control its use by others, by controlling its size, its rate of expansion, its connections, its input and output facilities, its operating cycle and its operating practices.

If, in fact, this line were wholly and effectively controlled by public authority, State or Federal, so that the companies did not have this degree of discretionary jurisdiction, there would still remain an anti-trust case, but it would not involve the

pipeline so deeply or so vitally.

In this examination, as in the other pipeline cases, the staff did not consider that the ICC controls were such an effective control effort, or that they were in fact a control effort at all. These controls do not, repeat not, effectively sway the discretion of the operator to run the line as a closed system. In this, our analysis parallels much of what you're trying to consider here. Just exactly what does the ICC control with respect to a pipeline. They do not control connections; they do not control inter-connections directly with other pipelines. Senator Silides in the earlier committee meeting asked what would happen if I came up to the TransAlaska Pipeline somewhere below Prudhoe Bay and asked to be flanged in, could I compel you to do it. The answer was not quite yes or no as given during Mr. Heard's testimony. Actually, the answer is no, you will not be given a connection unless you say "pretty please." In which case, you may but you will have one devil of a time enforcing a connection. Can the ICC compel the pipeline to build depots for loading tanks as it were--input and output tanks. Understand that in this, we are talking about the only transportation facility in the world which does not provide any conveniences for shippers. And I think this is probably the most significant part of a pipeline as a common carrier. It is as those a railroad said, we will take what you ship to us provided you throw it on the car as it goes by. We will give you no freight depots. There will be no passenger terminals. An airline without landing--without passenger loading

facilities. What in substance is done in virtually every major company-owned pipeline in the United States, you will see reflected in the tariffs, which they publish. The pipeline provides no facilities for shippers for input. Shipments will not be accepted unless shippers have provided adequate facilities for offtake from the line. And that, incidentally, is with respect to those shippers who through one means or another, have managed to gain the consent of the owners to access to the line.

If you have a regulatory system which fills these interstices, if you have an effective public agency control over the operating practices of this pipeline, then you will, to that extent, have eliminated a substantial amount of the problem which others may well soon to enjoy. If this pipeline in fact is publicly controlled as to its operating practices, if it is a common carrier in fact, not a common carrier in name as it would be under the Interstate Commerce Act; then you will have removed the pipeline. I will not say totally removed. You will have seriously mitigated the likelihood that someone may come along and enjoin it. Enjoin its construction, enjoin its operation.

Let's then turn for a moment to what authority do you have to regulate. Either by exercise of direct regulatory powers or by your leasing of public land power, or just in general by your situation as a sovereign state of the United States exercising a very considerable responsibility and power with respect to acts that are committed within the State of Alaska. You've already been bored and confused enough on preemption and concurrent

jurisdiction. Boiling them down, there are two main tests as to what a State may do within the Interstate Commerce clause. Did Congress so exercise its powers in a field as clearly and effectively to preempt it? That is, have they so completely legislated in an area, and deliberately so, that they express a clear intent that you had no power to operate within it? The second one was, if it did leave areas for state action, does the state action impose an undue and discriminatory burden on the free flow of commerce? Not as has been discussed here before, a burden on commerce, but an undue and discriminatory burden. Apply these tests here. As we have said, the Congress in the Interstate Commerce Act has enacted only the most fragmentary legislation. There is even a threshold question here. Is Alyeska subject to the Interstate Commerce Act at all, by the basic language of the law itself? I hate like the very devil to ask that you read carefully section 1. The reason I hesitate is because, as an old friend of mine who has worked Interstate Commerce Commission problems for forty years maintains, the Interstate Commerce Act is the most confusing and poorly written body of law that has existed since the code of Hammurabi. But section 1 says in substance, that (excuse me a moment) -- section 1 which is the critical part as regards pipelines, it says the provisions of this chapter shall apply to common carrier engaged in the transportation of oil or other commodity by pipeline or partly by pipeline and partly by water (I'm leaving out some words) from one state or territory to another or the District of Columbia... In other words, there is at the outset a very sharp difference

made between interstate commerce and interstate transportation. The Interstate Commerce Act relates only to interstate transportation and it calls a pipeline a common carrier if that pipeline is engaged in transportation interstate itself. Now, to accommodate to this definition, to make them squarely and completely within it, the Arco Pipeline Company, for example, which will be the common carrier, theoretically, on Alyeska will have to operate its own water carriage. As of now, neither Arco, nor Exxon, nor BP, operate any common carrier tankers nor are there any that I know of operated anywhere in the world. In fact, they do not operate tankers at all. Their refinery and other affiliates operate tankers. And so Exxon pipeline company is not engaged in the transportation of property by pipeline and by water. The oil will come tearing out at Valdez, drop into the tanks, sit there for awhile and somebody elses tanker, Exxon subsidiary No. 2, will come along and pick it up. But that is not the kind of connective transportation that the Congress spoke of in section 1 of the act. Moreover, to compound the difficulty, the provisions (says section 2), the provisions of this chapter, and again I'll leave out some words, shall also apply to such transportation of passengers and property but shall not apply (a) to the transportation of passengers or property or to the receiving, delivery, storage or handling of property, wholly within one state and not shipped to or from a foreign country, from or to any place in the United States as aforesaid, except as other wise provided in this chapter. There are outstanding on the books, although

this clause has been in the act since 1906, there are outstanding on the Interstate Commerce Act decisions and the decisions of the federal court, not one single case which holds that a pipeline in this situation is in actual fact, by operation of this clause, subject to the chapter. But they say we will exceed the jurisdiction of the Interstate Commerce Act. And this brings me to the old riddle which I learned as a child -- if you call a tail a leg, does a cow have five legs? And of course the answer is, calling a tail a leg doesn't make it so. And exceeding voluntarily to the jurisdiction of the Interstate Commerce Commission does not mean that they may not later secede voluntarily from the jurisdiction of the Interstate Commerce Commission. Again, then, there is a very considerable problem at the very threshold. Is this under the Interstate Commerce Act? Reference has been made to the pipeline right-of-way bill. The bill which has just now cleared the Congress and which is in the process of possibly approval by the President, although I understand the gossip is that the Bureau of the Budget is trying to get it vetoed because it contains some authority which gives the Federal Trade Commission a better shot at getting information respecting oil transportation. In the pipeline right-of-way bill, the committee print, I do not have the final bill as enacted because it was not out when I left last Thursday. But I understand the text is identical. It proposes that the pipeline which is given a permit by the Secretary of Interior must be a common carrier. It does not say what common carrier means. It does, however,

say that whenever the Secretary, this is on page 16 of the committee print, it's actually section 28.R 5 of the Mineral Leasing Act if it becomes enacted. Sub-section 5 says whenever the Secretary has reason to believe that any owner or operator subject to this section is not operating _____ the number of possibilities for suit against the pipeline. The number of interests of state, the federal government, private individuals, even informers who might have _____ beginning of the line. I have been making the point that in substance the anti-trust vulnerability of the pipeline is almost exactly the same proportion to which the pipeline owners have discretion to run the line as their own, and if that discretion can be demonstrated to be superseded by an effective public control, to that extent the vulnerability of the line to suit diminishes or disappears.

I have just completed, I hope completed, all that I have to say in terms of the general preemption of the field under the Interstate Commerce clause by the enactment of the Interstate Commerce Act. I have made the distinction between interstate transportation and interstate commerce and noted that Congress had here enacted only with respect to interstate transportation. Under section 1 I reviewed the doubts that exist that this line in fact is legally subject to the requirements of the Interstate Commerce Commission, that if that commission should by some enormous upsurge of vigor become an effective control agency, which it has never been, would the pipeline at that time be able to say "sorry, Charlie, we aren't

really an Interstate Commerce Act line after all." There is a very good argument can be made on that. I had just finished pointing out that in the pipeline right-of-way bill that Congress has just enacted there is a recognition, explicit recognition, that the Secretary of the Interior in enforcing the common carrier obligations under that act which are not clearly defined may go before the Interstate Commerce Commission or an appropriate state agency. Again, an explicit recognition in the overall regulatory scheme that Congress contemplated that there would be state action respecting such pipeline. Picking up from there that we have not really shown any evidence of a Congressional intent to oust the state jurisdiction, let's then go to the second leg of the question. Congress has, in part, applied some regulatory powers to interstate pipeline. This becomes basically a _____ question because under a long line of cases which you are as familiar with as I, the question comes whether or not the individual state regulation is one which completes or which contradicts the federal regulation. Even if you assume that Alyeska or the individual pipelines which each operate a share of Alyeska in this confusing undivided interest form, are subject to the Interstate Commerce Act, then you have to examine the degree to which that regulatory scheme applies. In the city of Burbank vs Lockheed Air Terminal decided this May by the Supreme Court the court said in reviewing a similar kind of question that when you look to see what the state may do in this confusing field you must examine "the peculiarities and special features" of

the federal regulatory scheme in question. And you do so in order to see whether or not what you propose to do is contrary to what they are in fact allowed to do. The entire settlement that has been proposed here rests, as I have said before, on the effectiveness and the scope and the vigor of ICC regulation. What are the peculiarities and special features of ICC regulation? You have read the press release I think that has been given by Chairman Stafford saying that the Interstate Commerce Commission will now become extremely vigorous in regulating pipelines within the full extent of its powers. A little over a year ago in June 1972 I believe, before the House Small Business Committee, a subcommittee under the chairmanship of Neil Smith from Iowa, Chairman Stafford accompanied by his principal subordinates from the Commission testified with respect to the anti-competitive impact of oil company ownership of joint product pipelines and he said, considering the size and economic significance of the oil pipeline industry the expenditure of regulatory effort is not large compared to that devoted to other types of carriers regulated by the commission.. This reflects the fact that Congress has determined the nature of the industry is such as to require, for the protection of the public interest, a less comprehensive range of regulatory devices. For example, oil pipelines are not required to obtain certificates of public convenience and necessity for the commission. Additionally the Interstate Commerce Act does not give us jurisdiction over such aspects of pipeline operation as issuance of security, formation of interlocking directorates,

mergers, consolidations, construction and abandonment of line, the granting of credit. Pipelines are not subject to the commodities clause, as are railroads (that's my interjection) prohibiting transportation of the products of their owners. However, oil pipelines are subject to those provisions of the act which forbid unjust discrimination and undue preference that require just and reasonable rates, reasonable facilities for interchange of traffic, compliance with the long haul and short haul clause of section 4, compliance with accounting, reporting and valuation regulations and the procedural provisions of the act with respect to rates and tariffs. They are subject to section 1, sub 4 of the act imposing upon all common carriers the duty to provide and furnish transportation upon reasonable request therefore. There is a footnote on that last statement. The footnote reads, admittedly this section provides a rather cumbersome remedy for the courts have held that it is not a self-enforcing provision, that is, even though the Commission may have made a finding that a carrier has not met its duty to provide service, the complainant must still take some additional legal action to enforce the Commission's order, and in some 67 years in which this has theoretically been available there are no cases in which that unknown type of additional legal action has ever been taken. Under questioning by Congressman _____ Mr. Serra, who had accompanied Mr. Stafford as his deputy general counsel, again going to the question Senator Silides raised awhile ago, it is not necessarily true that an independent shipper, so to speak, cannot ship over that line

because the ICC can be complained to by such an independant requesting that established facilities permit him to ship over that line. We cannot require the owners to build a long extension down to his own oil field but we can require the owners to accept the traffic and ship it. And if that independant happened to have also an independant pipeline in the vicinity of a joint-owners line we would require them to connect and establish through routes and joint rates. I think that's clear under the ICC act. Mr. Finn, counsel to the committee; have you ever done that. Mr. Serra: We have never had an opportunity to do that. We have never had a complaint.

In Mr. Hurd's testimony he referred, incidentally, and his assistant gave a little more detail on the experience of Tenacle and Murphy connecting to the Colonial Pipeline. A great deal of this hearing dealt with precisely that point, and the committee reports, which unfortunately I do not have with me, goes into detail the difficulties those companies had in trying to get the same kind of access to Colonial Pipeline that its owners had, and how they finally gained access only by arranging for a merger-joint relationship with one of the owners of the line as to the creation and operation of a substantial number of terminal facilities. In other words they said, PLEASE - I might also say without going into any of the confidential information which we had with respect with that particular investigation, that there was an incident in which one of Exxon's subsidiaries known as PLANTATION Pipeline sought to get connections with something less than success.

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I think that it does point up the specific problems Tenacle and Murphy had, in an appendage to it that was written by the Committee Council.

Again, to point up - I think probably the most significant foulup under the Interstate Commerce Act - they use the label "common carrier", but they do not give it CONTENT. . Mr. Sarra was asked by Congressman SMITH ,"in effect he is saying that a carrier that is only doing business with it's owners is not a common carrier," Mr. Sarra,"

I'm not saying that all. I think that is clearly spelled out in ~~this~~ the CHAMPLAIN cases. WHEN YOU HAVE ONE PARTICULAR PIPELINE THAT SHIPS ITS OWN GOODS FOR ITS OWN PARTICULAR PURPOSES,

~~I~~ they might be a carrier as defined in the act, they might be required to report full evaluation, to file an annual report, to establish ~~uniformity~~ UNIFORM ACCOUNTS, but we cannot require them to publish rates. We cannot force them to accept goods of others. This refers to the two Champlain CASES which I commend to you in sorrow, as an example of how the Supreme Court can read a very complex bill - very complex law, and arrive at some very contradictory results. There were two cases. In Camplin I, the Interstate Commission told Camplin that it must conform to evaluation of principles of the Interstate Commerce Act, do all the minor things which the ICC requires of pipelines. Camplin resisted. They said we are not a common carrier. The case went to the

IT MUST FILE BOOKS OF ACCOUNT, THAT

Supreme Court, and it said whether you are a common carrier ~~or~~ IN FACT ~~not~~ is irrelevant. You are called a common carrier under the Act, and you are therefor required to file books of account. The matter went back to the Commission and in Camplin II it came back up. This PIPELINE ~~twice~~ had been determined to be a common carrier for the purpose of the Interstate Commerce Act. In the Interstate Commerce Commission, they were then required to file a tariff and Camplin refused, and carried it back again to the Supreme Court. And the Supreme Court in a most complex decision said as I said awhile ago - that calling a leg does not make it a leg. You make call it a leg for purposes of classification as long as it is not meaningful in any kind of burden upon it. Camplin was held in the second case to be a common carrier for the purposes of filing valuations and books of account but it could not be required to be a common carrier for purposes of accepting shipments from others. This then, is something of the tangled, ~~and~~ complicated, vague, uncertain, illusory and almost completely non-existent regulatory powers which you are asked to accept as being the public control which would remove the discretionary power of the pipeline owners to control the market ON THE NORTH SLOPE AND from the North Slope to market to Valdez with North Slope oil. This I would submit, is a very weak reed indeed. If only I were not barred from trying to challenge this particular ~~case~~ WAY - I would love to do it.

Having then said that you have a wide power to flush out the regulatory system by your own control provisions. How ~~to~~ should you proceed to regulate? In giving advise, please understand, I have not had enough opportunity to become familiar with the provisions of the individual proposal so that I can relate them to the whole. It is a confusing package in and of itself. Even to a lawyer who has spent years in trying to understand confusing things. You must, I think, express very clearly - and I think your existing statute does express very clearly, your intent to use whatever base of powers the state has, whether it is the power of eminent domain - the equivalent very similar power to permit use of public lands, your regulatory power, your power in general ~~is~~ TO GIVE economic PROTECTION to the people and the economy of the State, but in doing so, may I call your attention to the fact, violating the rule I just said a moment ago, may I call attention to the fact that in the package of bills there is one part which I noted specifically. In SB 3 the Commissioner is given authority, in the event he deems it necessary, to call this pipeline a common carrier and to apply to it certain power. You will find on page 5 of the print that I have, sub 3 -- there the Commissioner may call it a COMMON carrier, but expressly, it may not require the lessees to accept tenders of crude oil except at points where there are existing pumping stations or other facilities for receipt of crude oil. In other words, if you come from the Coleville River crude, you have to go to the

Prudhoe Bay, INPUT point or there is no acceptance for shipment. Senator Silides thought--could I come at some mid-point between Prudhoe and Valdez and flange up to the line--is expressly denied here, unless Alyeska, OR ALYESKA'S OWNERS in their clear discretion choose to put an intake there for you, but they cannot be compelled under either Federal or State law to do so.

They can still accept or reject tenders of crude oil which are not good merchantable oil due to gravity, viscosity and other characteristics. Possibly this might be ~~true~~ THRU ~~from~~ SOME litigation through some interpretations made more meaningful, but I have in mind some of the complaints that we have received in the Department of Justice years ago concerning the failure to accept tender shipments at appropriate points by pipeline from shippers who had been on those lines. Because for some reason or other, the shippers on the line were also the owners of the line. did not want that particular oil on the line. It was merchantable oil. It had a slightly different asphalt index, and it was refused. There was nothing under the Interstate Commerce Act that the complainant could do. We started an investigation - he got his connection, for that reason. But not because the Interstate Commission or the Interstate Commerce Act gave him a right. But because the exclusion was purely an attempt to monopolize.

Even when an input point has been established. There was one matter which came up in Mr. Stafford's testimony - they were talking about the possibility that a man might have a connection

already established but for some reason or other the owners of the pipeline might decide to discontinue it. Mr. Serra, Deputy General Counsel was asked by Congressman Conti - "So if Colonial wanted to knock out its connection of Fairfax, Virginia, for example, it could do it." Mr. Serra,"Yes. They could do it without permission of ICC." Mr. Conti How about cutting off tanks and pumps." Mr. Serra, samething." In other words, those under S6 and under the Interstate Commerce Act there would be complete discretion in the owners of the line to put the input point where they chose, to drop them when they chose. In your enactment, in your existing law, you have some reasonably clear language. I would suggest in the interest of avoiding litigation, that you carry through with that fairly complete control system there spelled out rather than try to amend it. Rather than try to change it at least as it is proposed here, in one respect particularly. On certification, there has been a great deal of dispute raised. I heard Mr. Furman yesterday - I heard others speak to the same question. I think that it is important that you understand that the legal certification covers a regulatory process by which approval is granted to the total service of a line. The question was raised yesterday whether or not that certification may have been completely superseded by the determination of the congress made in enacting the right-of-way act. It is easy in reading and it will be easy when you have the final text of that act to find what it was what congress said was to be built. Roughly speaking in the

language they have here - they have said our certification in effect, our determination of public convenience and necessity says that there will be a 48" pipeline from Prudhoe Bay to Valdez as described in the final environmental impact statement. Now as I recall that final environmental impact statement it did not trace the precise input point, it did not trace the input tank of the shipping companies, it did not and indeed as yet could not trace the output facilities that are given. In short all it said is - that there will be a trunk line. The certification process for a railroad, a bus line, air carrier or any other kind of a public utility of a public transportation company which is the same thing in substance as a public utility. That the certification process covers not only the trunk line but also the facilities by which access to that line will be given. In short, congress even by that certification has not totally ousted your certification requirements which would go also to the point to the facilities that are established for the input-output of the pipeline at various points along its system at its headend - at its tailend. One other thing which I would urge - as I say I am not that familiar with your clause but I would urge that you insist either by separate enactment or hopefully you have it in existing law on full powers to compel information to be produced for the legislature, if necessary for the regulatory commission where appropriate full information powers.

I listened with a great deal of interest to Mr. Hurd's opening remarks the other day in which he said "we will tell you anything you wish". This runs alittle bit contrary

to the situation in which the joint committee on public domain of the California State Legislature now finds it so. Exxon is a party to a contract covering the operation of the Long Beach unit producing a 150,000 barrels a day. One element of that contract provides that the companies would give to the state a full and complete access to all papers relating to the pricing of the oil. There is a rather considerable dispute before the committee as to whether the pricing of the oil - the price at which these companies have accounted to the state for the oil is a fair price. We have testimony from independant prcduces to the effect that the state oil was worth somewhere between $.50 and $1.27 a barrel more than it was being accounted for to the state. Hearings where held, the prcducers testified, the chairman of the committee invited the purchasers and the contractors to testify - they refused. Exxon declined because it was too minor a factor in the West Coast operation to have anything to testify to. The chairman there upon sent requests to the individuals - in substance leaning on them - would you please come in and testify. They still for the most part refused. We got from one or two of the companies some testimony which was rather misleading and therefore as any organization that is trying to find the facts must do - we went to what subpoena powers we had. Exxon is currently in the Superior

Court in and for the city and county of Los Angeles enjoining the subpoena of the joint committee on public domain, on grounds among other things, that the state in asking about this complex set of relationships is acted only as a oil producer in its preparatory capacity and has no right to the information. It is also saying that most of the records we sougnt are dept outside the state and the state has no authority to compel them to be brought within. I'm sorry to intrude another's states experience on you. I think however it points up the necessity of being absolutely certain as you police the operation of this entire thing make certain that you have access to the information on the basis of which you and your successors will be able to judge whether or not this is an operation in the public interest or not. Finally let me associate myself with Dr. Witherspoon in one thing: I had not met him before we came here; I can associate myself with him gladly, and even with a little bit of modesty, say that I think really he has given you and extraordinarily excellent job of advice. But in closing his testimony he said that if you accept this package of bills that has been offered you you may end up with that horror of horrors a private government--an unregulated monopoly Now understand after a life time in antitrust I believe in free enterprise. I am a disiciple of John Sherman; the gospel of Sherman won I think is the whole basis on which this country's economy rests, on which it should continue to rest.

The one thing that it says in substance is this: You shall have no public interferance with business with the economy except to the extent it is absolutely necessary. You shall not permit private government to control areas of the economy. Monopolies--and Taps will be an monopoly--means the ability to control, the ability to govern; it is private government. If there must be regulation because of the natural monopoly characteristics of this pipeline, if there must be a monopoly, let it be publicly controlled. Do not leave that area of government to private interests for that I think is truly a horror of horrors.

Q by Senator Thomas: ...I understand YOUR POSITION very clearly but in a case like this, of this magnitude, I would certainly hesitate to think the public in COMPLETE control would be anything but just worse than private control.

Mr. Lamant:

I would say Sir, that if you have a government it is better to have a public government than a private one because you have at least some chance that the public interest will be more fully maintained. I do not like state ownership but I do not like private government, and as between the two it seems to me there is no choice but to have public control, not necessarily public ownership. There are a great many things, a great many decisions on the operation of this line where an independent private carrier could hustle a lot of business for the good of

the state. What I'm saying is, this is not an independent private carrier, it must be regulated then by the state government or by the federal government if it is to serve the public interest.

Q from Senator Thomas: What would you say to the arguement though that we've been presented with ...

they just feel that unless they can assure the banking firms that they are going to not be bothered—they can maximize their profits in the legal sense—that they will not get money to build the thing in the first place.

Mr. Lamant:

In one of the markup sessions on the Taps right of way bill, Senator Haskell made a remark that I think (I can't quote him verbatim now) I can give you the substance of it-- he said, "Gentlemen: You have ten billion barrels of oil at this end, you have a hungry market at this end. The transportation business (the moving business) is there. You are giving to these people what amounts to a monopoly franchise. If you will instead give it to me I will gladly resign from the Senate and arrange the financing. In fact," he said, "If my labrador retriever couldn't do, I'd shoot him."

Q from Senator Palmer

Yes, Mr. Lamant, Are you saying then, that in order to have this public government, not public ownership, that ...

or total of our present regulatory bill—present regulatory act of 1972—gives us the kind of protection that we need?

Mr. Lamant:

I think it does.

Q from Senator Palmer:

Are you saying that the certification requirement that we've heard discussed so much is an integral part of that bill that should be retained?

Mr Lamant:

I think it is a most essential part of it and I think it does not create a concept of jurisdiction to the degree that it should be thrown out without some very very careful interpretation. In other words, I think there is no conflict.between the federal certification as done by the congress in the right of way bill and the certification requirements that you have. It supplements what they did. You do not impose an undue or discriminatory burden. You are simply saying that the interstate commerce (not transportation) which will flow over this line will in fact be more effectively unburdened if your certification power remains to require the input and output facilities which alone can make this an effective instrumentality of free interstate commerce.

Q from Senator Palmer: What in truth may be the situation is that the action of the pipeline owners may be more burdened but interstate commerce may be more unburdened. Is that true?

Mr. Lamant: Precisely.

Palmer: As far as land owners rights and abilities to do things because of the property right and contract right, that they may or they may not be able to under regulatory right--this has been one of the main issues here, I believe, in the litigation: The companies saying we're attempting to do by indirect means what we cannot do by direct means. You touched on that,

I'm not sure exactly how you feel about that?

Mr. Lamant: Well, I think that in this area, rather than try to work out all the details, I would go back to what I said in general. You would be making a mistake if you did legislate I don't think that you did, you would be making a mistake if you did legislate or now legislate solely in terms of the leasing powers. I would think that the state of Alaska through its legislature could declare that whatever powers it has as a sovereign state in the commerce field, in the regulatory field in giving them public domain--I mean in the condemnation aspect and in the corresponding aspect reciprocal of allowing access to public lands that if it used all these powers and made it clear that it was using all these powers, it would eliminate a good deal of what rather complex arguements has been raised in that particular case. I've not had an opportunity to examine pleasings there. But this in general is my feeling. If you sought to use only leasing powers and nothing else that might be a valid arguement, it MIGHT be, but this state need not limit itself to using only those powers. Use all the powers which you have, and so declare.

PALMER: On another subject you have heard the discussion going back and forth on the Common Purchaser Provision. Would you comment on that?

LAMONT: Well, it is a little bit ambivalent. If you have absolute free access by any possible shipper to this line, you will have enough purchasers up here buying oil to ship that you will not worry about compelling those companies which are now in the business on the North Slope to be common purchasers. Moreover, if you compel them to be common purchasers, they will have an excuse for acting like monopolists with respect to the entire amount of oil. On the other hand, I was really very much amused to read in the Common Purchaser Bill of the proposed amendment here, that while it declares certain people to be common purchasers, on SB 7, Page 2, the provision about people who take only their own oil except for royalty oil, would mean in substance that your common purchaser enactment would apply only to anybody else and not to the people who will be doing business on the North Slope. It was a very interesting example of legal prestidigitation.

PALMER: I believe it was Mr. Spahr of SOHIO who indicated that any change in this package might result--would result in review by the companies on the agreement and may, possibly obstruct the beginning, and perhaps then a drop out of some of the smaller companies who are now a member of the consortium, and was very fearful that this would have an adverse impact--or could have an adverse impact--on the anti-trust suit or the consortium's

position in that anti-trust suit, and that also the State's excercise of its 20% option could be a factor in this thing that could be adverse to the corsortium. Would you care to comment on this a little?

LAMONT: Well, to the extent of the smaller companies presence in the consortium was intended as an anti-trust defense -- well, it's simply ridiculous. They have very little to say about the line. They have almost no clout within the consortium. Here I must get a little bit cautious. I don't want to go into the underlying documents which would go into that, but I would simply say that in general their presence would not be a signif-icant factor. If, in fact, they had to re-examine the organiza-tion of this line, and hopefuliy from your point of view, reorganize it in terms of a straight, independently owned corporate operation in which there will be a pipeline which accepts tenders -- not an undivided interest pipeline, but a pipeline which in itself is a common carrier, and not a complex bundle of common carriers each illegally sharing a portion of the capacity, I think, to be honest with you, it would sub-stantially lessen the anti-trust problem--not create more, but the mere existance of the minority interest here was never an obstacle.

PALMER: On this 20% option, if I may and this will be the last one, our Attorney General says that even if the State exercises its option and became a 20% owner, or a partial owner of the pipeline, this would not give them access to the Board table,

he, as Attorney General representing the State, would not be able to sit down with the other members and discuss policy, etc. Would you comment on that?

LAMONT: Well, you have a most complex corporate setup here. You have a operating company, Alyeska, which is a joint-venture company--this is public information--you have the pipeline itself/in undivided interest by individual pipeline companies, owned each of whom will set their own tariffs, operating practices, input and output points, assuming for example that they are left as interstate commerce act line. I do not know precisely to which your option referred. Was it an option to buy an interest in the line? An option to buy an interest in the company? An option to buy an interest in the companies which are actually operating the common carrier line? I think it probably is related only to the pipeline itself--the undivided interest in the line--the physical property, and possibly, an undivided interest in Alyeska, but since all Alyeska is is an operating agency obedient to the orders of it's owner, the states presence on the board of Alyeska would not be a terribly/factor, important in determining the operating practices of Exxon Pipeline Company. Which will be the Exxon, Arco, BP will be the actual operators, the actual parties shipping on the line.

Senator Thomas: I just wanted to ask mr. Lamont, what you think the odds are that there will be a suit against TAPS and what this could do in terms of further dealy?

Lamont: I really have no way of knowing - I opted out, of the discussion. I think there is a good likelihood that there will be a federal case on the entire proposition. Under the terms and

conditions that I have indicated, it may or may not include the pipeline. The federal government will almost certainly, unless they have changed the course that we set the investigation in 1968, the federal government will almost certainly not ask to enjoin the pipeline. As to whether private interests may or may not, it depends, there is a tremendous lure of trouble damages when this line becomes operative. And then I think there might be a considerable possibility that there would be suits. As to whether the environmentalists and some of the consumer organizations, I think not the consumerists, if the environmentalists, some of the native groups, some fisheries, if these people really

END OF TAPE I

Again, you have to go before a Federal Court, before a Federal Judge and say that the creation of this pipeline on these terms is of such likelihood of damage, such likelihood of anti-competitive damage that it ought not to be built on these terms. The court might then grant a preliminary injunction, it might well not. Anybody in the anti-trust field who trys to guess what different federal courts will do on preliminary injunctions, is really a gambler.

Q. One of our main concerns here are the best interests for the State of Alaska. Where we should go from here. I recognize that __ ___ (tape inaudible) ___ ___ ___the laws have been challenged in the courts ___ ___ ___ _____ and the recommendation of the administration. From the standpoint any interest of Alaska, I recognize your comments and appreciate your comments on ___ ___ ___ ___ __ this line. What do you suggest to be out best course of action.

A. At the moment, I would say inaction. In other words, you have a statute on the books. You know its been challeneged. The people who are challenging it, incidentally, are the ones who have the most at stake in getting the line built. The companies who have this enormous deposit of oil and this enormous investment in drilling that they have made are rather anxious to begin realizing on it, particularly now, in the world crisis, with the prices of crude oil skyrocketing. If their litigation alone stands in the way of completing this pipeline, I do not think that litigation will stand long.

Q. From the standpoint of the best interests of Alaska it has been suggested that additional delays will result from inaction. I would appreciate it if you would look only from the standpoint of Alaska; would you still suggest then that even though there were delays from inaction that we persist in inaction.

A. If, in fact, there would be significant delays, its difficult for me to put myself in your position as a legislator. Thank God I don't have to think as far in the future. All I have to do is think about just a couple of more years and then I can put my feet up on the hob in front of the fire and say to heck with it. What I mean by inaction is this: You have a good regulatory framework set up. It is complex, it needed to be so. It was created after a long consideration--long and arduous deliberation. It may need some refinement here and there. I do not mean total inaction. But I'm saying simply do not exchange to the degree to which you are asked to change it, for the reasons that you were asked to change it. Because the changes proposed will risk more litigation and more delay than they will end--most of the changes proposed. The basic, the core ones. You may be able to refine it in some sense to further mitigate those chances, and I wish you well in your responsibility and thank God it isn't mine.

Q. Are you in any position to tell us, in any way, whether the Justice Department currently has an anti-trust claim against the owners of Alyeska (rest of question inaudible)

A. That I can answer and I can answer it very bluntly. They have had, by both voluntary production and civil investigative demand, a rather considerable body of documentation. As of the time I left, the case was still proceeding. About a month ago they called me in to talk with the new staff that had been assigned since that time. They are still proceeding. They will intend to proceed, I'm certain. If they don't, to be perfectly honest with you, I think I will do an awful lot of yelling. But what they are proceeding with respect to is not to stop the pipeline, but to stop a rather monopolistic control organization. Did you think, did you ever stop to think, that you have within three companies hands, operating in a very close joint venture, a greater degree of total control over the crude oil markets of the West Coast and indeed of the entire United States, than the State of Texas had in the years in which Texas held the umbrella over the industry and virtually controlled prices and supplies.

Q. Are you in a position to disclose, in any way. whether that proceeding would be on the basis that this was a joint venture pipeline, or is it from the monopolistic standpoint?

A. As I told you, earlier in the testimony, I said in substance that we viewed the pipeline as merely one supplementary aspect of the overall case. That this joint venture nature did give to the basic dominance of the companies of the North Slope a very considerable amount of additional combilatory power. But that existed only to the extent that their discretion to accept shipments or reject them was not controlled by public authority; and that if

there were an effective public authority control, that would almost certainly become an extremely minor element of the case.

Q. Does the Justice Department, from a standpoint of Alaska, I assume that we're entitled to rely on the Justice Department's ability to prosecute and pursue these things. . .

A. In Boston about three weeks ago, I was on the rostrum with Bruce Wilson, who is the Deputy Assistant Attorney General. We played a rather peculiar Alphonse and Gaston act--he was my old boss. He is a very fine fellow and an extraordinarily active anti-truster. But we both made the same point--Anti-trust division has about, I've forgotten now, about a twelve--less than a twelve million dollars budget to police an economy which is rather considerably larger than that. The problem of allocation of staff becomes an extreme problem. When I was still in the Department, we were handling four pipeline cases, those which you have named with a total staff of four people. Like I said, its roughly like trying to clean Aegean stables with your left hand and dig the Panama Canal with your right. These are complicated matters and to do them justice they need more staff but Justice does not have more staff. You can rely on Justice to do what it sets out to do but you cannot rely on Justice to be able to police the entire economy. There will be a great deal that it cannot do and that which you can do for yourself, you should do.

Q. Is there any other way to finance a 4.5 billion dollar project than by joint venture of this type?

A. It is a very big project. There are a great many rather large companies which have been in the transportation business. One thing that has not come up for comment here is that you do have a number of independent pipeline carriers who are in the business of learning pipelines as a transportation business for the profit thats in it. Southern Pacific Railroad, for example--Union Pacific, Great Northern. These are transportation companies. Pennsylvania Railroad operates a buckeye company--the old Buckeye Pipeline which is a large and active system in areas in the East. Williams Brothers Pipeline Company runs a products pipeline that covers almost the entire mid-West. In other words, before you conclude that the size of this is so great that it couldn't otherwise be financed, look at it in terms of the size of the transportation business that exists so that a reasonable profit can be made on an independent basis by an independent company. I think the best of all possible worlds here, for you, as in the United States generally, would be if these carriers were in fact independent transportation companies in the business of hauling oil for profit for anybody who chose to bring it to them. And I might add, there are bills which, if enacted, would apply the commodities clause to pipelines, which are going to be undergoing active hearing before the Congress rather shortly. I think the Congress's interest in this area is extremely healthy because quite simply, I would just as soon General Motors didn't own the Pennsylvania Railroad or vice versa. I think my cars would be

shipped cheaper and there would be more competition in automobile shipment as long as the automobile companies have a choice of independent carriers and they are making their profit off automobiles, not off transportation. And they are making their profit in competition with other people by making automobiles, not by controlling the means of shipment.

Q. We would have to wait for federal law to pass before we could proceed on that theory, if I understand you correctly.

A. If the companies say that applying your fair regulatory system means that they will have to rethink the project, perhaps, God willing, they might rethink it in terms of an independent carrier. In the course of the hearings which you read on Colonial, you will recall Congressman Contes extreme interest in the fact that this risk was so great and the investment was to great that the companies had to restrict ownership to themselves and had to say that--had to agree--that if any one of them wished to transfer it that ownership, they had to offer it to the others. And Congressman Contes scratched his head and got a little bit bewildered and said, you mean to say that because of the risk involved you're not willing to share it with anybody else?

Q. (question by Sen. Silides completely inaudible)

A. I'm sorry sir, but I'm both not quite as familiar as I should be with the tax provisions and unfortunately I can remember rather distinctly some calculations that were made by some of the carriers here as to exactly what would happen there, and I would rather not comment on it.

Q. You think this would have an adverse affect.

A. Yes.

Q. Could you state who your first contact was in regard to coming to Alaska to testify.

A. I was called in California by Senator Croft to ask whether or not I would be available. I was then called in Washington by Mr. Elliott if I could come.

Q. Your comments on the pipeline and the ownership reminds me of the language of Senate Bill 3 on page 7 where we're talking about the 20% ownership; and the new language agreed to by the companies would afford the state an opportunity to negotiate

__ __ __ __ __ __ __ __ __ __ __ __ __ interest

in the pipeline, except for sales or transfer of interest in the pipeline among the owners of the pipeline. Is that reminiscent of the case you're talking about?

A. Yes, exactly. In the Colonial pipeline case, as is set out in the hearings that Congressman Smith held, it was a stockholders agreement. It said in substance, it set out precisely the shares of the owners in Colonial. It said before any owner can transfer any part of its share other than by reorganization or merger, it must offer it, it must say who's the buyer, what is the price and it must give the other owners a chance to buy that share or that interest proportionately. If, after a period of time, I think 90 days, all of the shares have not been opted for in a proportionate basis by the companies who have--the other owners of the company;

then there is a second round, in which it is again offered proportionately to each of the owners, dropping out the one who hadn't taken any shares the first time. If, at the end of that round, there were shares still left untaken, then they had to be offered to any one of the other owners who wished to take it. Only then, could that be sold to any outsider. I would presume, including the state, if this is that kind of an agreement. And I might add I have seen many of those agreements with respect to many pipelines.

Q. We have formed a bill dealing with the 480 acres, I believe, of onshore line in Valdez, along with the special offshore line and acreage for construction of the terminal facilities and loading facilities. The question is whether to sell this land in fee simple to the consortium or whether it would be in the State's interests to lease it. Would you comment on this as far as protection of the State's interests?

A. This gets a little bit into the complications of your reliance on the leasing power as well as the regulatory powers in the enactment in the 72 Legislation. I think it is, in fact, a tip off that the companies wish to buy this land in fee in order to have the tanks and loading terminals outside your jurisdiction if they can. Those tanks are an integral part of any kind of transportation system. The availability of common warehouse facilities at the end of the line would be an absolute essential if you were actually going to have a transportation business accepting shipments from outsiders for transport along the line. Because there will be some purchasers who, while they may wish to take oil in the field and ship it over the line on a regular basis, may not wish to make the multi-million dollar investment in tanks

and facilities to accept that shipment at the terminal point. For example, those Williams Brothers and Pennsylvania Railroad, as well as Southern Pacific, offer common warehouse facilities, common terminals. I think the companies will not do that, and I think the fact they wish the land in fee simple is an attempt to get outside what they think is your principle regulatory effort in order to do so. I would say under the circumstances I would be very very wary of the problem.

Q. You've testified rather extensively on the anti-trust laws, but isn't it true that anti-trust laws dealing with joint ventures are really very Fuzzy ___ _, isn't that . . .

A. No, sir it is not. Panollen pointed out that although in that particular situation there was not a violation of Section 7 that a joint venture was in effect a merger under Section 7. Here, however, you are dealing with something which in terms of size goes into Section 1 and Section 2 combinations. A joint venture is a combination beyond any plain adventure.

Q. When you and Mr. Wilson testified before the house committee, he made the statement, I believe, that finance was one area of the anti-trust law which is __ ___ _____ ___ ___ __ in the area of joint ventures.

A. Mr. Wilson is entitled to his opinion. What I think he was speaking of there and that was one of the answers he --we had not previously discussed before we went to the testimony. I think he was speaking there of joint venture pipelines, but you see, he was talking in terms of a line, which though it is large and though it involves a substantial number of refiners and markers,

does not come anywhere close to the proportion of market which you are dealing with here. And Mr. Wilson and no one else will tell you that there is any lack of clarity about a joint venture as a combination when it approaches Section 2 size.

Q. Was there any success in litigation on the basis of a joint venture pipeline?

A. There has not been. There have been at least four private cases that were based on our Gateway Glacier theories that were bought. All four of them were settled at the courthouse steps with some rather substantial payments. I think if I were to hazard a reason, I would say on the one hand Justic Department was not able to bring this litigation forth because of the application of massive political clout. The private individual who sues is apt to find a very nice settlement because the oil industry the larger integrated companies very much do not want a precedent on the books which will invite a multitude of treble damage suits, because their liabilities will be enormous.

Q. Do you know how many states have their own anti-trust laws?

A. I can't give you the exact number sir, but most.

Q. Unless I'm mistaken, Alaska does not have such. . .

A. Professor Witherspoon was talking to me about that last nigh ; I was not aware of the fact I think it is a very significant lack. There is a uniform anti-trust act, it is a good one, there is a great deal of effort been given to it. There is a wide area of intra-state commerce to which an anti-trust law could apply and it should.

Q. That fact that we don't have these laws, wouldn't that tend to make this strong regulatory commission all the more important?

A. Yes. I'm sorry I should have made the question before, because I think that is exactly the case.

Q. Do I gather that possibly Ralph Nader is considering an anti-trust suit in this case?

A. I do not think so. When I talked to him this morning, and again last night, the conversation was in terms of for the love of God, do not let the State of Alaska rely on the Interstate Commerce Commission as such. Now, I do not know, and I think I would know if Nader was considering a suit, because we have worked a time or two rather closely in the area of both legislation and other matters respecting anti-trust laws in oil.

Q. Would you think, then, if we were to change our laws, that Mr. Nader might rethink his position.

A. Mr. Nader might rethink it, but to be honest with you, you have a rather bewildering variety of environmentalists concerns who have probably more funds for this purpose than Mr. Nader does. He might think of it, I don't know. It certainly is an obvious possibility. But more obvious, are your arious environmentalists concerns who have made it very very clear that they don't want no pipeline nohow.

MR. CHAIRMAN: If there are no further question--then thank you very much for coming.

COMPARISAN-
TEXAS VS. SB3

STATE OF ALASKA
THE LEGISLATURE
LEGISLATIVE AFFAIRS AGENCY

POUCH Y - STATE CAPITOL
JUNEAU, ALASKA 99801

November 7, 1973

M E M O R A N D U M

TO: Senator Croft

FROM: Ray Manning, Legislative Counsel

SUBJECT: Comparison between Texas regulatory and leasing law and SB 3 in both the Resources and Finance Committee Substitutes

Sections 1 and 26 of the Finance Committee Substitute assume that there is some indefinite degree of federal preemption, whereas Texas in its Revised Civil Statutes, Arts. 6018 and 6019, assumes regulatory jurisdiction over "any pipeline or any part of any pipeline within the State of Texas", or any transportation from any oil field within the state to any distributing, refining, marketing or reshipping point within the state.

With regard to the general question of what can and what cannot be done by the use of a right-of-way lease upon state land, see the Revised Civil Statutes of Texas in Art. 6020, 6020a, secs. 3 and 5.

In both CSSB 3 (Finance) sec. 2 and CSSB 3 (Resources) sec. 1, field gathering lines are not required to be covered under the Right-of-Way Leasing Act with regard to common carrier status, etc. Under the Texas Revised Civil Statutes, Art. 6049a, secs. 8aa and 8aaa, field gathering lines or systems which purchase any petroleum are made common purchasers and common carriers and are subject to rate and tariff regulations by the commission. A gathering system which transports crude petroleum for hire would be a common carrier pipeline under Art. 6018, sec. 1 of the Texas Revised Civil Statutes and would be subject to regulation as a common carrier.

In sec. 12 of the CSSB 3 (Finance), language which appears in the Resources Substitute has been deleted (p. 6, lines 20-25). There is no such limitation placed on the Texas definition of Common Carrier (see Art. 6048 T.R.C.S.) and could come back at a later date in the form of a showing of legislative intent as an

indication that the legislature by striking this language showed it did not intend to have it applied to common carriers.

In covenant (4) of AS 38.35.120 of the FINANCE version, the language referring to throughput agreement transfers to the state has been deleted. The argument that the pipeline carrier-owners cannot transfer these because the banks will be holding them as collateral seems unconvincing since they obviously could not transfer what they do not have in the first place and the banks will not be holding these agreements as collateral forever. It would seem that when they become the sole property of the pipeline carrier they could and would be transferred to the state under the RESOURCES version of SB 3.

In covenant (7) of the FINANCE version, the addition of the language beginning with "provided" on page 8, line 4 could place the state in a position of having to bear costs of connections which it would not have to bear under the Texas statute. See Art. 6049a, sec. 7 which provides the language "...and required to be in the public interest and that the expense involved will not impair the ability of such common carrier...or perform its duty to the public." A new covenant (8) has been added in the FINANCE version which is supposed to permit the state to take its "royalty in kind" oil off the line at state expense. Covenant (8) in the RESOURCES version therefore becomes covenant (9) in the FINANCE version of SB 3.

In covenants (8) - (9) the FINANCE version deletes the language taken from the Texas statute found in Art. 6049a, sec. 7 and simply leaves it to the Public Interest test which exists in both versions.

In covenant (10) RESOURCES and (11) FINANCE (p. 9, line 2) the words "the protection of" have been added before the words "public interest". It is very difficult to determine whether or not this weakens the term of art "public interest" or not. If it does cast a cloud over whether or not the financial interests of the people are still covered or not, then it may not be good policy to have it remain in this covenant and in the FINANCE version (p. 13, line 18).

RM/sm

Art. 6018. Pipe line carriers

Every person, firm, corporation, limited partnership, joint stock association or association of any kind whatever;

1. Owning, operating or managing any pipe line or any part of any pipe line within the State of Texas for the transportation of crude petroleum to or for the public for hire, or engaged in the business of transporting crude petroleum by pipe line; or

2. Owning, operating or managing any pipe line or any part of any pipe line for the transportation of crude petroleum, to or for the public for hire, and which said pipe line is constructed or maintained upon, over or under any public road or highway, or in favor of whom the right of eminent domain exists; or

3. Owning, operating or managing any pipe line or any part of any pipe line or pipe lines for transportation to or for the public for hire, of crude petroleum, and which said pipe line or pipe lines is or may be constructed, operated or maintained across, upon, along, over or under the right of way of any railroad, corporation or other common carrier required by law to transport crude petroleum as a common carrier; or

4. Owning, operating or managing or participating in ownership, operation or management, under lease, contract of purchase, agreement to buy or sell, or other agreement or arrangement of any kind whatsoever, any pipe line or pipe lines, or part of any pipe line, for the transportation from any oil field or place of production within this State to any distributing, refining or marketing center or reshipping point thereof, within this State, of crude petroleum bought of others;

Is hereby declared to be a common carrier and subject to the provisions of this law. The provisions of this law shall not apply to those pipe lines which are limited in their use to the wells, stations, plants and refineries of the owner and which are not a part of the pipe line transportation system of any common carrier as above defined; nor shall such provisions apply to any property of such a common carrier which is not a part of or necessarily ident to its pipe line transportation system. Acts 1917, p. 48.

Art. 6019. Control of

It is declared that the operation of common carrier pipe lines is a business in which the public is interested, and is subject to regulation by law. The business of purchasing, or of purchasing and selling crude petroleum, using in connection with such business a pipe line of the class subject to this law to transport the crude petroleum so bought or sold, shall not be conducted, unless such pipe line so used is a common carrier within the purview of this law, and subject to the jurisdiction herein conferred upon the Railroad Commission. Id.

Art. 6020. Powers of carrier

The right to lay, maintain and operate pipe lines, together with telegraph and telephone lines incidental to and designed for use only in connection with the operation of such pipe lines along, across or under any public stream or highway in this State, is hereby conferred upon all said common carrier pipe lines. Any person, firm, limited partnership, joint stock association, or corporation may acquire such right by filing with said Commission a written acceptance of the provisions of this law expressly agreeing that in consideration of the rights so acquiring it shall be and become a common carrier pipe line, subject to the duties and obligations conferred or imposed by this law.

Art. 6020a. Telephone, telegraph, electric transmission and power lines; oil, gas and sulphur pipelines; irrigation canals and water pipelines; easements and rights of way over public lands and waters

Grants of right-of-way

Section 1. The Commissioner of the General Land Office may execute grants of all easements for right-of-ways for telephone, telegraph, electric transmission and power lines, for oil pipelines, gas pipelines, sulphur pipelines, and other electric and pipelines of whatsoever nature, and for irrigation canals, laterals, and water pipelines granted by this State, across all unsold Public Free School Land, and across all islands, salt-water lakes, bays, inlets, marshes and reefs owned by the State within tidewater limits, and across that portion of the Gulf of Mexico within the jurisdiction of Texas. The Board of Regents of the University of Texas may continue to execute, under authority heretofore granted, all right-of-way easements for telephone, telegraph, electric transmission and power lines, for oil pipelines, gas pipelines, sulphur pipelines, and other electric and pipelines of whatever nature, and for irrigation canals, laterals, and water pipelines across lands belonging to the State, and dedicated to the support and maintenance of the University of Texas. The Board of Regents of the University may continue to execute, under authority heretofore granted, easements or leases for the erection and maintenance of electric substations, pumping stations, loading racks, and tank farms on University Lands, and the Commissioner of the General Land Office may execute easements or leases for electric substations, for pumping stations, loading racks, and tank farms to be located on State Lands other than those owned by the University.

Approval of forms; recording and fees

Sec. 2. All easements granted under Section 1 of this Act shall be on forms approved by the Attorney General and shall be recorded in the office of the county clerk of the county in which the land lies. The recording fee shall be paid by the persons, firm, or corporation obtaining the easement or right-of-way who shall furnish a certificate of such recording to the Commissioner of the General Land Office.

AGO 533902

Term of easement

Sec. 3. No right-of-way easement, electric substation, or tank farm, loading rack, or pumping station easement or lease of the character enumerated in Section (1) hereof may be granted for a longer term than ten (10) years, but any such easement may be renewed by the official or officials charged with the execution thereof, in his or their discretion. includes pipelines

Privilege fee for right-of-way

Sec. 4. From and after the passage of this Act every person or corporation occupying or using any unsold Public Free School Land, any islands, salt-water lakes, bays, inlets, marshes and reefs owned by the State within tidewater limits, any portion of the Gulf of Mexico within the jurisdiction of Texas, and any unsold public land dedicated to the University of Texas, or any part thereof, as a telephone, telegraph, electric transmission and/or power line right-of-way, as an oil and/or gas pipeline right-of-way, or sulphur pipeline right-of-way, or irrigation canal, lateral, and water pipeline right-of-way, shall, as a condition to such further use or occupancy, pay annually in advance for such privileges, to the Commissioner of the General Land Office at the General Land Office in Austin, Texas a sum equal to two and one-half cents (2½c) per lineal rod per annum for each and every rod of telephone, telegraph, electric transmission and power line, oil pipeline and/or gas pipeline used, possessed, or maintained by any such person or corporation on any unsold Public Free School Land, on any islands, salt-water lakes, bays, inlets, marshes and reefs owned by the State within tidewater limits, on any portion of the Gulf of Mexico within the jurisdiction of Texas, and on any public land dedicated to the University of Texas. This annual privilege fee shall be paid by all such persons and corporations on all oil pipelines, gas pipelines, telephone, telegraph, electric transmission and/or power lines now existing and situated on public lands of the classes above mentioned which have not heretofore paid such fee. All amounts due shall be paid annually unless the easement granted provides otherwise.

Terms of easements fixed by Land Commissioner and Board of Regents of University

Sec. 5. Hereafter all telephone, telegraph, electric transmission, power lines, and/or all pipeline right-of-way easements and easements or right-of-ways for irrigation canals, laterals, and water pipelines shall be executed on terms to be fixed by the Land Commissioner and by the Board of Regents of the University of Texas, respectively, but no oil and/or gas pipeline right-of-way easement, or sulphur pipeline right-of-way easement, telephone, telegraph, electric transmission and/or power line right-of-way easement shall be granted which does not provide for an annual privilege fee of not less than two and one-half cents (2½c) per lineal rod per annum of oil and/or gas pipeline for which a right-of-way is sought. A higher fee may be fixed by contract between the officials named and any grantee of such easement.

AGO 533903

Rentals for pumping stations, etc.

Sec. 6. The rental to be charged for an easement or lease for electric substation sites, pumping stations, loading racks, and tank farms shall be such as shall be agreed upon between the lessee and the Board of regents with respect to University lands, and the Commissioner of the General Land Office with respect to other State Lands.

Disposition of funds

Sec. 7. All income received by the Land Commissioner under this Act from Public School Land shall be credited to the Available School Fund; all income received by the Land Commissioner under this Act from University Lands shall be credited to the Available University Fund, and all income received by the Land Commissioner under this Act from the other lands herein set out shall be credited to the General Revenue Fund.

Interest on past due payments

Sec. 8. All past due payments under this Act shall bear interest at the rate of ten per centum (10%) per annum. In event the date of payment is not fixed by contract, or in event no written contract has been executed, all unpaid annual fees due shall bear interest at the rate of ten per centum (10%) calculated from the first day of January following the year for which such annual privilege fee was due.

Penalty for violations

Sec. 9. No person or corporation shall hereafter construct any telephone, telegraph, transmission and/or electric lines, pipeline, electric substation, tank farm, loading rack, and/or pumping station, irrigation canal, lateral, and water pipe line of the kind and character enumerated in Section 1 hereof across or on any section or part of a section of land of the character enumerated in Section 1 hereof and owned by the State of Texas, nor shall any person or corporation owning or possessing any telephone, telegraph, transmission, and/or electric lines, pipeline, electric substation, tank farm, loading rack, and/or pumping station, irrigation canal, lateral, and water pipeline of the kind and character enumerated in Section 1 hereof now lying and situated on or across any section or part of a section of land of the character enumerated in Section 1 hereof and owned by the State of Texas, who has not obtained a proper easement as herein provided for, continue in possession of any such lands without obtaining from the Commissioner of the General Land Office, or the Board of Regents of the University of Texas, respectively, a grant of a right-of-way easement or other easement across or on such lands where such telephone, telegraph, transmission and/or electric lines, pipeline, electric substation, tank farm, loading rack, or pumping station, irrigation canal, lateral, and water pipeline is to be constructed. Any person or corporation violating this section of this Act shall be liable for a penalty of One Hundred Dollars ($100) per day for each day of such violation, said penalty to be recovered by the Attorney General.

Venue of suits

Sec. 10. The venue of all suits by the State arising out of this Act, or for violation of any provision of this Act, is hereby fixed in Travis County. Acts 1933, 43rd Leg., p. 168, ch. 77; Acts 1943, 48th Leg., p. 275, ch. 147, § 1; Acts 1955, 54th Leg., p. 479, ch. 131, § 1.

AGO 533904

Art. 6021. Injury to roads, etc.

The right to run pipe lines, telegraph and telephone lines along, across or over any public road or highway can only be exercised upon condition that the traffic thereon be not interfered with, and that such road or highway be promptly restored to its former condition of usefulness, and the restoration thereof to be subject also to the supervision of the commissioners court or other proper local authority. In the exercise of the privileges herein conferred, such pipe lines shall compensate the county or road district, respectively, for any damage done to such public road. Nothing herein shall be construed to grant any pipe line company the right to use any public street or alley of any incorporated or unincorporated city or town, except by express permission from the governing body thereof. Acts 1917, p. 48.

Art. 6022. Eminent domain

Every person, firm, corporation, limited partnership, joint stock association, or association of any kind whatsoever owning, operating or managing any pipe line, or any part of any pipe line within this State for the transportation of crude petroleum that is declared by this title to be a common carrier, shall have the right and power of eminent domain in the exercise of which he, it or they may enter upon and condemn the lands, rights of way, easements and property of any person or corporation necessary for the construction, maintenance or operation of his, its or their common carrier pipe line; and shall have the right to lay his, its or their pipes or pipe lines under any railroad, railroad right of way, street railroad, canal or stream in this State; and along and under any street or alley in any incorporated city or town in this State with the consent and under the direction of the governing body of such city or town; and across and under any public road, provided that no pipes or pipe lines shall be laid parallel with and on any public highway closer than fifteen feet from the improved section thereof except with the approval and under the direction of the commissioners court of the county in which such public highway is located; and such other rights in the matter of laying pipes and pipe lines as are conferred by Article 1197, subject to the conditions, limitations and restrictions therein stated. Acts 1919, p. 273.

Art. 6023. Jurisdiction

Power and authority are hereby conferred upon the Railroad Commission of Texas, over all common carrier pipe lines conveying oil or gas in Texas, and over all oil and gas wells in Texas, and over all persons, associations or corporations owning or operating pipe lines in Texas, and over all persons, associations and corporations owning or engaged in drilling or operating oil or gas wells in Texas; and all such persons, associations and corporations and their pipe lines, oil and gas wells are subject to the jurisdiction conferred by law upon the Commission, and the Commission is authorized and empowered to make all necessary rules and regulations for the govern-

ment and regulation of such persons, associations and corporations and their operations, and the Attorney General shall enforce the provisions of this title by injunction or other adequate remedy and as otherwise provided by law. The word "Commission," as used in this title, shall mean the Railroad Commission of Texas. The word "Commissioner" shall mean any member of the Railroad Commission.

Art. 6024. Powers

In all matters pertaining to the discharge of its duties and the enforcement of its powers and authority as provided by the terms of this title, the Commission shall institute suits, hear and determine complaints, require the attendance of witnesses, pay their expenses out of the fund herein created, and sue out such writs and process as may be necessary for the enforcement of its orders, and punish for contempt or disobedience of its orders as the district court may do.

Art. 6025. Attendance of witnesses

If any witness fails or refuses to obey a subpoena from the Commission, or a Commissioner, the Commission or Commissioner may issue an attachment for such witness as in civil cases, and compel him to attend before the Commission or any Commissioner thereof, and give his testimony upon such matter as may be lawfully required of him, and to bring with him and produce on examination such records, books, vouchers, memoranda, true copies thereof, prints and such other matter as may be required, if any, in such subpoena.

Art. 6026. Criminating testimony

If a witness fails or refuses to attend on being summoned, or to answer any question propounded to him, or to produce any record or data required to be produced by such subpoena, the claim that any such testimony may tend to criminate the person giving it shall not excuse such witness from testifying or producing such records and data, but such evidence or testimony shall not be used against such person on the trial of any criminal proceeding.

Art. 6027. Witness fees

Each witness who shall appear before the Commission or a Commissioner at a place outside the county of his residence shall receive for his attendance three dollars per day and three cents per mile traveled by the nearest practicable route, in going to and returning from the place of meeting of said Commission or Commissioner, which shall be ordered paid, upon the presentation of proper vouchers, sworn to by such witness and approved by the Commission or chairman thereof, provided, that no witness shall be entitled to any witness fees or mileage who is directly or indirectly interested in any public utility involved in or concerning which, in any way, the investigation or hearing on account of which he is summoned, shall re-

late, or who is in anywise interested in any stock, bond, mortgages, security or earnings of any such utility, or who shall be the agent, attorney or employee of such utility, or any officer thereof, when summoned at the instance of such utility. No witness furnished with free transportation shall receive pay for the distance he may have traveled on such free transportation.

Art. 6028. Officer's fees

The sheriff or constable executing any process issued by the Commission or any Commissioner thereof under the provisions of this title shall receive such compensation as the Commission may allow.

Art. 6029. Rules and regulations

The Commission shall make and enforce rules, regulations or orders for the conservation of crude petroleum oil and natural gas and to prevent the waste thereof, including rules, regulations or orders for the following purposes:

(1) To prevent the waste, as hereinbefore defined, of crude petroleum oil and natural gas in drilling and producing operations and in the storage, piping and distribution thereof.

(2) To require dry or abandoned wells to be plugged in such way as to confine crude petroleum oil, natural gas, and water in the strata in which they are found and to prevent them from escaping into other strata.

(3) For the drilling of wells and preserving a record thereof.

(4) To require wells to be drilled and operated in such manner as to prevent injury to adjoining property.

(5) To prevent crude petroleum oil and natural gas and water from escaping from the strata in which they are found into other strata.

(6) To establish rules and regulations for shooting wells and for separating crude petroleum oil from natural gas.

(7) To require records to be kept and reports made.

(8) It shall do all things necessary for the conservation of crude petroleum oil and natural gas and to prevent the waste thereof, and shall make and enforce such rules, regulations or orders as may be necessary to that end.

(9) To provide for the issuance of permits, tenders, and other evidences of permission when the issuance of such permits, tenders, or permission is necessary or incident to the enforcement of its rules, regulations, or orders for the prevention of waste. Acts 1919, p. 285; Acts 1931, 42nd Leg., 1st C.S., p. 46, ch. 26, § 15; Acts 1932, 42nd Leg., 4th C.S., p. 3, ch. 2, § 7; Acts 1935, 44th Leg., p. 180, ch. 76, § 4.

Art. 6029a. Rules and regulations; drilling exploratory wells and wells; abandoning wells; pollution prevention

The Railroad Commission shall also make and enforce rules, regulations and orders in connection with the drilling of exploratory wells and wells for oil or gas or any purpose in connection therewith; the production of oil or gas; and the operation, abandonment and proper plugging of such wells to prevent the pollution of the streams and public bodies of surface water of the State, and any sub-surface water strata that are capable of producing water suitable for domestic or livestock use, or for irrigation of crops or for industrial use, which would or might result from the escape or release of crude petroleum oil, salt water or other mineralized waters from any such well, or from operations in connection therewith.

In all cases where an application to drill a new well, or to redrill or deepen an old well, is made to the Railroad Commission of Texas, and in all cases where an application is filed with the Railroad Commission of Texas to authorize the connection of any producing well or wells to a pipe line or other outlet by any operator who has acquired said producing well or wells, and in all cases where a well potential form is filed by any operator who has reworked and brought into production any previously non-producing well and thereby makes application for an allowable for production of oil and/or gas therefrom, the Railroad Commission, prior to approving any such application, may require the applicant or applicants to execute and file with the Railroad Commission a bond in the penal sum of Five Thousand Dollars ($5,000) for any such well to be so drilled or operated, or in lieu of a separate bond for each such well, a blanket bond in the penal sum of Ten Thousand Dollars ($10,000) to cover all wells drilled, to be drilled, and/or operated in the State of Texas, conditioned that the operator will plug and abandon said well in accordance with the laws of the State of Texas and the rules, regulations, and orders of the Railroad Commission. Each of such bonds shall be executed by a corporate surety authorized to do business in Texas, and shall be renewed and be continued in effect until the aforesaid conditions have been complied with or release of same is authorized by the Railroad Commission. The discretion of the Railroad Commission in requiring a bond hereunder shall be final and not subject to appeal. In the event that any well covered by any such bond is transferred, sold, or assigned by its operator, a new bond covering said well or wells may be required by the Railroad Commission of the party acquiring same, and the bond of the prior operator shall remain in effect until the new bond is so provided or the filing of same is waived.

The Railroad Commission is hereby authorized and directed to employ such additional personnel as may be necessary to the administration and enforcement of this Act and related laws and orders, rules and regulations adopted by the Commission. Added Acts 1955, 54th Leg., p. 1097, ch. 406, § 1.

Art. 6030. Supervisor and employees

The Commission shall employ a Chief Supervisor of its Oil and Gas Division to aid the Commission in the enforcement of the provision of this Act and all Oil or Gas Conservation Laws of Texas, and all rules, regulations and orders of said Commission made thereunder. He shall also perform the duties placed upon the pipe line expert as set out in the pipe line statutes of this State. The Commission may also appoint a Chief Deputy Supervisor and such other Deputy Supervisors as may be necessary to assist in carrying out the provisions of this Act and related Statutes and shall employ such other assistants and clerical help as may be necessary for the same purpose. The salary of the Chief Supervisor and of Chief Deputy Supervisor and of the Deputy Supervisors shall be fixed by the Legislature in its appropriation bill for the Railroad Commission; provided such salaries shall not exceed the following amounts: That of the Chief Supervisor shall be Six Thousand ($6,000.00) dollars per annum, that of the Chief Deputy Supervisor shall be Five Thousand ($5,000.00) Dollars per annum, and that of the Deputy Supervisors shall be Thirty-six Hundred ($3,600.00) dollars each per annum. In addition to any other qualifications that may be required by the Commission, no one shall hereafter be appointed Chief Supervisor who has not had at least five years experience in some line of the oil or gas business, or in some other business or profession calculated to fit him for the performance of his duties. No one shall hereafter be appointed as Chief Deputy Supervisor who has not had at least three years experience in oil and gas field work, and no one shall hereafter be appointed deputy supervisor who has not had at least two years experience in oil and gas field work, a substantial portion of which shall be in the drilling or production department. All salaries and other expenses of every kind and character necessary in the administration and enforcement of this Act shall be paid out of the funds created in Chapter 30, Acts of 1917, being now Article 6032, Revised Civil Statutes of 1925, and in the manner therein provided. The Chief Supervisor, Chief Deputy Supervisor and all Deputy Supervisors and all other employees shall perform the duties prescribed by the Railroad Commission and in conformity to the rules and regulations of the Commission dealing with the production, transportation and conservation of crude oil and natural gas. As amended Acts 1929, 41st Leg., p. 694, ch. 313, § 3.

Art. 6031. Duties of supervisor

The supervisor and his deputies shall supervise the plugging of all abandoned wells and the shooting of wells and conform to the rules and regulations of the Commission, dealing with the production and conservation of oil and gas. The supervisor shall gather information, and assist the Commission in the performance of its duties under this title. Acts 1919, p. 285.

Art. 6033. Certificate of compliance

Owners or operators of oil or gas wells shall, before connecting with any oil or gas pipe line, secure from the Commission a certificate showing compliance with the oil or gas conservation laws of the State and conservation rules, regulations and orders of the Commission. No operator of a pipe line or other carrier shall connect with any oil or gas well until the owner or operator of such well shall furnish a certificate from the Commission that such conservation laws and such rules, regulations and orders have been complied with; provided, this Section shall not prevent a temporary connection with any well in order to take care of production and prevent waste until opportunity shall have been given the owner or operator of such well to secure such certificate.

The Commission shall have the power to cancel any certificate of compliance issued under the provisions of this Section when it appears that the owner or operator of a well covered by the provisions of same has violated or is violating, in connection with the operation of said well or the production of oil or gas therefrom, any of the oil or gas conservation laws of this State or any of the rules, regulations or orders of the Commission promulgated thereunder. Upon notice from the Commission to the operator of any pipe line or other carrier connected to any such oil or gas well that the certificate of compliance with reference to such well has been cancelled by the Commission, the operator of such pipe line or other carrier shall disconnect from such well and it shall be unlawful for the operator of such pipe line or other carrier to transport oil therefrom until a new certificate of compliance has been issued by the Commission. Upon notice from the Commission that a certificate of compliance as to any oil or gas well has been cancelled by it as herein provided, it shall be unlawful for the owner or operator of such well to produce oil or gas therefrom until a new certificate of compliance covering such well has been issued by the Commission as herein provided. Acts 1919, p. 285; Acts 1935, 44th Leg., p. 180, ch. 76, § 11.

Art. 6034. Books and records

All owners and operators of oil and gas wells shall keep books, showing accurately the amount of stock sold and unsold and amount of promotion money paid, amount of oil and gas produced and disposed of, with the price for which the same was sold, together with the receipts from the sale or transfer of leases or other property, and the disbursements made in connection with or for the benefit of such business; which books shall be kept open for the inspection of the Commission or any accredited representative thereof, and of any stockholder or shareholder or royalty owner in said business, and shall report such information to the Commission for its information when required by the Commission to do so. Acts 1919, p. 287; Acts 2nd C.S.1919, p. 79.

Art. 6035. Report to Commission

Any person, firm, partnership, joint stock association, corporation or other organization, domestic or foreign, operating wholly or partially within this State, acting as principal or agent for another, for the purpose of drilling, owning or operating any oil or gas well, or owning or controlling leases of oil and mineral rights or the

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transportation of oil or gas by pipe line, shall immediately file with the Commission the name of the company or organization, giving the name and post-office address of the organization, the plan under which it was organized, and the names and post-office addresses of the trustee or trustees thereof, and the names and post-office addresses of the officers and directors. Id.

Art. 6036. Penalty

In addition to being subject to any forfeiture that may be provided for by law and to any penalty that may be imposed by the Commission for contempt for the violation of its rules, regulations, or orders, any person violating any of the provisions of this Act or of Title 102, Revised Civil Statutes of Texas, 1925, as amended, or violating any rule, regulation, or order of the Commission promulgated thereunder, shall be subject to a penalty of not more than One Thousand Dollars ($1000) for each and every day of such violation, and for each and every act of such violation, to be recovered in any Court of competent jurisdiction in Travis County, or in the county of the residence of the defendant or, if there be more than one defendant, in the county of the residence of any of them, or in the county in which the violation is alleged to have occurred, such suit by direction of the Commission to be instituted and conducted in the name of the State of Texas by the Attorney General or by the county or district attorney where such suit is brought. The recovery or payment of any such penalty shall not authorize the violation of any provision of this Act, or Title 102, Revised Civil Statutes of Texas, 1925, as amended, or of any rule, regulation, or order of the Commission promulgated thereunder.

Any person aiding or abetting any other person in the violation of this Act, or of Title 102, Revised Civil Statutes of Texas, 1925, as amended, or of any rule, regulation, or order of the Commission promulgated thereunder, shall be subject to the same penalties as are prescribed herein for violation thereof by any such other person. Acts 1919, p. 287; Acts 1929, 41st Leg., p. 691, ch. 313, § 4; Acts 1931, 42nd Leg., 1st C.S., p. 46, ch. 26, § 3; Acts 1933, 43rd Leg., 3rd C.S., p. 120, ch. 64, § 2; Acts 1935, 44th Leg., p. 180, ch. 76, § 12.

Art. 6036a. Notice of hearing

No rule, regulation or order shall be adopted by the Commission under the provisions of this Act or of Title 102 of the Revised Civil Statutes of Texas, 1925, as amended, dealing with the conservation of oil and gas and the prevention of the waste thereof, except after hearing upon at least ten (10) days notice given in the manner and form prescribed by the Commission; provided that in case an emergency is found by the Commission to exist which, in its judgment requires the making of a rule, regulation or order without notice and hearing, such emergency rule, regulation or order may be promulgated and shall have the same validity as if a hearing with respect to the same had been held after due notice. The emergency rule, regulation or order authorized herein shall remain in force no longer than fifteen (15) days from its effective date, and, in any event, it shall expire when the rule, regulation or order made after due notice and hearing with respect to the subject matter of such emergency rule, regulation or order becomes effective.

The Commission may, without prior notice, revoke any rule, regulation or order promulgated by it; and it may, without prior notice, amend the same, provided the subject matter of the amendment was considered at the hearing made the basis for such rule, regulation or order. The renewal or extension of any rule, regulation or order shall be based upon a hearing after proper notice, subject to the provisions of this Section with reference to emergency rules, regulations and orders. Acts 1929, 41st Leg., p. 694, ch. 313, § 5; Acts 1935, 44th Leg., p. 180, ch. 76, § 7.

Art. 6038. Hearing, notice

No order establishing or prescribing rates, rules and regulations shall be made except after hearing and at least ten days and not more than thirty days notice to the person, firm, corporation, partnership, joint stock association, or association, owning or controlling and operating the pipe line or pipe lines affected. Acts 1917, p. 48.

Art. 6039. Reimbursement, when

If any rate shall be filed by a pipe line and complaint against same or petition to reduce same shall be filed by a shipper, and such complaint be sustained, in whole or in part, all shippers who shall have paid the rates so filed by the pipe line shall have the right to

Art. 6040. Exchange of facilities

Every common carrier as above defined shall exchange crude petroleum tonnage with each like common carrier and the Commission is authorized to require such connections and facilities for the interchange of such tonnage to be made at every locality reached by both pipe lines whenever a necessity therefor exists and subject to such rates and regulations as may be made by the Commission; and any such common carrier under like rules and regulations shall be required to install and maintain facilities for the receipt and delivery of crude petroleum of patrons at all points on such pipe line. Id.

Art. 6041. Grades of oil carried

No carrier shall be required to receive or transport any crude petroleum except such as may be marketable under rules and regulations to be prescribed by the Commission, and the Commission shall make rules for the ascertainment of the amount of water and other foreign matter in oil tendered for transportation, and for deduction therefor and for the amount of deduction to be made for temperature, leakage and evaporation. Id.

Art. 6042. Powers not limited

Particular powers herein granted to the Commission shall not be construed to limit the general powers conferred by law, and until set aside or vacated by some order or decree of a court of competent jurisdiction, all orders of the Commission as to any matter within its jurisdiction shall be accepted as prima facie evidence of their validity. Id.

Art. 6043. Publication of tariffs

Such common carriers of crude petroleum shall make and publish their tariffs under such rules and regulations as the Commission may prescribe, and the Commission shall require them to make reports, and may investigate their books and records kept in connection with such business. Id.

Art. 6044. Monthly reports

The Commission shall require of such common carrier pipe lines duly verified monthly reports of the total quantities of crude petroleum owned by such pipe lines and of that held by them in storage for others, as also of their unfilled storage capacity, but no publicity shall be given by the Commission as to stock of crude petroleum on hand of any particular pipe line; but the Commission in its discretion may make public the aggregate amounts held by all pipe lines making such reports, and of their aggregate storage capacity. Id.

Art. 6045. Discrimination prohibited

No such common carrier in its operations as such shall discriminate between or against shippers in regard to facilities furnished or service rendered or rates charged under the same or similar circumstances in the transportation of crude petroleum; nor shall there be any discrimination in the transportation of crude petroleum produced or purchased by itself directly or indirectly. In this connection the pipe line shall be considered as a shipper of the crude petroleum produced or purchased by itself directly or indirectly and handled through its facilities. No such carrier in such operations shall directly or indirectly charge, demand, collect or receive from any one a greater or less compensation for any service rendered than from another for a like and contemporaneous service; provided, this shall not limit the right of the Commission to prescribe rates and regulations different from or to some places from other rates or regulations for transportation from or to other places, as it may determine; nor shall any carrier be guilty of discrimination when obeying any order of the Commission. When there shall be offered for transportation more crude petroleum than can be immediately transported, the same shall be equitably apportioned. The Commission may make and enforce general or specific regulations in this regard. No such common carrier shall at any time be required to receive for shipment from any person, firm, corpora-

Art. 6046. Rules for prevention of waste

The Commission, when necessary, shall make and enforce rules and regulations either general in their nature or applicable to particular oil fields for the prevention of actual waste of oil or operations in the field dangerous to life or property. Id.

Art. 6047. Penalty

Any common carrier as herein defined who shall violate any provision of this law, or who shall fail to perform any duty herein imposed, or any valid order of the Commission when not stayed or suspended by order of court, shall be subject to a penalty of not less than one hundred nor more than one thousand dollars for each offense, recoverable in the name of the State. Such penalty may also be recovered by and for the use of any person, corporation or association of persons against whom there shall have been an unlawful discrimination as herein defined; such suit to be brought in the name of and for the use of the party aggrieved. Id.

Art. 6048. Transportation of crude petroleum

Subject to the provisions of the law and the rules or regulations which may be prescribed by the Commission, every such common carrier shall receive and transport crude petroleum delivered to it for transportation and shall so receive and transport same and perform its other duties with respect thereto without discrimination. Id.

Art. 6049. Salary of expert and other expenses

The salary of the expert for the Commission and all other employees shall be paid out of the fund created under Article 6032, by monthly warrants drawn by the Comptroller on the State Treasurer. All other expenses incurred in the administration and enforcement of the provisions of this subdivision shall be paid out of the same fund by like warrants issued upon duly verified statements of the persons entitled, with the approval of the chairman.

Art. 6049a. Regulating storage tanks for hire and pipe lines as public utilities

Public utilities, who declared

Sec. 1. Every person, association of persons, or corporation owning, operating or managing any crude petroleum storage tanks or storage facilities for the public for hire, either in connection with a pipe line, pipe lines, or otherwise, is hereby declared to be a public utility, subject to the provisions of this law.

Discrimination forbidden

Sec. 2. No such public utility in its operations as such shall discriminate between or against its patrons in regard to facilities furnished or services rendered, or rates charged under the same similar circumstances, in the storage of crude petroleum.

Bond required for conformity to regulations

Sec. 3. All such public utilities as herein defined shall within thirty days after this Act takes effect, or in case of persons, associations or corporations, hereafter engaging in such business, before they actually engage therein, file a bond which shall not exceed Twenty-five Thousand Dollars ($25,000.00), properly executed, payable to the State of Texas, the amount of such bond and the sureties thereon to be subject to the approval of the Railroad Commission of the State of Texas. The amount of such bond may be chang-

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ed from time to time by order of the Railroad Commission, after notice and hearing as prescribed by Article 6038, Revised Civil Statutes, in accordance with the volume of business done, or to be done, by such public utility and such bond or securities in lieu thereof as provided by Article 836 of the Revised Civil Statutes of Texas, shall be approved by the Railroad Commission before it is filed. Such bond shall be conditioned that the utility will observe the provisions of this law and the rules of the Railroad Commission in so far as its business is regulated and controlled by such Commission, and that the utility will exercise ordinary care in the storage, preservation, handling and delivery of all petroleum products entrusted to it and shall guarantee the classification, measurements and grades made by such public utility, under its authority in conformity herewith. The bond shall be for the benefit of the patrons of such utility and their assignees as though they were named obligees therein and they shall severally have the right of suit thereon.

Regulations by Railroad Commission

Sec. 4. The Railroad Commission of Texas shall establish and enforce rules and regulations governing the character of facilities to be furnished by such utilities, the forms of receipts to be issued by them, the rates, charges and regulations for the storage of crude petroleum by such public utilities in respect to their storage facilities and for the inspection, grading, measurement, deductions for waste or deterioration, the delivery of such products, and it shall also exercise such power upon petition of any person showing a substantial interest in the subject matter thereof.

Lien for storage charges

Sec. 5. Any such public utility shall have a lien on the commodity in its possession to secure it in the payment of all proper storage charges against such commodity, and/or the transportation charges accrued to or paid or advanced by it, superior to all other liens thereon, except lien for taxes.

Monthly statements as to quantity of petroleum

Sec. 6. Every common carrier of crude petroleum within this State as defined by law and every public utility as defined herein shall on or before the twentieth day of each calendar month file with the Railroad Commission of Texas, and post in a conspicuous place, accessible to the general public, in each of its division offices, and in its principal office in this State, a statement, duly verified, containing the following information concerning its business during the preceding calendar month:

1. How much petroleum, crude or refined, was in the actual and immediate custody of such carrier or public utility at the beginning and close of such month, and where same was located or held, including the location and designation of each tank or place of deposit, and the name of its owner.

2. How much petroleum, crude or refined, was received by such carrier or public utility during such month.

3. How much petroleum, crude or refined, was delivered by such carrier or public utility during such month.

4. What quantity of such petroleum, crude or refined, is held by it for the account of itself or parent or affiliated organizations.

5. The available empty storage owned or controlled by it and where located.

6. The foregoing information shall be set out in each statement separately as to crude petroleum and each refined product thereof.

Rates established by Railroad Commission after hearings

Sec. 6a. The Commission shall establish and promulgate rates of charges and regulations for gathering, transporting, loading and delivering crude petroleum by such common carriers in this State, and for the use of storage facilities necessarily incident to such transportation, and prescribe and enforce rules and regulations for the government and control of such common carriers in respect to their pipe line and receiving, transferring and loading facilities. Such rates shall include both single and joint line transportation, deductions for evaporation and shrinkage, demurrage, storage, and overage, charges, and all other similar items. The basis of such rates shall be such as will provide a fair return upon the aggregate value of the property of any such carrier used and useful in the services performed after providing reasonable allowance for depreciation and other proper factors, and for reasonable operating expenses under honest, efficient and economical management, and provided further that the Commission shall have reasonable latitude in the establishment and adjustment of competitive rates.

Immediately after this Act shall become effective it shall be the duty of the Commission to hold hearings as to rates now charged and shall reset them on all existing and operating lines, in accordance with the preceding article, taking into consideration the past earnings of such carrier.

When any carrier makes application or files tariff to establish a new rate, either for a new or old line, a temporary rate may be placed into effect immediately upon filing said tariff with the Commission. If any rates shall be filed, shippers who have paid the rates so filed by the pipe line company shall have the right to reparation or reimbursement of all excess rates or transportation charges so paid over and above the rate as finally determined on all shipments. When any person or persons at interest hereafter file an application for a change in a rate or rates the Commission shall call a hearing or hearings and shall immediately thereafter establish and promulgate a rate or rates in accordance with the basis herein set out. The Commission, shall on its own motion or motion of any interested person, hold a hearing or hearings when it has reason to believe that any rate or rates do not conform to the basis herein set out, said hearings or hearing to be for the purpose of adjusting, establishing and promulgating a proper rate or rates, and said Commission shall hold a general hearing once each year for the purpose of adjusting all rates to conform to the basis of rates and charges as herein set out. Article 6037, Revised Civil Statutes, is hereby repealed.

No common carriers by pipe line within this State shall hereafter abandon any of its connections or lines except under authority of a permit granted by the Railroad Commission, or with written consent of the owner or duly authorized agent of the wells to which connections are made. Before granting any such permit the Railroad Commission shall issue notice and have a hearing as now provided for in Section 6038 of the Revised Civil Statutes of Texas for 1925.

Hearing by Commission as to enlargement or extension of facilities

Sec. 7. The Railroad Commission of Texas may, after hearing in a proceeding upon complaint by a party at interest, or upon its own initiative without complaint, and after notice and hearing as provided by Article 6038, Revised Civil Statutes of Texas, 1925, authorize or require by order any person, association of persons, or corporation owning or operating pipe lines in the State of Texas, which is a common carrier as defined by law, or owning, operating, or managing any crude petroleum storage tanks, or crude petroleum facilities for the public for hire, to extend or enlarge such pipe lines, or storage facilities, provided such extension or enlargement shall be found to be reasonable and required in the public interest and that the expense involved will not impair the ability of such common carrier or public utility to perform its duty to the public.

Common purchaser of petroleum defined; discrimination forbidden

Sec. 8. Every person, association of persons or corporation who purchases crude oil or petroleum in this State, which is affiliated through stock-ownership, common control, contract, or otherwise, with a common carrier by pipe line, as defined by law, or is itself such common carrier, shall be a common purchaser of such crude petroleum and shall purchase oil offered it for purchase without discrimination in favor of one producer or person as against another in the same field, and without unjust or unreasonable discrimination as between fields in this State; the question of justice or reasonableness to be determined by the Railroad Commission, taking into consideration the production and age of wells in respective fields and all other proper factors. It shall be unlawful for any such common purchaser to discriminate between or against crude oil or petroleum of a similar kind or quality in favor of its own production, or production in which it may be directly or indirectly interested, either in whole or in part, but for the purpose of prorating the purchase of crude oil or petroleum to be marketed, such production shall be taken in like manner as that of any other person or producer and shall be taken in the ratable proportion that such production bears to the total production offered for market in such field. The Railroad Commission of Texas shall have authority, however, to relieve any such common purchaser, after due notice and hearing as hereinafter provided, from the duty of purchasing petroleum of inferior quality or grade.

Purchases under regulations prescribed by Commission

Sec. 8a. That in order to further conserve the natural gas resources of this State every person, association of persons, joint stock company, limited co-partnership, partnership, corporation, gas pipe line company or gas purchaser now, or hereafter, claiming or exercising the right to carry or transport natural gas by pipe line, or pipe lines, for hire, compensation or otherwise within the limits of this State, or which is now engaged or shall hereafter engage in the business of purchasing, or taking, natural gas, or residue gas or casinghead gas shall be a common purchaser thereof, and shall purchase, or take, such gas under such rules or regulations as may be prescribed by the Commission, in the same manner, under the same inhibitions against discriminations and subject to the same provisions as are herein set out with respect to common purchasers of oil.

Additional persons as common purchasers; rates and charges

Sec. 8aa. In addition to persons enumerated in Section 8 hereof, any and all persons, associations of persons, or corporations operating any crude oil gathering system, whether by pipeline or by truck, other than persons, associations of persons, or corporations transporting only crude oil from properties in which any such person, association of persons, or corporation owns an operating interest, which may now or hereafter purchase crude oil or petroleum in this state, whether they be common carriers or affiliated with common carriers shall be a common purchaser of such crude oil or petroleum offered for purchase without discrimination in favor of one producer or person as against another in the same field and without unjust or unreasonable discrimination as between fields in this state as provided in Section 8 hereof. Such common purchasers shall be subject to the same regulation concerning rates and charges for gathering, transporting, loading and delivering crude petroleum as set out in Section 6a hereof. As amended Acts 1965, 59th Leg., p. 611, ch. 303, § 1.

Effective Aug. 30, 1965, 90 days after date of adjournment.

Operation of gathering systems for crude petroleum

Sec. 8aaa. It is declared that the operation of gathering systems for crude petroleum by pipeline or by truck in connection with the purchase, or purchase and sale of crude petroleum, is a business in the mode of the conduct of which the public is interested, and as such is subject to regulation by law; and accordingly it is provided that from and after the expiration of thirty (30) days from the time this law takes effect the business of purchasing, or of purchasing and selling crude petroleum by the use of a gathering system for crude petroleum, whether by pipeline or by truck, shall not be conducted, unless the person, association of persons or corporation operating such gathering system so used in connection with such business be a common purchaser within the purview of this law and subject to the jurisdiction herein conferred upon the Commission; provided, however, the operation of any crude oil gathering system by persons, association of persons or corporation transporting only crude oil from properties in which any such person, association of persons or corporation owns an operating interest, shall not be deemed to be in the business of purchasing, or of purchasing and selling crude petroleum, within the meaning of this Article. Added Acts 1965, 59th Leg., p. 611, ch. 303, § 2.

Rules and regulations by Railroad Commission

Sec. 8b. It shall be the duty of the Railroad Commission of Texas to see that the provisions of this Act are fully complied with, and it shall have the power, after notice and hearing, to make rules, regulations and orders, defining the distance that extensions or gathering lines shall be made to all oil or gas wells; and such other rules, regulations or orders as may be necessary to carry out the provisions of this Act, and to prevent discrimination in purchases.

Anti-trust laws unaffected

Sec. 8bb. It is expressly provided that no provision of this Act shall be construed as in any wise modifying, limiting, changing, repealing, or affecting any part of the present laws of this State defining and regulating trusts, monopolies, and conspiracies in restraint of trade; and that no provision of this Act shall be construed as authorizing any agreement and/or combination of capital, skill, or acts and/or any combination or consolidation now prohibited by the Anti-trust Laws of this State and/or the laws of this State prohibiting trusts, monopolies, and/or conspiracies in restraint of trade; and that no provision of this Act is intended or shall be construed as authorizing any agreement, act, combination, consolidation, or otherwise, which is now prohibited under the Anti-trust Laws of this State and/or the laws prohibiting and defining trusts, monopolies and/or conspiracies in restraint of trade.

Restrictions as to oil transported

Sec. 8c. No person, association of persons or corporation, whether a common carrier or otherwise, shall be permitted to transport crude oil or petroleum in this State unless such crude oil or petroleum has been produced and or purchased in accordance with the laws of the State of Texas and/or any order, rule or regulation of the Railroad Commission made in pursuance thereof.

Enforcement by Railroad Commission

Sec. 9. The Railroad Commission of Texas shall have authority to make rules and regulations for the enforcement of the provisions of this Act.

Commission's jurisdiction to hear complaints

Sec. 10. Any person, association of persons or corporation, or the Attorney General of Texas on behalf of the State, may institute proceedings before the Railroad Commission, or apply for a hearing before said Commission, upon any question relating to the enforcement of this Act, and jurisdiction is hereby conferred upon said Commission to hear and determine the same after the notice provided by Article 6038, Revised Civil Statutes of Texas. The Commission shall not make any order establishing, prescribing or modifying rates, rules or regulations, as herein provided, except upon like notice and hearing as provided in said Article 6038.

Penalty for violations

Sec. 11. For the violation of any provision of this Act, or for the violation of any valid rule or regulation promulgated hereunder or any order passed by the Railroad Commission in pursuance of any such provision, rule or regulation, such person, association of persons, or corporation shall be subject to a penalty of not less than One Hundred Dollars ($100.00) nor more than One Thousand Dollars ($1000.00) for each offense recoverable in the name of the State in any District Court in Travis County, Texas, and each day of such violation shall constitute a separate offense. One half of such penalty may be recovered by and for the use of any person, association of persons or corporation against whom there shall have been an unlawful discrimination as herein defined, such suit to be brought in the name of and for the use of the party or parties aggrieved.

Attorney General may institute proceedings for forfeiture of charter for violations

Sec. 11a. For any violation of any provision of this Act, or for the violation of any valid rule or regulation promulgated hereunder by the Railroad Commission, in pursuance of such provision, by any domestic corporation, which is a common purchaser as defined herein, the Attorney General may bring suit in the District Court of Travis County, Texas, for the purpose of forfeiting the charter of such corporation, and enjoining and forever prohibiting such corporation from doing business in this State, and if adjudged guilty by the Court before whom the action is brought, the charter of such corporation may be forfeited and the injunction may be granted, provided said forfeiture and injunction shall be in addition to all other penalties.

Forfeiture of charters of foreign corporations

Sec. 11b. For any violation of any provision of this Act, or for the violation of any valid rule or regulation promulgated hereunder by the Railroad Commission in pursuance of such provision, by any foreign corporation, which is a common purchaser as defined herein, the Attorney General may bring suit in the District Court of Travis County for the purpose of cancelling the permit of such corporation and of enjoining and forever prohibiting such corporation from doing business in this State, and if adjudged guilty by the Court before whom the action is brought, the permit may be cancelled and the injunction may be granted, provided said cancellation and injunction shall be in addition to all other penalties.

Actions for damages for discriminations

Sec. 11c. When any person, persons, association or corporation is discriminated against by a common purchaser as defined herein in favor of the production of said common purchaser, a cause of action for damages, when such has occurred, shall lie against said common purchaser and said person, persons, association or corporation may bring suit for same in any court of competent jurisdiction in the county in which the damage occurred.

Prevention of discrimination

Sec. 11d. The Railroad Commission shall make inquiry in each field concerning the connections of the various producers and when discrimination is found to be practiced by any common purchaser as defined in this Act the said Railroad Commission shall issue an order to such common purchaser to make such reasonable extensions of their lines, such reasonable connections and such ratable purchases as will prevent such discrimination. The Commission may issue a show cause order to any common purchaser requesting it to appear and show cause why it should not purchase the allowable production of any producer so discriminated against. As amended Acts 1965, 59th Leg., p. 611, ch. 303, § 3.

Effective Aug. 30, 1965, 90 days after date of adjournment.

Duties and responsibilities of common purchasers, purchasers, gatherers or transporters

Sec. 11dd. Notwithstanding the provisions of any Statute or law, including Article 6049a, Revised Civil Statutes, 1925, as amended, none of the provisions of this Act shall increase or decrease the duties or responsibilities of any common purchaser, purchaser, gatherer or transporter of natural gas, residue gas, or casinghead gas. Added Acts 1965, 59th Leg., p. 611, ch. 303, § 4.

Injunction by Attorney General to prevent discrimination

Sec. 11e. The Railroad Commission shall, upon information that discrimination is practiced in its purchases by any common purchaser, request the Attorney General to bring a mandatory injunction suit against said common purchaser to compel such reasonable extensions as are necessary to prevent discrimination.

Receiver at instance of Commission for violation of regulations

Sec. 11f. Whenever, any order, rule or regulation promulgated by the Commission pursuant to this Act has been finally adjudged to be valid, in whole or in part, in any suit to which the Commission is a party, and thereafter any party to the suit or other proceedings in which such matter has been so adjudged, shall violate such rule, regulation, order or judgment, or shall suffer any property owned or controlled by him to be used in violation of any such rule, regulation, order or judgment, the Commission shall have the power, and it shall be its duty, to make, application to the Judge of the trial court,

lation, order, or judgment, and shall fix a proper bond for such receiver. As soon as such receiver has qualified, he shall take possession of such property, and such receiver thereafter shall perform his duties as receiver of such property under the orders of said court, strictly observing such rule, regulation, order or judgment. Any party whose property has been so placed in the hands of a receiver may move to dissolve such receivership and discharge the receiver only upon showing that such party has not wilfully violated nor suffered property owned or controlled by him to be used in violating such rule, regulation, order or judgment or upon other good cause shown. In its discretion such court may, before dissolving such receivership or discharging such receiver, require the party applying for such dissolution or discharge to give bond with good and sufficient sureties in an amount to be fixed by the court, sufficient reasonably to indemnify all persons who may suffer damage by reason of the violation of the rule, regulation or order so adjudged to be valid. In determining the amount of such bond, the judge shall take into consideration all of the facts and circumstances surrounding the parties which he may deem necessary to determine the reasonableness of the amount of such bond and any bond so executed, if made by any bonding or surety company, shall be by some company authorized to do business in Texas. Such bond shall be made payable to, and be approved by, the judge of said court and shall be for the use and benefit of, and may be sued on, by all persons who may suffer damage by reason of any further violation by the party giving the bond of the rule, regulation or order so adjudged to be valid, and who may bring suit thereon. From time to time on motion the court may increase or decrease the amount of such bond, and may require new or additional sureties as the facts may warrant or justify.

Discrimination as to royalty oil forbidden

Sec. 11g. Any common purchaser of oil or gas as herein defined shall, in making purchases of royalty oil, comply with all the provisions of this Act, and shall not discriminate between royalty and/or land owners in making such purchases. Neither shall said common purchaser unreasonably delay payments to said land and/or royalty owner for said oil or gas purchased. For violation whereof in addition to the other penalties herein set out, the land and royalty owner or owners damaged thereby shall have a cause of action against said common purchaser for damages and may file suit for same in any court of competent jurisdiction in the county where the royalty lies.

Provisions applicable to enforcement

Sec. 11h. All the provisions of Title 102 of the Revised Civil Statutes as amended shall apply in the enforcement of this Act.

ALASKA PIPELINE FEDERAL CONFERENCE

93D CONGRESS
1st Session
HOUSE OF REPRESENTATIVES
REPORT
No. 93-617

AMENDING SECTION 28 OF THE MINERAL LEASING ACT OF 1920, AND TO AUTHORIZE THE TRANS-ALASKA PIPELINE

OCTOBER 31, 1973.—Ordered to be printed

Mr. MELCHER, from the committee of conference, submitted the following

CONFERENCE REPORT

[To accompany S. 1081]

The committee of conference on the disagreeing votes of the two Houses on the amendment of the House to the bill (S. 1081) to authorize the Secretary of the Interior to grant rights-of-way across Federal lands where the use of such rights-of-way is in the public interest and the applicant for the right-of-way demonstrates the financial and technical capability to use the right-of-way in a manner which will protect the environment, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows::

That the Senate recede from its disagreement to the amendment of the House and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the House amendment insert the following:

TITLE I

SECTION 101. Section 28 of the Mineral Leasing Act of 1920 (41 Stat. 449), as amended (30 U.S.C. 185), is further amended to read as follows:

"Grant of Authority

"SEC. 28. (a) Rights-of-way through any Federal lands may be granted by the Secretary of the Interior or appropriate agency head for pipeline purposes for the transportation of oil, natural gas, synthetic liquid or gaseous fuels, or any refined product produced therefrom to any applicant possessing the qualifications provided in section 1 of this Act, as amended, in accordance with the provisions of this section.

"Definitions

"(b)(1) For the purposes of this section 'Federal lands' means all lands owned by the United States except lands in the National Park

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System, lands held in trust for an Indian or Indian tribe, and lands on the Outer Continental Shelf. A right-of-way through a Federal reservation shall not be granted if the Secretary or agency head determines that it would be inconsistent with the purposes of the reservation.

"(2) 'Secretary' means the Secretary of the Interior.

"(3) 'Agency head' means the head of any Federal department or independent Federal office or agency, other than the Secretary of the Interior, which has jurisdiction over Federal lands.

"Inter-Agency Coordination

"(c)(1) Where the surface of all of the Federal lands involved in a proposed right-of-way or permit is under the jurisdiction of one Federal agency, the agency head, rather than the Secretary, is authorized to grant or renew the right-of-way or permit for the purposes sets forth in this section.

"(2) Where the surface of the Federal lands involved is administered by the Secretary or by two or more Federal agencies, the Secretary is authorized, after consultation with the agencies involved, to grant or renew rights-of-way or permits through the Federal lands involved. The Secretary may enter into interagency agreements with all other Federal agencies having jurisdiction over Federal lands for the purpose of avoiding duplication, assigning responsibility, expediting review of rights-of-way or permit applications, issuing joint regulations, and assuring a decision based upon a comprehensive review of all factors involved in any right-of-way or permit application. Each agency head shall administer and enforce the provisions of this section, appropriate regulations, and the terms and conditions of rights-of-way or permits insofar as they involve Federal lands under the agency head's jurisdiction.

"Width Limitations

"(d) The width of a right-of-way shall not exceed fifty feet plus the ground occupied by the pipeline (that is, the pipe and its related facilities) unless the Secretary or agency head finds, and records the reasons for his finding, that in his judgment a wider right-of-way is necessary for operation and maintenance after construction, or to protect the environment or public safety. Related facilities include but are not limited to valves, pumpstations, supporting structures, bridges, monitoring and communication devices, surge and storage tanks, terminals, roads, airstrips and campsites, and they need not necessarily be connected or contiguous to the pipe and may be the subjects of separate rights-of-way.

"Temporary Permits

"(e) A right-of-way may be supplemented by such temporary permits for the use of Federal lands in the vicinity of the pipeline as the Secretary or agency head finds are necessary in connection with construction, operation, maintenance, or termination of the pipeline, or to protect the natural environment or public safety.

"Regulatory Authority

"(f) Rights-of-way or permits granted or renewed pursuant to this section shall be subject to regulations promulgated in accord with the provisions of this section and shall be subject to such terms and conditions as the Secretary or agency head may prescribe regarding extent, duration, survey, location, construction, operation, maintenance, use, and termination.

"Pipeline Safety

"(g) The Secretary or agency head shall impose requirements for the operation of the pipeline and related facilities in a manner that will protect the safety of workers and protect the public from sudden ruptures and slow degradation of the pipeline.

"Environmental Protection

"(h)(1) Nothing in this section shall be construed to amend, repeal, modify, or change in any way the requirements of section 102(2)(C) or any other provision of the National Environmental Policy Act of 1969 (Public Law 91-190, 83 Stat. 852).

"(2) The Secretary or agency head, prior to granting a right-of-way or permit pursuant to this section for a new project which may have a significant impact on the environment, shall require the applicant to submit a plan of construction, operation, and rehabilitation for such right-of-way or permit which shall comply with this section. The Secretary or agency head shall issue regulations or impose stipulations which shall include, but shall not be limited to: (A) requirements for restoration, revegetation, and curtailment of erosion of the surface of the land; (B) requirements to insure that activities in connection with the right-of-way or permit will not violate applicable air and water quality standards nor related facility siting standards established by or pursuant to law; (C) requirements designed to control or prevent (i) damage to the environment (including damage to fish and wildlife habitat), (ii) damage to public or private property, and (iii) hazards to public health and safety; and (D) requirements to protect the interests of individuals living in the general area of the right-of-way or permit who rely on the fish, wildlife, and biotic resources of the area for subsistence purposes. Such regulations shall be applicable to every right-of-way or permit granted pursuant to this section, and may be made applicable by the Secretary or agency head to existing rights-of-way or permits, or rights-of-way or permits to be renewed pursuant to this section.

"Disclosure

"(i) If the applicant is a partnership, corporation, association, or other business entity, the Secretary or agency head shall require the applicant to disclose the identity of the participants in the entity. Such disclosure shall include where applicable (1) the name and address of each partner, (2) the name and address of each shareholder

owning 3 per centum or more of the shares, together with the number and percentage of any class of voting shares of the entity which such shareholder is authorized to vote, and (3) the name and address of each affiliate of the entity together with in the case of an affiliate controlled by the entity, the number of shares and the percentage of any class of voting stock of that affiliate owned, directly or indirectly, by that entity, and, in the case of an affiliate which controls that entity, the number of shares and the percentage of any class of voting stock of that entity owned, directly or indirectly, by the affiliate.

"Technical and Financial Capability

"(j) The Secretary or agency head shall grant or renew a right-of-way or permit under this section only when he is satisfied that the applicant has the technical and financial capability to construct, operate, maintain, and terminate the project for which the right-of-way or permit is requested in accordance with the requirements of this section.

"Public Hearings

"(k) The Secretary or agency head by regulation shall establish procedures, including public hearings where appropriate, to give Federal, State, and local government agencies and the public adequate notice and an opportunity to comment upon right-of-way applications filed after the date of enactment of this subsection.

"Reimbursement of Costs

"(l) The applicant for a right-of-way or permit shall reimburse the United States for administrative and other costs incurred in processing the application, and the holder of a right-of-way or permit shall reimburse the United States for the costs incurred in monitoring the construction, operation, maintenance, and termination of any pipeline and related facilities on such right-of-way or permit area and shall pay annually in advance the fair market rental value of the right-of-way or permit, as determined by the Secretary or agency head.

"Bonding

"(m) Where he deems it appropriate the Secretary or agency head may require a holder of a right-of-way or permit to furnish a bond, or other security, satisfactory to the Secretary or agency head to secure all or any of the obligations imposed by the terms and conditions of the right-of-way or permit or by any rule or regulation of the Secretary or agency head.

"Duration of grant

"(n) Each right-of-way or permit granted or renewed pursuant to this section shall be limited to a reasonable term in light of all circumstances concerning the project, but in no event more than thirty years. In determining the duration of a right-of-way the Secretary or agency head shall, among other things, take into consideration the cost of the facility, its useful life, and any public purpose it serves. The Secre-

tary or agency head shall renew any right-of-way, in accordance with the provisions of this section, so long as the project is in commercial operation and is operated and maintained in accordance with all of the provisions of this section.

"Suspension or Termination of Right-of-Way

"(o)(1) Abandonment of a right-of-way or noncompliance with any provision of this section may be grounds for suspension or termination of the right-of-way if (A) after due notice to the holder of the right-of-way, (B) a reasonable opportunity to comply with this section, and (C) an appropriate administrative proceeding pursuant to title 5, United States Code, section 554, the Secretary or agency head determines that any such ground exists and that suspension or termination is justified. No administrative proceeding shall be required where the right-of-way by its terms provides that it terminates on the occurrence of a fixed or agreed upon condition, event, or time.

"(2) If the Secretary or agency head determines that an immediate temporary suspension of activities within a right-of-way or permit area is necessary to protect public health or safety or the environment, he may abate such activities prior to an administrative proceeding.

"(3) Deliberate failure of the holder to use the right-of-way for the purpose for which it was granted or renewed for any continuous two-year period shall constitute a rebuttable presumption of abandonment of the right-of-way: Provided, That where the failure to use the right-of-way is due to circumstances not within the holder's control the Secretary or agency head is not required to commence proceedings to suspend or terminate the right-of-way.

"Joint Use of Rights-of-Way

"(p) In order to minimize adverse environmental impacts and the proliferation of separate rights-of-way across Federal lands, the utilization of rights-of-way in common shall be required to the extent practical, and each right-of-way or permit shall reserve to the Secretary or agency head the right to grant additional rights-of-way or permits for compatible uses on or adjacent to rights-of-way or permit area granted pursuant to this section.

"Statutes

"(q) No rights-of-way for the purposes provided for in this section shall be granted or renewed across Federal lands except under and subject to the provisions, limitations, and conditions of this section. Any application for a right-of-way filed under any other law prior to the effective date of this provision may, at the applicant's option, be considered as an application under this section. The Secretary or agency head may require the applicant to submit any additional information he deems necessary to comply with the requirements of this section.

"Common Carriers

"(r)(1) Pipelines and related facilities authorized under this section shall be constructed, operated, and maintained as common carriers.

"(2)(A) *The owners or operators of pipelines subject to this section shall accept, convey, transport, or purchase without discrimination all oil or gas delivered to the pipeline without regard to whether such oil or gas was produced on Federal or non-Federal lands.*

"(*B*) *In the case of oil or gas produced from Federal lands or from the resources on the Federal lands in the vicinity of the pipeline, the Secretary may, after a full hearing with due notice thereof to the interested parties and a proper finding of facts, determine the proportionate amounts to be accepted, conveyed, transported or purchased.*

"(3)(A) *The common carrier provisions of this section shall not apply to any natural gas pipeline operated by any person subject to regulation under the Natural Gas Act or by any public utility subject to regulation by a State or municipal regulatory agency having jurisdiction to regulate the rates and charges for the sale of natural gas to consumers within the State or municipality.*

"(*B*) *Where natural gas not subject to State regulatory or conservation laws governing its purchase by pipelines is offered for sale, each such pipeline shall purchase, without discrimination, any such natural gas produced in the vicinity of the pipeline.*

"(4) *The Government shall in express terms reserve and shall provide in every lease of oil lands under this Act that the lessee, assignee, or beneficiary, if owner or operator of a controlling interest in any pipeline or of any company operating the pipeline which may be operated accessible to the oil derived from lands under such lease, shall at reasonable rates and without discrimination accept and convey the oil of the Government or of any citizen or company not the owner of any pipeline operating a lease or purchasing gas or oil under the provisions of this Act.*

"(5) *Whenever the Secretary has reason to believe that any owner or operator subject to this section is not operating any oil or gas pipeline in complete accord with its obligations as a common carrier hereunder, he may request the Attorney General to prosecute an appropriate proceeding before the Interstate Commerce Commission or Federal Power Commission or any appropriate State agency or the United States district court for the district in which the pipeline or any part thereof is located, to enforce such obligation or to impose any penalty provided therefor, or the Secretary may, by proceeding as provided in this section, suspend or terminate the said grant of right-of-way for noncompliance with the provisions of this section.*

"(6) *The Secretary or agency head shall require, prior to granting or renewing a right-of-way, that the applicant submit and disclose all plans, contracts, agreements, or other information or material which he deems necessary to determine whether a right-of-way shall be granted or renewed and the terms and conditions which should be included in the right-of-way. Such information may include, but is not limited to: (A) conditions for, and agreements among owners or operators, regarding the addition of pumping facilities, looping, or otherwise increasing the pipeline or terminal's throughput capacity in response to actual or anticipated increases in demand; (B) conditions for adding or abandoning intake, offtake, or storage points or facilities; and (C) minimum shipment or purchase tenders.*

"*Right-of-Way Corridors*

"(*s*) *In order to minimize adverse environmental impacts and to prevent the proliferation of separate rights-of-way across Federal*

lands, the Secretary shall, in consultation with other Federal and State agencies, review the need for a national system of transportation and utility corridors across Federal lands and submit a report of his findings and recommendations to the Congress and the President by July 1, 1975.

"Existing Rights-of-Way

"(t) The Secretary or agency head may ratify and confirm any right-of-way or permit for an oil or gas pipeline or related facility that was granted under any provision of law before the effective date of this subsection, if it is modified by mutual agreement to comply to the extent practical with the provisions of this section. Any action taken by the Secretary or agency head pursuant to this subsection shall not be considered a major Federal action requiring a detailed statement pursuant to section 102(2)(C) of the National Environmental Policy Act of 1970 (Public Law 90-190; 42 U.S.C. 4321).

"Limitations on Export

"(u) Any domestically produced crude oil transported by pipeline over rights-of-way granted pursuant to section 28 of the Mineral Leasing Act of 1920, except such crude oil which is either exchanged in similar quantity for convenience or increased efficiency of transportation with persons or the government of an adjacent foreign state, or which is temporarily exported for convenience or increased efficiency of transportation across parts of an adjacent foreign state and reenters the United States, shall be subject to all of the limitations and licensing requirements of the Export Administration Act of 1969 (Act of December 30, 1969; 83 Stat. 841) and, in addition, before any crude oil subject to this section may be exported under the limitations and licensing requirements and penalty and enforcement provisions of the Export Administration Act of 1969 the President must make and publish an express finding that such exports will not diminish the total quantity or quality of petroleum available to the United States, and are in the national interest and are in accord with the provisions of the Export Administration Act of 1969: Provided, That the President shall submit reports to the Congress containing findings made under this section, and after the date of receipt of such report Congress shall have a period of sixty calendar days, thirty days of which Congress must have been in session, to consider whether exports under the terms of this section are in the national interest. If the Congress within this time period passes a concurrent resolution of disapproval stating disagreement with the President's finding concerning the national interest, further exports made pursuant to the aforementioned Presidential findings shall cease.

"State Standards

"(v) The Secretary or agency head shall take into consideration and to the extent practical comply with State standards for right-of-way construction, operation, and maintenance.

"Reports

"(w)(1) The Secretary and other appropriate agency heads shall report to the House and Senate Committees on Interior and Insular

Affairs annually on the administration of this section and on the safety and environmental requirements imposed pursuant thereto.

"(2) The Secretary or agency head shall notify the House and Senate Committees on Interior and Insular Affairs promptly upon receipt of an application for a right-of-way for a pipeline twenty-four inches or more in diameter, and no right-of-way for such a pipeline shall be granted until sixty days (not counting days on which the House of Representatives or the Senate has adjourned for more than three days) after a notice of intention to grant the right-of-way, together with the Secretary's or agency head's detailed findings as to terms and conditions he proposes to impose, has been submitted to such committees, unless each committee by resolution waives the wating period.

"(3) Periodically, but at least once a year, the Secretary of the Department of Transportation shall cause the examination of all pipelines and associated facilities on Federal lands and shall cause the prompt reporting of any potential leaks or safety problems.

"(4) The Secretary of the Department of Transportation shall report a... ually to the President, the Congress, the Secretary of the Interior, and the Interstate Commerce Commission any potential dangers of or actual explosions, or potential or actual spillage on Federal lands and shall include in such report a statement of corrective action taken to prevent such explosion or spillage.

"Liability

"(x)(1) The Secretary or agency head shall promulgate regulations and may impose stipulations specifying the extent to which holders of rights-of-way and permits under this Act shall be liable to the United States for damage or injury incurred by the United States in connection with the right-of-way or permit. Where the right-of-way or permit involves lands which are under the exclusive jurisdiction of the Federal Government, the Secretary or agency head shall promulgate regulations specifying the extent to which holders shall be liable to third parties for injuries incurred in connection with the right-of-way or permit.

"(2) The Secretary or agency head may, by regulation or stipulation, impose a standard of strict liability to govern activities taking place on a right-of-way or permit area which the Secretary or agency head determines, in his discretion, to present a foreseeable hazard or risk of danger to the United States.

"(3) Regulations and stipulations pursuant to this subsection shall not impose strict liability for damage or injury resulting from (A) an act of war, or (B) negligence of the United States.

"(4) Any regulation or stipulation imposing liability without fault shall include a maximum limitation on damages commensurate with the foreseeable risks or hazards presented. Any liability for damage or injury in excess of this amount shall be determined by ordinary rules of negligence.

"(5) The regulations and stipulations shall also specify the extent to which such holders shall indemnify or hold harmless the United States for liability, damage, or claims arising in connection with the right-of-way or permit.

"(6) Any regulation or stipulation promulgated or imposed pursuant to this section shall provide that all owners of any interest in, and all affiliates or subsidiaries of any holder of, a right-of-way or permit shall be liable to the United States in the event that a claim for damage or injury cannot be collected from the holder.

"(7) In any case where liability without fault is imposed pursuant to this subsection and the damages involved were caused by the negligence of a third party, the rules of subrogation shall apply in accordance with the law of the jurisdiction where the damage occurred.

"Antitrust Laws

"(y) The grant of a right-of-way or permit pursuant to this section shall grant no immunity from the operation of the Federal antitrust laws."

TITLE II

SHORT TITLE

SEC. 201. This title may be cited as the "Trans-Alaska Pipeline Authorization Act".

CONGRESSIONAL FINDINGS

SEC. 202. The Congress finds and declares that:

(a) The early development and delivery of oil and gas from Alaska's North Slope to domestic markets is in the national interest because of growing domestic shortages and increasing dependence upon insecure foreign sources.

(b) The Department of the Interior and other Federal agencies, have, over a long period of time, conducted extensive studies of the technical aspects and of the environmental, social, and economic impacts of the proposed trans-Alaska oil pipeline, including consideration of a trans-Canada pipeline.

(c) The earliest possible construction of a trans-Alaska oil pipeline from the North Slope of Alaska to Port Valdez in that State will make the extensive proven and potential reserves of low-sulfur oil available for domestic use and will best serve the national interest.

(d) A supplemental pipeline to connect the North Slope with a trans-Canada pipeline may be needed later and it should be studied now, but it should not be regarded as an alternative for a trans-Alaska pipeline that does not traverse a foreign country.

CONGRESSIONAL AUTHORIZATION

SEC. 203. (a) The purpose of this title is to insure that, because of the extensive governmental studies already made of this project and the national interest in early delivery of North Slope oil to domestic markets, the trans-Alaska oil pipeline be constructed promptly without further administrative or judicial delay or impediment. To accomplish this purpose it is the intent of the Congress to exercise its constitutional powers to the fullest extent in the authorizations and directions herein made and in limiting judicial review of the actions taken pursuant thereto.

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(b) The Congress hereby authorizes and directs the Secretary of the Interior and other appropriate Federal officers and agencies to issue and take all necessary action to administer and enforce rights-of-way, permits, leases, and other authorizations that are necessary for or related to the construction, operation, and maintenance of the trans-Alaska oil pipeline system, including roads and airstrips, as that system is generally described in the Final Environmental Impact Statement issued by the Department of the Interior on March 20, 1972. The route of the pipeline may be modified by the Secretary to provide during construction greater environmental protection.

(c) Rights-of-way, permits, leases, and other authorizations issued pursuant to this title by the Secretary shall be subject to the provisions of section 28 of the Mineral Leasing Act of 1920, as amended by title I of this Act (except the provisions of subsections (h)(1), (k), (q), (w)(2), and (x)); all authorizations issued by the Secretary and other Federal officers and agencies pursuant to this title shall include the terms and conditions required, and may include the terms and conditions permitted, by the provisions of law that would otherwise be applicable if this title had not been enacted, and they may waive any procedural requirements of law or regulation which they deem desirable to waive in order to accomplish the purposes of this title. The direction contained in section 203(b) shall supersede the provisions of any law or regulation relating to an administrative determination as to whether the authorizations for construction of the trans-Alaska oil pipeline shall be issued.

(d) The actions taken pursuant to this title which relate to the construction and completion of the pipeline system, and to the applications filed in connection therewith necessary to the pipeline's operation at full capacity, as described in the Final Environmental Impact Statement of the Department of the Interior, shall be taken without further action under the National Environmental Policy Act of 1969; and the actions of the Federal officers concerning the issuance of the necessary rights-of-way, permits, leases, and other authorizations for construction and initial operation at full capacity of said pipeline system shall not be subject to judicial review under any law except that claims alleging the invalidity of this section may be brought within sixty days following its enactment, and claims alleging that an action will deny rights under the Constitution of the United States, or that the action is beyond the scope of authority conferred by this title, may be brought within sixty days following the date of such action. A claim shall be barred unless a complaint is filed within the time specified. Any such complaint shall be filed in a United States district court, and such court shall have exclusive jurisdiction to determine such proceeding in accordance with the procedures hereinafter provided, and no other court of the United States, of any State, territory, or possession of the United States, or of the District of Columbia, shall have jurisdiction of any such claim whether in a proceeding instituted prior to or on or after the date of the enactment of this Act. Any such proceeding shall be assigned for hearing at the earliest possible date, shall take precedence over all other matters pending on the docket of the district court at that time, and shall be expedited in every way by such court. Such court shall not have

jurisdiction to grant any injunctive relief against the issuance of any right-of-way, permit, lease, or other authorization pursuant to this section except in conjunction with a final judgment entered in a case involving a claim filed pursuant to this section. Any review of an interlocutory or final judgment, decree, or order of such district court may be had only upon direct appeal to the Supreme Court of the United States.

(e) The Secretary of the Interior and the other Federal officers and agencies are authorized at any time when necessary to protect the public interest, pursuant to the authority of this section and in accordance with its provisions, to amend or modify any right-of-way, permit, lease, or other authorization issued under this title.

LIABILITY

SEC. 204. (a)(1) Except when the holder of the pipeline right-of-way granted pursuant to this title can prove that damages in connection with or resulting from activities along or in the vicinity of the proposed trans-Alaskan pipeline right-of-way were caused by an act of war or negligence of the United States, other government employee, or the damaged party, such holder shall be strictly liable to all damaged parties, public or private, without regard to fault for such damages, and without regard to ownership of any affected lands, structures, fish, wildlife, or biotic or other natural resources relied upon by Alaska Natives, Native organizations, or others for subsistence or economic purposes. Claims for such injury or damages may be determined by arbitration or judicial proceedings.

(2) Liability under paragraph (1) of this subsection shall be limited to $50,000,000 for any one incident, and the holders of the right-of-way or permit shall be liable for any claim allowed in proportion to their ownership interest in the right-of-way or permit. Liability of such holders for damages in excess of $50,000,000 shall be in accord with ordinary rules of negligence.

(3) In any case where liability without fault is imposed pursuant to this subsection and the damages involved were caused by the negligence of a third party, the rules of subrogation shall apply in accordance with the law of the jurisdiction where the damage occurred.

(4) Upon order of the Secretary, the holder of a right-of-way or permit shall provide emergency subsistence and other aid to an affected Alaska Native, Native organization, or other person pending expeditious filing of, and determination of, a claim under this subsection.

(5) Where the State of Alaska is the holder of a right-of-way or permit under this title, the State shall not be subject to the provisions of subsection 204(a), but the holder of the permit or right-of-way for the trans-Alaska pipeline shall be subject to that subsection with respect to facilities constructed or activities conducted under rights-of-way or permits issued to the State to the extent that such holder engages in the construction, operation, maintenance, and termination of facilities, or in other activities under rights-of-way or permits issued to the State.

(b) If any area within or without the right-of-way or permit area granted under this title is polluted by any activities conducted by

or on behalf of the holder to whom such right-of-way or permit was granted, and such pollution damages or threatens to damage aquatic life, wildlife, or public or private property, the control and total removal of the pollutant shall be at the expense of such holder, including any administrative and other costs incurred by the Secretary or any other Federal officer or agency. Upon failure of such holder to adequately control and remove such pollutant, the Secretary, in cooperation with other Federal, State, or local agencies, or in cooperation with such holder, or both, shall have the right to accomplish the control and removal at the expense of such holder.

(c)(1) Notwithstanding the provisions of any other law, if oil that has been transported through the trans-Alaska pipeline is loaded on a vessel at the terminal facilities of the pipeline, the owner and operator of the vessel (jointly and severally) and the Trans-Alaska Pipeline Liability Fund established by this subsection, shall be strictly liable without regard to fault in accordance with the provisions of this subsection for all damages, including clean-up costs, sustained by any person or entity, public or private, including residents of Canada, as the result of discharges of oil from such vessel.

(2) Strict liability shall not be imposed under this subsection if the owner or operator of the vessel, or the Fund, can prove that the damages were caused by an act of war or by the negligence of the United States or other governmental agency. Strict liability shall not be imposed under this subsection with respect to the claim of a damaged party if the owner or operator of the vessel, or the Fund, can prove that the damage was caused by the negligence of such party.

(3) Strict liability for all claims arising out of any one incident shall not exceed $100,000,000. The owner and operator of the vessel shall be jointly and severally liable for the first $14,000,000 of such claims that are allowed. Financial responsibility for $14,000,000 shall be demonstrated in accordance with the provisions of section 311(p) of the Federal Water Pollution Control Act, as amended (33 U.S.C. 1321(p)) before the oil is loaded. The Fund shall be liable for the balance of the claims that are allowed up to $100,000,000. If the total claims allowed exceed $100,000,000, they shall be reduced proportionately. The unpaid portion of any claim may be asserted and adjudicated under other applicable Federal or state law.

(4) The Trans-Alaska Pipeline Liability Fund is hereby established as a non-profit corporate entity that may sue and be sued in its own name. The Fund shall be administered by the holders of the trans-Alaska pipeline right-of-way under regulations prescribed by the Secretary. The Fund shall be subject to an annual audit by the Comptroller General, and a copy of the audit shall be submitted to the Congress.

(5) The operator of the pipeline shall collect from the owner of the oil at the time it is loaded on the vessel a fee of five cents per barrel. The collection shall cease when $100,000,000 has been accumulated in the Fund, and it shall be resumed when the accumulation in the Fund falls below $100,000,000.

(6) The collections under paragraph (5) shall be delivered to the Fund. Costs of administration shall be paid from the money paid to the Fund, and all sums not needed for administration and the satisfaction of claims shall be invested prudently in income-producing securi-

ties approved by the Secretary. Income from such securities shall be added to the principal of the Fund.

(7) The provisions of this subsection shall apply only to vessels engaged in transportation between the terminal facilities of the pipeline and ports under the jurisdiction of the United States. Strict liability under this subsection shall cease when the oil has first been brought ashore at a port under the jurisdiction of the United States.

(8) In any case where liability without regard to fault is imposed pursuant to this subsection and the damages involved were caused by the unseaworthiness of the vessel or by negligence, the owner and operator of the vessel, and the Fund, as the case may be, shall be subrogated under applicable State and Federal laws to the rights under said laws of any person entitled to recovery hereunder. If any subrogee brings an action based on unseaworthiness of the vessel or negligence of its owner or operator, it may recover from any affiliate of the owner or operator, if the respective owner or operator fails to satisfy any claim by the subrogee allowed under this paragraph.

(9) This subsection shall not be interpreted to preempt the field of strict liability or to preclude any State from imposing additional requirements.

(10) If the Fund is unable to satisfy a claim asserted and finally determined under this subsection, the Fund may borrow the money needed to satisfy the claim from any commercial credit source, at the lowest available rate of interest, subject to approval of the Secretary.

(11) For purposes of this subsection only, the term "affiliate" includes—

(A) Any person owned or effectively controlled by the vessel owner or operator; or

(B) Any person that effectively controls or has the power effectively to control the vessel owner or operator by—

(i) stock interest, or

(ii) representation on a board of directors or similar body, or

(iii) contract or other agreement with other stockholders, or

(iv) otherwise; or

(C) Any person which is under common ownership or control with the vessel owner or operator.

(12) The term "person" means an individual, a corporation, a partnership, an association, a joint-stock company, a business trust, or an unincorporated organization.

ANTITRUST LAWS

SEC. 205. The grant of a right-of-way, permit, lease, or other authorization pursuant to this title shall grant no immunity from the operation of the Federal anti-trust laws.

ROADS AND AIRPORTS

SEC. 206. A right-of-way, permit, lease, or other authorization granted under section 203(b) for a road or airstrip as a related facility of the trans-Alaska pipeline may provide for the construction of a public road or airstrip.

TITLE III—NEGOTIATIONS WITH CANADA

SEC. 301. The President of the United States is authorized and requested to enter into negotiations with the Government of Canada to determine—

(a) the willingness of the Government of Canada to permit the construction of pipelines or other transportation systems across Canadian territory for the transport of natural gas and oil from Alaska's North Slope to markets in the United States, including the use of tankers by way of the Northwest Passage;

(b) the need for intergovernmental understandings, agreements, or treaties to protect the interests of the Governments of Canada and the United States and any party or parties involved with the construction, operation, and maintenance of pipelines or other transportation systems for the transport of such natural gas or oil;

(c) the terms and conditions under which pipelines or other transportation systems could be constructed across Canadian territory;

(d) the desirability of undertaking joint studies and investigations designed to insure protection of the environment, reduce legal and regulatory uncertainty, and insure that the respective energy requirements of the people of Canada and of the United States are adequately met;

(e) the quantity of such oil and natural gas from the North Slope of Alaska for which the Government of Canada would guarantee transit; and

(f) the feasibility, consistent with the needs of other sections of the United States, of acquiring additional energy from other sources that would make unnecessary the shipment of oil from the Alaskian pipeline by tanker into the Puget Sound area.

The President shall report to the House and Senate Committees on Interior and Insular Affairs the actions taken, the progress achieved, the areas of disagreement, and the matters about which more information is needed, together with his recommendations for further action.

SEC. 302. (a) The Secretary of the Interior is authorized and directed to investigate the feasibility of one or more oil or gas pipelines from the North Slope of Alaska to connect with a pipeline through Canada that will deliver oil or gas to United States markets.

(b) All costs associated with making the investigations authorized by subsection (a) shall be charged to any future applicant who is granted a right-of-way for one of the routes studied. The Secretary shall submit to the House and Senate Committees on Interior and Insular Affairs periodic reports of his investigation, and the final report of the Secretary shall be submitted within two years from the date of this Act.

SEC. 303. Nothing in this title shall limit the authority of the Secretary of the Interior or any other Federal official to grant a gas or oil pipeline right-of-way or permit which he is otherwise authorized by law to grant.

TITLE IV—MISCELLANEOUS

VESSEL CONSTRUCTION STANDARDS

SEC. 401. Section 4417a of the Revised Statutes of the United States (46 U.S.C. 391a), as amended by the Ports and Waterways Safety Act

of 1972 (86 Stat. 424, Public Law 92-340), is hereby amended as follows:

"(C) Rules and regulations published pursuant to subsection (7) (A) shall be effective not earlier than January 1, 1974, with respect to foreign vessels and United States-flag vessels operating in the foreign trade, unless the Secretary shall earlier establish rules and regulations consonant with international treaty, convention, or agreement, which generally address the regulation of similar topics for the protection of the marine environment. In absence of the promulgation of such rules and regulations consonant with international treaty, convention, or agreement, the Secretary shall establish an effective date not later than January 1, 1976, with respect to foreign vessels and United States-flag vessels operating in the foreign trade, for rules and regulations previously published pursuant to this subsection (7) which he then deems appropriate. Rules and regulations published pursuant to subsection (7) (A) shall be effective not later than June 30, 1974, with respect to United States-flag vessels engaged in the coastwise trade.".

VESSEL TRAFFIC CONTROL

SEC. 402. The Secretary of the Department in which the Coast Guard is operating is hereby directed to establish a vessel traffic control system for Prince William Sound and Valdez, Alaska, pursuant to authority contained in title I of the Ports and Waterways Safety Act of 1972 (86 Stat. 424, Public Law 92-340).

CIVIL RIGHTS

SEC. 403. The Secretary of the Interior shall take such affirmative action as he deems necessary to assure that no person shall, on the grounds of race, creed, color, national origin, or sex, be excluded from receiving, or participating in any activity conducted under, any permit, right-of-way, public land order, or other Federal authorization granted or issued under title II. The Secretary of the Interior shall promulgate such rules as he deems necessary to carry out the purposes of this subsection and may enforce this subsection, and any rules promulgated under this subsection, through agency and department provisions and rules which shall be similar to those established and in effect under title VI of the Civil Rights Act of 1964.

CONFIRMATION OF THE DIRECTOR OF THE ENERGY POLICY OFFICE

SEC. 404. The Director of the Energy Policy Office in the Executive Office of the President shall be appointed by the President, by and with the advice and consent of the Senate: Provided, That if any individual who is serving in this office on the date of enactment of this Act is nominated for such position, he may continue to act unless and until such nomination shall be disapproved by the Senate.

CONFIRMATION OF THE HEAD OF THE MINING ENFORCEMENT AND SAFETY ADMINISTRATION

SEC. 405. The head of the Mining Enforcement and Safety Administration established pursuant to Order Numbered 2953 of the Secretary of the Interior issued in accordance with the authority provided by section 2 of Reorganization Plan Numbered 3 of 1950 (64 Stat. 1262) shall be appointed by the President, by and with the advice and con-

sent of the Senate: Provided, That if any individual who is serving in this office on the date of enactment of this Act is nominated for such position, he may continue to act unless and until such nomination shall be disapproved by the Senate.

EXEMPTION OF FIRST SALE OF CRUDE OIL AND NATURAL GAS OF CERTAIN LEASES FROM PRICE RESTRAINTS AND ALLOCATION PROGRAMS

SEC. 406. (a) The first sale of crude oil and natural gas liquids produced from any lease whose average daily production of such substances for the preceding calendar month does not exceed ten barrels per well shall not be subject to price restraints established pursuant to the Economic Stabilization Act of 1970, as amended, or to any allocation program for fuels or petroleum established pursuant to that Act or to any Federal law for the allocation of fuels or petroleum.

(b) To qualify for the exemption under this section, a lease must be operating at the maximum feasible rate of production and in accord with recognized conservation practices.

(c) The agency designated by the President or by law to implement any such fuels or petroleum allocation program is authorized to conduct inspections to insure compliance with this section and shall promulgate and cause to be published regulations implementing the provisions of this section.

ADVANCE PAYMENTS TO ALASKA NATIVES

SEC. 407. (a) In view of the delay in construction of a pipeline to transport North Slope crude oil, the sum of $5,000,000 is authorized to be appropriated from the United States Treasury into the Alaska Native Fund every six months of each fiscal year beginning with the fiscal year ending June 30, 1976, as advance payments chargeable against the revenues to be paid under section 9 of the Alaska Native Claims Settlement Act, until such time as the delivery of North Slope crude oil to a pipeline is commenced.

(b) Section 9 of the Alaskan Native Claims Settlement Act is amended by striking the language in subsection (g) thereof and substituting the following language: "The payments required by this section shall continue only until a sum of $500,000,000 has been paid into the Alaska Native Fund less the total of advance payments paid into the Alaska Native Fund pursuant to section 407 of the Trans-Alaska Pipeline Authorization Act. Thereafter, payments which would otherwise go into the Alaska Native Fund will be made to the United States Treasury as reimbursement for the advance payments authorized by section 407 of the Trans-Alaskan Pipeline Authorization Act. The provisions of this section shall no longer apply, and the reservation required in patents under this section shall be of no further force and effect, after a total sum of $500,000,000 has been paid to the Alaska Native Fund and to the United States Treasury pursuant to this subsection.".

FEDERAL TRADE COMMISSION AUTHORITY

SEC. 408. (a)(1) The Congress hereby finds that the investigative and law enforcement responsibilities of the Federal Trade Commission have been restricted and hampered because of inadequate legal authority to enforce subpenas and to seek preliminary injunctive relief to avoid unfair competitive practices.

(2) *The Congress further finds that as a direct result of this inadequate legal authority significant delays have occurred in a major investigation into the legality of the structure, conduct, and activities of the petroleum industry, as well as in other major investigations designed to protect the public interest.*

(b) *It is the purpose of this Act to grant the Federal Trade Commission the requisite authority to insure prompt enforcement of the laws the Commission administers by granting statutory authority to directly enforce subpenas issued by the Commission and to seek preliminary injunctive relief to avoid unfair competitive practices.*

(c) *Section 5(l) of the Federal Trade Commission Act (15 U.S.C. 45(l)) is amended by striking subsection (l) and inserting in lieu thereof:*

"(l) *Any person, partnership, or corporation who violates an order of the Commission after it has become final, and while such order is in effect, shall forfeit and pay to the United States a civil penalty of not more than $10,000 for each violation, which shall accrue to the United States and may be recovered in a civil action brought by the Attorney General of the United States. Each separate violation of such an order shall be a separate offense, except that in the case of a violation through continuing failure to obey or neglect to obey a final order of the Commission, each day of continuance of such failure or neglect shall be deemed a separate offense. In such actions, the United States district courts are empowered to grant mandatory injunctions and such other and further equitable relief as they deem appropriate in the enforcement of such final orders of the Commission.*"

(d) *Section 5 of the Federal Trade Commission Act (15 U.S.C. 45) is amended by adding at the end thereof the following new subsection:*

"(m) *The Commission shall have the power to initiate, prosecute, defend, or appeal any court action in the name of the Commission for the purpose of enforcing the laws subject to its jurisdiction through its own legal representative, after formally notifying and consulting with and giving the Attorney General 10 days to take the action proposed by the Commission.*"

(e) *Section 6 of the Federal Trade Commission Act (15 U.S.C. 46), is amended by adding at the end thereof the following provisio: "Provided, That the exception of 'banks and common carriers subject to the Act to regulate commerce' from the Commission's powers defined in clauses (a) and (b) of this section, shall not be construed to limit the Commission's authority to gather and compile information, to investigate, or to require reports or answers from, any such corporation to the extent that such action is necessary to the investigation of any corporation, group of corporations, or industry which is not engaged or is engaged only incidentally in banking or in business as a common carrier subject to the Act to regulate commerce.*"

(f) *Section 13 of the Federal Trade Commission Act (15 U.S.C. 53) is amended by redesignating "(b)" as "(c)" and inserting the following new subsection:*

"(b) *Whenever the Commission has reason to believe—*

"(1) *that any person, partnership, or corporation is violating, or is about to violate, any provision of law enforced by the Federal Trade Commission, and*

"(2) *that the enjoining thereof pending the issuance of a complaint by the Commission and until such complaint is dismissed by*

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the Commission or set aside by the court on review, or until the order of the Commission made thereon has become final, would be in the interest of the public—

the Commission by any of its attorneys designated by it for such purpose may bring suit in a district court of the United States to enjoin any such act or practice. Upon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest, and after notice to the defendant, a temporary restraining order or a preliminary injunction may be granted without bond: Provided, however, That if a complaint is not filed within such period (not exceeding 20 days) as may be specified by the court after issuance of the temporary restraining order or preliminary injunction, the order or injunction shall be dissolved by the court and be of no further force and effect: Provided further, That in proper cases the Commission may seek, and after proper proof, the court may issue, a permanent injunction. Any such suit shall be brought in the district in which such person, partnership, or corporation resides or transacts business."

(g) Section 16 of the Federal Trade Commission Act (15 U.S.C. 56) is amended to read as follows:

"SEC. 16. Whenever the Federal Trade Commission has reason to believe that any person, partnership, or corporation is liable to a penalty under section 14 or under subsection (l) of section 5 of this Act, it shall—

"(a) certify the facts to the Attorney General, whose duty it shall be to cause appropriate proceedings to be brought for the enforcement of the provisions of such section or subsection; or

"(b) after compliance with the requirements with Section 5(m), itself cause such appropriate proceedings to be brought."

GENERAL ACCOUNTING OFFICE AUTHORITY

SEC. 409. (a) Section 3502 of title 44, United States Code is amended by inserting in the first paragraph defining "Federal agency" after the words "the General Accounting Office" and before the words "nor the governments" the words "independent Federal regulatory agencies,".

(b) Chapter 35 of title 44, United States Code, is amended by adding after section 3511 the following new section:

"§ 3512. Information for independent regulatory agencies

"(a) The Comptroller General of the United States shall review the collection of information required by independent Federal regulatory agencies described in section 3502 of this chapter to assure that information required by such agencies is obtained with a minimum burden upon business enterprises, especially small business enterprises, and other persons required to furnish the information. Unnecessary duplication of efforts in obtaining information already filed with other Federal agencies or departments through the use of reports, questionnaires, and other methods shall be eliminated as rapidly as practicable. Information collected and tabulated by an independent regulatory agency shall, as far as is expedient, be tabulated in a manner to maximize the usefulness of the information to other Federal agencies and the public.

"(b) *In carrying out the policy of this section, the Comptroller General shall review all existing information gathering practices of independent regulatory agencies as well as requests for additional information with a view toward—*

"(1) *avoiding duplication of effort by independent regulatory agencies, and*

"(2) *minimizing the compliance burden on business enterprises and other persons.*

"(c) *In complying with this section, an independent regulatory agency shall not conduct or sponsor the collection of information upon an identical item from ten or more persons, other than Federal employees, unless, in advance of adoption or revision of any plans or forms to be used in the collection—*

"(1) *the agency submitted to the Comptroller General the plans or forms, together with the copies of pertinent regulations and of other related materials as the Comptroller General has specified; and*

"(2) *the Comptroller General has advised that the information is not presently available to the independent agency from another source within the Federal Government and has determined that the proposed plans or forms are consistent with the provision of this section. The Comptroller General shall maintain facilities for carrying out the purposes of this section and shall render such advice to the requestive independent regulatory agency within forty-five days.*

"(d) *While the Comptroller General shall determine the availability from other Federal sources of the information sought and the appropriateness of the forms for the collection of such information, the independent regulatory agency shall make the final determination as to the necessity of the information in carrying out its statutory responsibilities and whether to collect such information. If no advice is received from the Comptroller General within forty-five days, the independent regulatory agency may immediately proceed to obtain such information.*

"(e) *Section 3508(a) of this chapter dealing with unlawful disclosure of information shall apply to the use of information by independent regulatory agencies.*

"(f) *The Comptroller General may promulgate rules and regulations necessary to carry out this chapter.*"

EQUITABLE ALLOCATION OF NORTH SLOPE CRUDE OIL

SEC. 410. The Congress declares that the crude oil on the North Slope of Alaska is an important part of the Nation's oil resources, and that the benefits of such crude oil should be equitably shared, directly or indirectly, by all regions of the country. The President shall use any authority he may have to insure an equitable allocation of available North Slope and other crude oil resources and petroleum products among all regions and all of the several States.

SEPARABILITY

SEC. 411. If any provision of this Act or the applicability thereof is held invalid the remainder of this Act shall not be affected thereby.

And the House agree to the same.

That the Senate recede from its disagreement to the amendment of the House to the title of the bill and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the amendment of the House to the title of the bill insert the following:

"*To amend section 28 of the Mineral Leasing Act of 1920, and to authorize a trans-Alaska oil pipeline, and for other purposes*".

And the House agree to the same.

JAMES A. HALEY,
JOHN MELCHER,
HAROLD T. JOHNSON,
MORRIS K. UDALL,
JOHN P. SAYLOR,
SAM STEIGER,
DON YOUNG,
Managers on the Part of the House.

HENRY M. JACKSON,
ALAN BIBLE,
J. BENNETT JOHNSTON, JR.,
FLOYD K. HASKELL,
PAUL J. FANNIN,
CLIFFORD P. HANSEN,
MARK O. HATFIELD,
Managers on the Part of the Senate.

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JOINT STATEMENT OF THE COMMITTEE OF CONFERENCE

The managers on the part of the House and the Senate at the conference on the disagreeing votes of the two Houses on the amendment of the House to the bill (S. 1081) to authorize the Secretary of the Interior to grant rights-of-way across Federal lands where the use of such rights-of-way is in the public interest and the applicant for the right-of-way demonstrates the financial and technical capability to use the right-of-way in a manner which will protect the environment, submit this joint statement in explanation of the effect of the language agreed upon by the managers and recommended in the accompanying conference report.

I. Major Provisions

The language agreed upon by the Conference Committee differs from the bill enacted by the Senate and the amendment enacted by the House in the following respects:

1. The Senate bill enacted a completely new system for granting rights-of-way across Federal lands. It applied to rights-of-way for many different purposes.

The House amendment applied only to rights-of-way for oil and gas pipelines. It took the form of an amendment to section 28 of the Mineral Leasing Act of 1920, which is the principal authority for granting oil and gas pipeline rights-of-way across public lands.

The Conferees adopted the House approach, but expanded it to include pipelines for oil, gas, synthetic liquid or gaseous fuels and refined products therefrom in anticipation of developments in coal gasification and liquification, oil shale, and tar sands. It is the understanding of the Conferees, however, that the House will consider broader right-of-way legislation in connection with other bills that are presently pending.

2. The Senate bill applied to all lands owned by the United States except five specified categories. The House amendment retained the present language of the Mineral Leasing Act of 1920, which applies to "public lands, including forest reserves." The meaning of this phrase is not completely clear, but it clearly does not apply to lands acquired by the United States, as distinguished from the public domain.

The Conferees adopted the Senate approach, but excluded three categories rather than five categories of land. The three categories excluded are the National Park System, the Outer Continental Shelf, and Indian lands. The two categories of land that were not excluded are the National Wildlife Refuge System and the National Wilderness Preservation System, both of which are presently subject to the Mineral Leasing Act. The Conferees provided, however, that rights-

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of-way through reserved areas may not be granted if they would be inconsistent with the purposes of the reservation.

3. The Conferees combined and adopted the guidelines governing the grant of rights-of-way that were contained in the Senate bill and in the House amendment. The two sets of guidelines, while different in some respects, are compatible, and both are intended to spell out in greater statutory detail policies that were formerly left to administrative determination. None of the House guidelines was omitted.

4. Both the Senate bill and the House amendment provided for the immediate grant of a Trans-Alaska oil pipeline right-of-way without further proceedings under the National Environmental Protection Act and with only a limited right of judicial review. The Conferees merged the provisions of the two Houses without making major substantive changes.

5. Both the Senate bill and the House amendment provided for further study and negotiations with respect to possible additional oil and gas pipelines from the North Slope of Alaska, through Canada, to the Midwest. The Conferees merged the provisions of the two Houses without making substantial changes. The results of the negotiations and investigations are intended to serve as comparative information in the evaluation of the best possible methods for future transportation of North Slope energy resources to United States markets, and the bill is not intended to confer any special status on a trans-Canada route in the selection process for future pipelines.

6. The Senate bill had a number of miscellaneous provisions that were not directly related to oil pipeline rights-of-way. The House amendment had no comparable provisions. The Conferees' action was as follows:

(a) The Senate provision amending the Ports and Waterways Safety Act of 1972 with respect to vessel construction standards, and the provision directing the Coast Guard to exercise its present authority to establish a vessel traffic control system for the Valdez area, were adopted.

(b) The provisions requiring Senate confirmation of the Director of the Energy Policy Office in the Executive Office of the President, and the head of the Mining Enforcement and Safety Administration, were adopted.

(c) The provision exempting the first sale of oil and gas from stripper wells from the price restraints of the Economic Stabilization Act of 1970, and from any allocation program, was adopted. A stripper well is defined as a well with an average daily production during the preceding month of not more than ten barrels. In order to qualify for the exemption the lease must be operating at a maximum feasible rate of production and in accord with recognized conservation practices.

(d) The provision amending the Alaska Native Claims Settlement Act and providing for advance payments to Natives was adopted, after reducing the amount of the advance payments from $7,500,000 each six months to $5,000,000, after delaying the starting time for the payments from the beginning of fiscal year 1975 to the beginning of fiscal year 1976, and after deleting the provision making the advance payments a gift if transportation of oil through the pipeline does not commence by December 31, 1976.

(e) The provision amending the Federal Trade Commission Act was adopted, with amendments. It increased the civil penalty for violating a final order of the Commission, gave the Commission broader authority to initiate injunction actions and enforce subpoenas, and gave the Commission authority to represent itself in court if the Attorney General failed to do so after ten days notice.

(f) The provision amending the Federal Reports Act was adopted. It substituted the Comptroller General for the Office of Management and Budget in reviewing questionnaires proposed to be issued by independent Federal regulatory agencies. The regulatory agency will determine whether it needs the information, but it may not send its questionnaire if the Comptroller General determines that the information is already available from another source within the Federal Government.

(g) The provision giving the President broad authority to take any action necessary to insure an equitable allocation of crude oil and petroleum products among the various regions and States was adopted after it was amended to require the President to use his existing authority to accomplish that objective.

7. The House amendment contained (a) a provision prohibiting any form of discrimination in connection with any activity on the trans-Alaska pipeline, (b) a provision limiting the employment of foreign nationals for work on the trans-Alaska pipeline, and (c) a "buy-American" provision for the construction, operation, and maintenance of the trans-Alaska pipeline. The Senate bill had no comparable provisions. The Conferees adopted the first provision and dropped the second and third.

8. The Senate bill and the House amendment had different provisions regarding the liability of the owner or operator of an oil pipeline for damages resulting from its construction and operation. The Senate bill had one provision which related to pipelines on rights-of-way granted under the general law, and which applied only to damages incurred by the United States. The Senate had another provision which related to damages incurred by Alaska Natives in connection with the trans-Alaska pipeline. The House amendment had three provisions which related only to the trans-Alaska oil pipeline. One related to damages to anyone that were caused by the activities of the pipeline owner along the route of the pipeline. A second provision related to damages to anyone from discharges of oil from vessels owned or controlled by the pipeline owner in violation of the Federal Water Pollution Control Act. A third provision related to damages sustained by Alaska Natives.

The Conferees adopted modified versions of all of these provisions. One provision is of general application and appears in section 28(x). It requires the Secretary or agency head to specify the extent to which the holder of a right-of-way or permit shall be liable to the United States for damage or injury incurred in connection with the right-of-way. Joint regulations by the agencies involved, as authorized in section 28(c), are contemplated by the Conferees. Strict liability without regard to fault may be imposed, but a maximum dollar limitation must be stated, and liability in excess of this amount may be determined under ordinary rules of negligence.

The second provision is in section 204. It relates only to the trans-Alaska pipeline, and is in three parts. Subsection (a) imposes on the holder of the right-of-way or permit strict liability without regard to fault, and without regard to ownership of the land or resource involved if the land or resource is relied upon for subsistence or economic purposes, for damages or injury in connection with or resulting from activities along or in the vicinity of the pipeline right-of-way. Strict liability is limited to $50,000,000 for any one incident, and liability for damages in excess of that amount will be determined in accordance with ordinary rules of negligence.

Subsection (b) imposes on the holder of a right-of-way or permit liability for the full cost of control and removal of the pollutant of any area that is polluted by operations of the holder.

Subsection (c) imposes on the owner or operator of a vessel that is loaded with any oil from the trans-Alaska pipeline strict liability without regard to fault for damages sustained by any person as the result of discharges of oil from such vessel. Strict liability is limited to $100,000,000 for any one incident. The owner or operator is liable for the first $14,000,000. A Trans-Alaska Pipeline Liability Fund, which is created by the bill, is liable for the balance of the allowed claims up to $100,000,000. The portion of any valid claim not payable by the Fund may be asserted and adjudicated under other applicable Federal or State law.

The Fund will accumulate and maintain not less than $100,000,000 derived from the collection of a fee of five cents per barrel at the time the oil is loaded on the vessel, from income from invested funds, and from borrowed money if needed.

Strict liability under subsection (c) will cease when the oil is first brought ashore at a port under the jurisdiction of the United States, and the subsection applies only to vessels engaged in coastwise transportation, including transportation to and beyond deepwater ports.

9. Both the Senate bill and the House amendment contained provisions limiting the export of crude oil and making such exports subject to congressional oversight. The Senate bill applied only to oil from the North Slope of Alaska. The House amendment applied to all oil transported over rights-of-way through Federal lands. The Conferees adopted the House language.

The Senate bill provided for disapproval of proposed exports by joint resolution of the Congress. The House amendment prohibited proposed exports unless affirmatively authorized by a concurrent resolution of the Congress. The Conferees adopted the Senate language after changing "joint resolution" to "concurrent resolution."

The Conferees also adopted an exception intended to take care of oil exchanges and transportation involving Canada and Mexico.

II. Comments Regarding Specific Provisions

1. Section 28(e), which authorizes the grant of temporary permits for the use of Federal lands "in the vicinity of the pipeline" is not intended to restrict unnecessarily the placement of temporary construction or maintenance facilities such as construction camps, storage areas, communications sites and soil disposal areas, but to permit them to be placed wherever convenient to construction activities.

The term "temporary" relates to duration and imposes no limitation on the type of facility or activity which may be allowed. Thus, slope cuts and fills, berm construction, access facilities and other permanent changes in terrain are permissible. The Secretary or agency head may require, as a condition of such temporary permits, removal of structures and rehabilitation of the area.

This section will overcome an interpretation of the United States Court of Appeals for the District of Columbia in the case of *Wilderness Society* v. *Morton* (Feb. 9, 1973).

2. Section 28(f) contemplates that general regulations governing the grant of rights-of-way or permits will be issued by the Secretary or agency head. This does not preclude the grant of rights-of-way or permits in advance of the issuance of the regulations and the inclusion of appropriate conditions and stipulations to carry out the purposes of the Act.

3. Section 28(g), relating to pipeline safety, is not intended to require the Secretary or agency head to impose safety requirements that would duplicate requirements of the Secretary of Labor or the Secretary of Transportation under other law.

4. Section 28(h), relating to environmental protection, does not require the plan for construction, operation, and rehabilitation of the right-of-way or permit area to be a final one, since all details and conditions cannot be known at the time of application. However, the plan should be a description in as much detail as the state of the planning for the particular project will permit and must be adequate enough for the Secretary or agency head to make an informed judgment on the application and on the need for imposing any special terms and conditions which the public interest may require. Information called for pursuant to this section which is already on file with respect to applications pending on the date of enactment need not be refiled.

5. Section 28(k) does not require public hearings that would duplicate the public participation procedures required by the National Environmental Policy Act. It also permits a public hearing to cover all aspects of a pipeline proposal, regardless of whether one or more rights-of-way or permits, or whether one or more agencies, are involved.

6. Section 28(l) requires reimbursement of costs incurred in processing an application. These costs include the cost of preparing an environmental impact statement. It also requires payment annually in advance of the fair market rental value of the right-of-way or permit. This value can be based on any combination of factors that might reasonably be considered by a landowner in a free market, when determining the price to be asked for the right to use or cross his land.

7. Section 28(m) authorizes the Secretary or agency head to require a right-of-way or permit holder to furnish a bond or other satisfactory security. The term "security" is not used in a technical sense but may include any undertaking which gives adequate assurance that all obligations of the grantee will be met. Such flexibility is needed because some grantees may not be legally able to post such security, and in other cases a requirement of technical security may be impossible or unnecessary to comply with. Flexibility also permits the Secretary or agency head to require more than one type of security.

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8. Section 28(p), relating to joint uses of a right-of-way, gives the Secretary or agency head sufficient control to prevent any hazardous or technologically inoperable placement of various facilities.

9. Section 28(t) permits the Secretary or agency head to ratify and confirm the validity of existing rights-of-way for oil or gas regardless of the statutory authority under which they were granted. It is needed because of the possible application of the decision of the United States Court of Appeals in *The Wilderness Society, et al.* v. *Morton, et al.*

The conferees expect that previously granted rights-of-way should be confirmed only after careful study and the fullest possible compliance with the provisions of Section 28 as amended by this Act.

10. Section 28(v), relating to State standards, is included because rights-of-way frequently cross from State or private land into Federal land and back into State or private land. Different construction, operation, and maintenance standards may apply. This section is intended to assure that the Secretary or agency head will carefully consider State standards and comply with them in the interest of uniform practice throughout the State where such compliance is practical in the judgment of the Secretary or agency head. The section is not intended to require that those standards be followed in every case.

11. Section 203(b) provides new and independent statutory authorization and direction for the issuance, administration and enforcement of all rights-of-way, permits, leases and other authorizations necessary for or related to construction, operation and maintenance of the trans-Alaska pipeline system as generally described in the Final Environmental Impact Statement of the Department of the Interior dated March 20, 1972. It is a plenary grant of authority to the appropriate Federal agencies. All grants of rights-of-way, leases, permits, and other authorizations for the use of Federal lands shall be made under the authority of this subsection, rather than under other provisions of law.

After years of delay and protracted litigation on this matter, Congress has determined that the national interest requires a clear-cut and unequivocal policy decision on the pipeline. Congress has decided that an oil pipeline is necessary to move North Slope oil to domestic markets in the lower forty-eight States. This title implements that national policy decision.

In adopting this title, Congress intends to exercise its constitutional powers to the fullest extent necessary to achieve the objective of this title and to make this policy binding upon the Executive Branch and on the Federal courts.

Congress has decided, as a matter of national policy, that the appropriate Federal authorizations shall be issued. The Secretary and other Federal officials have no discretion in this matter. Congress does, however, require that applicable standards of substantive law be followed in connection with these authorizations, and vests liberal discretion in the Executive Branch to determine the conditions and stipulations to be incorporated into the necessary authorizations and the specific facilities to be authorized.

This subsection also identifies the "trans-Alaska oil pipeline system" as that system is generally described in the Secretary of the Interior's Final Environmental Impact Statement of March 20, 1972. The sub-

ject of that statement was a 48-inch diameter pipeline system with an ultimate capacity of 2 million barrels a day throughput for which a right-of-way and other permit applications were filed by a number of oil companies which had purchased leases on the North Slope of Alaska. This provision is intended to generally specify the facilities to be authorized and their general location. This provision is not, however, to be narrowly construed. If environmental conditions or new technological developments warrant, new facilities or changes in route or in location of proposed facilities are authorized so long as they are required or appropriate for the construction and operation at full capacity of the trans-Alaska pipeline system as generally described in the impact statement.

The route of the trans-Alaska pipeline will cross lands under the jurisdiction of more than one Federal agency. The Congress intends in Title II that the Secretary of the Interior will issue the right-of-way over all such Federal lands.

12. Section 203(c) provides that, if under any other statute a Federal agency could have issued an authorization relating to the construction of the trans-Alaska pipeline system, the agency shall still issue such authorization, but it shall act under the authority of subsection 203(b) of this Title and not under the authority of the other statute. Authorizations issued under subsection 203(b) shall contain all those provisions that the supplanted statute would have required, and may include any provisions which were authorized but not required by the supplanted statute.

Authorizations issued by the Secretary of the Interior shall follow the applicable provisions of Section 28 of the Mineral Leasing Act, as it is amended by Title I of this Act, except as provided in subsection 203(c). Not all of the Section 28 provisions will be applicable. The determination of applicability is left to the Secretary's judgment.

13. Section 203(d) provides for construction and completion of the pipeline system without further proceedings under National Environmental Policy Act of 1969. Section 202(d) of the House amendment and section 502(d) of the Senate bill contained a declaration that the actions of the Secretary of Interior heretofore taken with respect to the proposed trans-Alaska pipeline shall be regarded as satisfactory compliance with the provisions of the National Environmental Policy Act of 1969. Section 502(d) of the Senate bill also applied to the actions of other Federal agencies and officers, and referred not only to the National Environmental Policy Act of 1969, but also to "all other applicable laws." The Conferees did not adopt this declaration because they considered it as unnecessary and subject to misinterpretation. Inasmuch as section 203(d) of the Conference Report directs that the actions necessary for construction and completion of the trans-Alaska pipeline system shall be taken without further action under the National Environmental Policy Act, a declaration with respect to the effect to be accorded prior actions was not regarded as necessary or material.

Section 203(d) also limits the grounds for judicial review of Federal actions relating to issuance and implementation of all rights-of-way, permits, leases and other authorizations necessary or appropriate for completion of construction of the trans-Alaska pipeline, and its initial operation at full capacity of 2,000,000 barrels throughput per day (i.e., actions under 203(b) and 203(c)).

The permissible grounds for judicial review are limited to constitutional questions and questions of federal actions beyond the scope of authority conferred by Title II. Congress intended such grounds to be construed very narrowly, in keeping with the purpose stated in 203(a). This purpose also underlies the jurisdictional and procedural provisions in Section 203(d), which are designed to assure the most prompt possible resolution of any case involving the trans-Alaska pipeline, and to assure that issuance of the rights-of-way, permits, leases or other authorizations cannot be enjoined except pursuant to a final judgment.

14. Section 204(c) provides, for vessels that transport North Slope oil in the coastal trade, liability standards that are much stricter than those that apply to vessels that transport other oil in the coastal or foreign trade.

It is expected that tankers as large as 250,000 deadweight tons will transport North Slope crude to ports on the West Coast of the United States and elsewhere. Oil discharges from vessels of this size could result in extremely high damages to property and natural resources, including fisheries and amenities, especially if the mishap occurred close to a populated shoreline area.

Under the Limitation of Liability Act of 1851 (46 U.S.C. 183), the owner of a vessel is entitled to limit his liability for property damage caused by the vessel to the value of the vessel and its cargo. The value determination is made *after* the incident causing the damage. It is therefore quite possible for injured parties to go uncompensated if a vessel and its cargo are totally lost.

In the Water Quality Improvement Act of 1970 (33 U.S.C. 1161 et seq.), Congress expanded the liability of a vessel carrying oil to cover Federal government cleanup costs up to the lesser of $100 per ton or $14 million. Under that Act, damages are imposed without regard to the fault of the owner or operator, thereby creating a strict liability to United States Government for cleanup costs. However, State governments and private parties are still obliged to proceed under maritime law, subject to the limits of liability contained in that body of law.

The Conferees concluded that existing maritime law would not provide adequate compensation to all victims, including residents of Canada, in the event of the kind of catastrophe which might occur. Consequently, the Conferees established a rule of strict liability for damages from discharges of the oil transported through the trans-Alaska Pipeline up to $100,000,000.

Strict liability is primarily a question of insurance. The fundamental reason for the limits placed on liability in the Federal Water Quality Improvement Act stemmed from the availability, or non-availability, of marine insurance. Without a readily available commercial source of insurance, liability without a dollar limitation would be meaningless and many independent owners could not operate their vessels. Since the world-wide maritime insurance industry claimed $14 million was the limit of the risk they would assume, this was the limit provided for in the Federal Water Quality Improvement Act. There has been no indication that this level has since increased.

Accordingly, the Conferees adopted a liability plan which would make the owner or operator strictly liable for all claims (for both

clean-up costs and damages to public and private parties) up to $14 million. This limit would provide an incentive to the owner or operator to operate the vessel with due care and would not create too heavy an insurance burden for independent vessel owners lacking the means to self-insure.

Financial responsibility up to this limit would have to be demonstated before the vessel could be loaded with oil. Since the Federal Water Quality Improvement Act has an existing mechanism for establishing proof of financial responsibility, reference was made to the appropriate provision (13 U.S.C. 1321(p)). Such provision would be used to the extent it is consistent with the purposes of this Act; for example, references to tonnage limitations would not apply. Claims for clean-up costs would take precedence over other claims thereby preserving the provisions of the Federal Water Quality Improvement Act.

All claims over $14 million up to the $100 million ceiling would be asserted against the Trans-Alaska Pipeline Liability Fund established by the bill.

The owners of oil loaded onto tankers at Valdez will pay the Fund five cents per barrel until there is $100 million in the Fund. Payments would resume at any time the Fund fell below $100 million. (The Fund is described in more detail under Major Provisions.) Thus, the owners of the oil would have an incentive to select carefully vessels to carry their oil. Moreover, such owners would then share the risk associated with transporting the oil on water.

The Fund is not precluded from proceeding against the owner or operator of the vessel or other third parties, if either or both were negligent or caused the discharged.

The States are expressly not precluded from setting higher limits or from legislating in any manner not inconsistent with the provisions of this Act.

The Conferees hope that the appropriate committees of the House and Senate which are considering the more general subject of marine liability will harmonize the liability provisions of the Trans-Alaska Pipeline Authorization Act and the liability provisions of any general legislaton that may be developed.

15. Section 406, relating to stripper oil wells, was a Senate floor amendment to S. 1081. The Conferees have adopted the general concept of the floor amendment, but have added new provisions to insure that the exemption is narrowly defined and prudently administered, and to insure that the incentive being granted is properly limited in accord with congressional intent.

The purpose of exempting small stripper wells—wells whose average daily production does not exceed ten barrels per well—from the price restraints of the Economic Stabilization Act (now in Phase IV) and from any system of mandatory fuel allocation is to insure that direct or indirect price ceilings do not have the effect of resulting in any loss of domestic crude oil production from the premature shutdown of stripper wells for economic reasons.

As of January 1, 1973, there were 350,000 stripper wells producing ten barrels a day or less. Stripper wells account for 71 percent of all of the oil wells in this country, but produce an average of only 3.6

barrels per day, or only 13 percent of total U.S. domestic crude production.

Many stripper wells are of only marginal economic value. When the costs of their operation exceed the value of their production, they are shut in, and a known and developed crude oil reserve is lost to U.S. production. Removing Phase IV price restraints from these marginal stripper wells has the effect of increasing the value of the crude oil they produce by about $1.30 per barrel (the difference between $4.02, the current per-barrel ceiling average under Phase IV, and $5.32, the per-barrel average price for "new" domestic crude oil production which is not subject to Phase IV). This price incentive will encourage owners and operators of stripper wells to maintain production and to keep these wells in operation for longer periods of time than would be possible if the value of their crude oil production were determined under Phase IV price ceilings. This increased incentive will, it is anticipated, permit stripper well operators to make new investments in the eligible wells and improve the gathering and other facilities for moving this oil to market.

The words "first sale" in Section 406(a) refer to the initial sale from the producer to a refiner, oil broker or other party. Thereafter, the exemption expires and any applicable provision of the Economic Stabilization Act or any mandatory allocation program may apply.

The exemption also runs only to "crude oil and natural gas liquids." It does not run to natural gas produced by these wells. Natural gas production and pricing continue to be regulated by the Federal or State agency having jurisdiction over the particular wells involved.

The Congress intends that the provisions of this section will be strictly enforced and regulated by the administering agency to insure that the limited exemption of this class of wells for the express purposes described above is not in any way broadened. To achieve this, Congress authorizes on-site inspections to insure compliance. Congress also directs that the administering agency shall promulgate regulations to implement the provisions of this section before it becomes operative. The Conferees expect the administering agency to utilize State data regarding production volumes, and to provide by regulation safeguards against the manipulation or gerrymandering of lease units in a manner that evades the price control and allocation programs.

These regulations shall be so designed as to provide safeguards against any abuse, over-reaching or altering of normal patterns of operations to achive a benefit under this section which would not otherwise be available. Congress specifically intends that the regulations shall, among other things, prevent any "gerrymandering" of leases to average down high production wells with a number of low production stripper wells to remove the high production wells from price ceilings. The *sole* purpose and objective of this Section 406 is to keep stripper wells—those producing less than ten barrels per day—in production and to insure that the crude oil they produce continues to be available for U.S. refineries and U.S. consumers. It is not intended to confer any benefit on the owners and operators of wells producing in excess of ten barrels per day.

The Congress also intends that the regulations provide appropriate limitations and provisions in the definition of "lease" to insure that an administratively workable system is established which does not permit abuse.

16. Section 408(f) relates to the standard of proof to be met by the Federal Trade Commission for the issuance of a temporary restraining order or a preliminary injunction. It is not intended in any way to impose a totally new standard of proof different from that which is now required of the Commission. The intent is to maintain the statutory or "public interest" standard which is now applicable, and *not* to impose the traditional "equity" standard of irreparable damage, probability of success on the merits, and that the balance of equities favors the petitioner. This latter standard derives from common law and is appropriate for litigation between private parties. It is not, however, appropriate for the implementation of a Federal statute by an independent regulatory agency where the standards of the public interest measure the propriety and the need for injunctive relief.

The inclusion of this new language is to define the duty of the courts to exercise independent judgment on the propriety of issuance of a temporary restraining order or a preliminary injunction. This new language is intended to codify the decisional law of *Federal Trade Commission* v. *National Health Aids*, 108 F. Supp. 340, and *Federal Trade Commission* v. *Sterling Drug, Inc.*, 317 F.2d 669, and similar cases which have defined the judicial role to include the exercise of such independent judgment. The conferees did not intend, nor do they consider it appropriate, to burden the Commission with the requirements imposed by the traditional equity standard which the common law applies to private litigants.

17. Section 409(a) exempts "independent Federal regulatory agencies" from the provisions of the Federal Reporting Services Act. In general, the Reporting Services Act provides that Federal agencies may not collect information from ten or more persons without having first obtained the advance approval and clearance of the Office of Management and Budget. The term "Federal agencies" has been construed to include the independent Federal regulatory agencies for the purposes of the Reporting Services Act.

The purpose of Section 409(a) is to preserve the independence of the regulatory agencies to carry out the quasi-judicial functions which have been entrusted to them by the Congress. The intent of this section is not to encourage a proliferation of detailed questionnaires to industry, small business or other persons which could result in unnecessary and unreasonable expense. Any legitimate need for information in carrying out the statutory responsibilities of these agencies would, however, be carried out even though responses may entail some expense and inconvenience.

The purpose of this section is to insure that the existing clearance procedure for questionnaires or requests for data does not become, inadvertently or otherwise, a device for delaying or obstructing the investigations and data collection necessary to carry out the important regulatory functions assigned to the independent agencies by the Congress.

The Congress intends the term "independent Federal regulatory agencies" as used in Section 409(a) to include, but not necessarily be limited to, the following agencies:

Civil Aeronautics Board,
Federal Communications Commission,
Atomic Energy Commission (insofar as its regulatory and adjudicative functions are concerned),
Federal Trade Commission,
Interstate Trade Commission,
Securities and Exchange Commission, and
Federal Power Commission.

Subsection 409(b) provides a procedure for advance review which is designed to insure that information required by independent Federal regulatory agencies is obtained with a minimum burden upon business enterprises, especially small businesses, and other persons required to furnish such information.

The Comptroller General of the General Accounting Office is charged with the review responsibility. Since this will be a new function for the General Accounting Office, the Comptroller General has informed the Congress that he will need until July 1, 1974 to enable him to obtain the staff which will be required to carry out the full responsibilities provided for in Section 409(b). This is satisfactory to the Congress so long as appropriate interim arrangements are made to carry out the Section 409(b) review of the Federal agencies which should not or cannot be delayed until July 1, 1974.

JAMES A. HALEY,
HAROLD T. JOHNSON,
MORRIS K. UDALL,
JOHN MELCHER,
JOHN P. SAYLOR,
SAM STEIGER,
DON YOUNG,
Managers on the Part of the House.

HENRY M. JACKSON,
ALAN BIBLE,
J. BENNETT JOHNSTON, JR.,
FLOYD K. HASKELL,
PAUL J. FANNIN,
CLIFFORD P. HANSEN,
MARK O. HATFIELD,
Managers on the Part of the Senate.

SENT TO YOU BY YOUR
UNITED STATES SENATOR

Ted Stevens

ALASKA

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ALASKA PIPELINE COMMISSION ACT OF 1972

LAWS OF ALASKA

1972

Source: FCCS HCS CSSB 314

Chapter No.: 139

AN ACT

Relating to oil and gas pipelines and to the creation of the Alaska Pipeline Commission; and providing for an effective date.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. AS 42 is amended by adding a new chapter to read:

CHAPTER 6. ALASKA PIPELINE COMMISSION ACT.

ARTICLE 1. DECLARATION OF POLICY.

Sec. 42.06.010. LEGISLATIVE DECLARATION OF POLICY. The transportation of oil or gas by pipeline in this state is a business involved with the public interest. It is the purpose of this chapter to

(1) promote and oversee the development of an oil and gas pipeline transportation system in this state properly adapted to the present and future needs of the domestic commerce of the state and of the interstate and foreign commerce of the United States;

(2) promote and ensure, in conjunction with the Alaska Public Utilities Commission within its jurisdiction, nondiscriminatory, efficient, and economical oil and gas pipeline transportation at reasonable rates.

ARTICLE 2. ESTABLISHMENT OF ALASKA PIPELINE COMMISSION.

Sec. 42.06.020. ALASKA PIPELINE COMMISSION CREATED. There is created within the Department of Commerce the Alaska Pipeline Commission, as a commission to regulate pipeline facilities and pipeline carriers, to regulate the access of information concerning pipeline facilities

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and carriers to this state, and to represent the interests of the state in any proceedings relating to them as provided for in this chapter.

Sec. 42.06.030. COMPOSITION OF ALASKA PIPELINE COMMISSION. (a) The Alaska Pipeline Commission consists of three members, appointed by the governor and confirmed by a majority of the members of the legislature in joint session.

(b) The governor shall designate one member of the commission as chairman of the commission. This member shall serve as chairman for a term of two years, and may be appointed for successive terms.

Sec. 42.06.040. TERM OF OFFICE; VACANCY. (a) The members of the commission shall be appointed for terms of six years, except that of the members first appointed to the commission, one shall be appointed for a term of two years, one for a term of four years, and one for a term of six years. Commissioners may be appointed to successive terms. A commissioner, upon the expiration of his term, shall continue to hold office until his successor is appointed and qualified.

(b) A vacancy arising on the commission shall be filled by appointment by the governor and confirmation by a majority of the members of the legislature in joint session, and an appointee to fill a vacancy shall hold office for the balance of the term for which his predecessor on the commission was appointed.

(c) A vacancy in the commission does not impair the authority of a quorum of commissioners to exercise all the powers and perform all the duties of the commission.

Sec. 42.06.050. REMOVAL OF COMMISSIONERS. The governor may remove a commissioner from office by and with the consent of a majority of the legislature.

Sec. 42.06.060. QUALIFICATIONS OF COMMISSIONERS. Members of the commission shall be qualified as follows: one member shall be an attorney duly admitted to practice law in this state, and preferably having experience in administrative or regulatory law; one member shall be a graduate of an accredited university with a major or a degree in land management, civil engineering or transportation economics, preferably with experience in oil and gas transportation; one member shall be a graduate of an accredited university with a major or a degree in finance, accounting, or, if not otherwise represented on the commission, transportation economics. A member of the commission may not hold any other state or federal office, position or employment, either elective or appointive, except as a member of the armed forces of the United States or of this state.

Sec. 42.06.070. QUORUM. Two members of the commission constitute a quorum for the transaction of business, for the performance of a duty, or for the exercise of a power of the commission.

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Sec. 42.06.080. OATH OF OFFICE. Each commissioner and the executive director of the commission, before entering upon the duties of his office, shall take and subscribe to the oath prescribed for principal officers of the state.

Sec. 42.06.090. COMPENSATION OF MEMBERS OF THE COMMISSION. Members of the commission are in the exempt service described in AS 39.25 and receive an annual salary equal to that of a superior court judge, to be paid in 12 equal monthly installments.

Sec. 42.06.100. PRINCIPAL OFFICE; SEAL. (a) The commission shall establish a principal office, and may establish branch offices at locations in this state necessary or convenient to the discharge of its duties. For the convenience of the public or of other interested persons the commission may hold meetings, hearings or other proceedings at any of its offices or at other locations in this state.

(b) The commission shall have an official seal.

Sec. 42.06.110. LEGAL COUNSEL. (a) The attorney general is legal counsel for the commission. He shall advise the commission in legal matters arising in the discharge of its duties and represent the commission in actions to which it is a party. If, in the opinion of the commission, the public interest is not adequately represented by counsel in a proceeding, the attorney general, upon request of the commission, shall represent the public interest.

(b) The commission may employ temporary legal counsel from time to time in matters in which the commission is involved.

Sec. 42.06.120. EMPLOYMENT OF COMMISSION PERSONNEL. (a) The commission may employ an executive director who shall have had at least five years of experience in oil or gas transportation, management, law, accounting, or an allied field. The executive director may not be one of the commissioners.

(b) The commission may, as it considers necessary for the purpose of performing its duties under this chapter, employ or contract for the services of hearing officers, engineers, experts, clerks, accountants, and other consultants, agents and assistants. The commission shall make the maximum possible use of employees and experts available in the various departments and agencies of state government.

(c) The executive director, his deputy, and his secretary, shall be in the partially exempt service described in AS 39.25. All other employees of the commission, other than legal counsel, are in the classified service under AS 39.25.

Sec. 42.06.130. RESTRICTIONS ON COMMISSIONERS AND EMPLOYEES. No member or employee of the commission may have an official connection with, or hold stock or

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securities in, or have a pecuniary interest in, any corporation, company or association engaged in the production or the transportation of oil or gas. No member or employee may act upon a matter in which his relationship with any person creates a conflict of interest.

ARTICLE 3. POWERS AND DUTIES OF COMMISSION.

Sec. 42.06.140. POWERS AND DUTIES OF THE COMMISSION. As provided in this chapter, the commission

(1) shall regulate pipelines and pipeline carriers in this state;

(2) may investigate upon complaint or its own motion, the rates, classifications, rules, regulations, prices, services, practices and facilities of pipeline carriers, and the performance of obligations under and compliance with the terms of leases issued by the state;

(3) may make, prescribe or require just, fair and reasonable rates, classifications, regulations, practices, services and facilities for pipeline carriers;

(4) may require pipeline carriers to file with the commission reports and other information and data required or permitted to be required by other provisions of this chapter;

(5) may adopt regulations that are necessary and proper to the performance of its duties under this chapter, including regulations governing practices and procedures of the commission, which regulations shall not be inconsistent with state law;

(6) shall during normal business hours have access to and may designate any of its employees, agents or consultants to inspect and examine, the accounts, financial and property records, books, maps, inventories, appraisals, valuations, and related reports kept by a pipeline carrier, or kept for it by others, which directly affect the interests of the state and directly relate and pertain to pipelines located in this state;

(7) may initiate, intervene in, and appear personally or by counsel and offer evidence in and participate in, any proceedings involving a pipeline carrier, and affecting the interests of the state, before any officer, department, board, commission or court of this state or of another state or of the United States;

(8) shall require permits for the construction, enlargement in size or operating capacity, extension, operation or abandonment of any oil or gas pipeline facility, subject to necessary and reasonable terms, conditions and limitations;

(9) may prescribe the system of accounts and regulate the service of an oil or gas pipeline facility.

Sec. 42.06.150. POWERS AND DUTIES WITH RESPECT TO FEDERALLY REGULATED CARRIERS. Sec. 140 of this chapter

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applies to oil and gas pipeline carriers regulated under the Interstate Commerce Act of 1906, or the Natural Gas Act of 1938, only to the extent not preempted under those federal Acts.

Sec. 42.06.160. ADMINISTRATIVE AUTHORITY OF COMMISSION; REGULATIONS AND HEARING PROCEDURES. (a) The commission may adopt regulations, not inconsistent with the law, necessary or proper to exercise its powers and to perform its duties under this chapter.

(b) The commission shall adopt regulations governing practice and procedure, consistent with due process of law, including the conduct of formal and informal investigations, prehearing conferences, hearings and proceedings, and the handling of procedural motions by a single commissioner. Technical rules of evidence need not apply to investigations, prehearing conferences, hearings and proceedings before the commission. The commission shall provide for representation by out-of-state attorneys substantially in accordance with Civil Rule 81.

(c) The commission, a commissioner or an employee authorized by the commission may administer oaths, certify to all official acts, and issue subpoenas, subpoenas duces tecum and other process to compel the attendance of witnesses and the production of testimony, records, papers, accounts and documents in any inquiry, investigation, hearing or proceeding before the commission in the state. Each commissioner is authorized to issue orders on procedural motions. The commission may petition a court of this state to enforce its subpoenas, subpoenas duces tecum and other process.

Sec. 42.06.170. APPLICATION OF ADMINISTRATIVE PROCEDURE ACT. (a) The administrative adjudication procedures of the Administrative Procedure Act (AS 44.62) do not apply to adjudicatory proceedings of the commission except that final administrative determinations by the commission are subject to judicial review under that Act as provided in sec. 551(a) of this chapter.

(b) The Administrative Procedure Act applies to regulations adopted by the commission.

Sec. 42.06.180. FORMAL HEARINGS. A formal hearing which the commission has power to hold may be held by or before two or more commissioners designated for the purpose by the commission. The testimony and evidence in a formal hearing may be taken by the commissioners to whom the hearing has been assigned. A commissioner who has not heard the testimony, including the argument, may not participate in making a decision of the commission. In determining the place of a hearing the commission shall give preference to holding the hearing at a place most convenient for those interested in the subject of the hearing.

Sec. 42.06.190. FINAL ORDERS OF THE COMMISSION. No final order of the commission compelling affirmative action, denying a right or privilege, or granting a right or privilege over protest of the oil or gas pipeline

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facility or any party of record may be entered without giving the interested party reasonable notice and an opportunity to be heard.

Sec. 42.06.200. FORMAT OF ORDERS. Formal orders of the commission shall be based upon the facts of record. An order entered pursuant to a hearing shall state the commission's findings, the basis of its findings and conclusions, together with its decision. These orders shall be entered of record and a copy of them shall be served on all parties of record in the proceeding.

Sec. 42.06.210. PUBLICATION OF REPORTS, ORDERS, DECISIONS AND REGULATIONS. All reports, orders, decisions and regulations of the commission shall be in writing. The commission shall apprise all affected operators of oil or gas pipeline facilities and interested parties of these reports, orders, decisions, and regulations as they are issued and adopted, and, when appropriate to do so, shall publish them in a manner that will reasonably inform the public or the affected consumers of the services of any oil or gas pipeline facility. The commission may set charges for costs of printing or reproducing and furnishing copies of its reports, orders, decisions and regulations. The publication requirement, as it pertains to regulations, does not supersede the requirements of the Administrative Procedure Act (AS 44.62).

Sec. 42.06.220. ANNUAL REPORT. The commission shall publish an annual report reviewing its work and submit it to the legislature by February 15 of each year. The report shall contain information and data which bear a significant relationship to the development and regulation of oil or gas pipeline facilities in the state and include an outline of the commission's program for the development and regulation of oil or gas pipeline facilities in the forthcoming year.

Sec. 42.06.230. JURISDICTION OF COMMISSION. Except as otherwise provided in this chapter or hereafter otherwise expressly provided by law, and except as to any concurrent jurisdiction with the Alaska Public Utilities Commission under ch. 5 of this title as to a public utility described in AS 42.05.701(2)(D) and (E), the jurisdiction and authority over the subject matters of this chapter shall be exclusively in the commission. To the extent that the performance of any duties of the commission affect a pipeline carrier or a pipeline subject to the Interstate Commerce Act or the Natural Gas Act, the performance of its duties shall not, as to that pipeline carrier or pipeline, conflict with applicable federal laws, regulations, rules, orders, or other requirements.

Sec. 42.06.240. CERTIFICATE REQUIRED. (a) After January 1, 1973 no pipeline carrier, or person which will be a pipeline carrier upon completion of any proposed construction or extension, shall engage in the transportation of oil or gas by pipeline subject to the jurisdiction of the commission, or undertake the construction or extension of any pipeline facilities for that purpose, or acquire or operate any pipeline facilities or extensions, unless there is in force with respect to that pipeline

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carrier a certificate of public convenience and necessity issued by the commission authorizing those acts or operations. A certificate shall describe the nature and extent of the authority granted in it, including, as appropriate for the services involved, a description of the authorized area and scope of operation of the oil or gas pipeline facility.

(b) If any person or predecessor in interest was engaged in transportation of oil or gas by pipeline subject to the jurisdiction of the commission on or before January 1, 1973, over the route or routes for which application is made, the commission shall issue the certificate without requiring further proof that public convenience and necessity will be served by the operation, and without further proceedings, if application for the certificate is made to the commission before January 1, 1973; pending the determination of the application, the continued operation of the pipeline or pipelines is lawful.

(c) In an area where the commission determines that two or more oil or gas pipeline facilities are competing or are planning to compete to offer identical oil or gas pipeline service, and this competition is not in the public interest, the commission shall take appropriate action to eliminate or not allow the competition and undesirable duplication of facilities.

(d) The commission may attach to certificates of convenience and necessity terms and conditions and require issuance of securities it considers necessary for the protection of the environment and for the best interest of the oil or gas pipeline facility and the general public.

(e) The requirement for a certificate shall not operate to impose state regulation which has been preempted under the Interstate Commerce Act of 1906 or the Natural Gas Act of 1938. When federal law has preempted state regulation the commission must accept the findings made under the federal scheme of regulation.

Sec. 42.06.250. APPLICATION. Application for certificate shall be made in writing to the commission, verified under oath, and shall be in the form, and contain the information, and notice of the application shall be served upon the interested parties and in the manner, that the commission by regulation requires.

Sec. 42.06.260. PUBLIC HEARINGS. At least 30 days before issuing a certificate of convenience and necessity, the commission shall hold a public hearing on the application. Copies of the completed application shall be made available to the public at least 10 days before the public hearing date. A transcript of the public hearing shall be included in the permanent record of agency action on that application, and copies of the public hearing transcripts shall be available to the public. The commission may, without notice of hearing and pending the determination of an application for a certificate, issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, and may by regulation exempt from the

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requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest.

Sec. 42.06.270. GRANT OR DENIAL OF APPLICATION. (a) Unless governed by sec. 240(b) of this chapter, a certificate shall be issued to any qualified applicant, authorizing the whole or any part of the operation, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of this chapter and the requirements, rules, and regulations of the commission, and that the proposed service, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise the application shall be denied.

(b) The commission, after a hearing had upon its own motion or upon application, may determine the gathering areas, or the routes over which, the fixed termini between which, and the intermediate and off route points, if any, to which each authorization under this section is to be limited.

(c) Nothing contained in this chapter shall be construed as a limitation upon the power of the commission to grant certificates of public convenience and necessity for service of an area, or routes, already being served by another pipeline.

Sec. 42.06.280. INSURANCE OR DEPOSIT OF SECURITY. (a) In granting a certificate of convenience and necessity the commission shall require the oil or gas pipeline carrier to either procure and file liability and property damage insurance from a company licensed to write insurance in the state or deposit security for the limits of liability upon the terms and conditions the commission determines necessary for the reasonable protection of the public against damage and injury for which the owner or operator of the oil or gas pipeline facility may be liable by reason of the operation of an oil or gas pipeline facility.

(b) In fixing the amount of insurance or security, the commission shall give consideration to the character and amount of traffic, the number of persons affected and the degree of danger which the proposed operation involves.

Sec. 42.06.290. ABANDONMENT. (a) No pipeline carrier may abandon or permanently discontinue use of all or any portion of a pipeline or abandon or discontinue any service rendered by means of a pipeline that is the subject of a certificate of convenience and necessity, without the permission and approval of the commission after due notice and hearing, and a finding by the commission that continued service is not required by public convenience and necessity. Any interested person may file with the commission a protest or memorandum of opposition to or in support of discontinuance or

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abandonment. The commission may authorize temporary suspension of a service or of part of a service.

(b) Upon complaint or upon its own motion, the commission may reinvestigate a previously authorized discontinuance, abandonment or suspension of a service described in (a) of this section. If, after due notice and hearing, the commission finds that the public convenience and necessity requires the service to be resumed, and that there has not been detrimental reliance on the previous authorization, it may order the operator or owner of the oil or gas pipeline facility to again provide the service.

Sec. 42.06.300. MODIFICATION, SUSPENSION OR REVOCATION OF CERTIFICATES. Upon complaint or upon its own motion the commission, after due notice and hearing and for good cause shown, may amend, modify, suspend, or revoke a certificate, in whole or in part. Good cause for amendment, modification, suspension or revocation of a certificate shall be

(1) the requirements of public convenience and necessity;

(2) misrepresentation of a material fact in obtaining the certificate;

(3) unauthorized discontinuance or abandonment of all or part of a service that is the subject of such certificate;

(4) wilful failure to comply with the provisions of this chapter, or the rules, regulations or orders of the commission; or

(5) wilful failure to comply with a term, condition, or limitation of the certificate.

Sec. 42.06.305. TRANSFER OF CERTIFICATE. A certificate may not be sold or leased, rented or transferred without the prior approval of the commission; the transfer of a certificate not involving a substantial change of ownership shall be summarily approved.

Sec. 42.06.310. STANDARDS OF SERVICE AND FACILITIES. (a) Each oil or gas pipeline facility shall furnish and maintain adequate, efficient and safe service and facilities. This service shall be reasonably continuous and without unreasonable interruption or delay.

(b) If the commission, upon its own motion or upon complaint, after providing reasonable notice and opportunity for hearing, finds that the service or facilities of an oil or gas pipeline facility are unreasonable, unsafe, inadequate, insufficient, or unreasonably discriminatory, or otherwise in violation of this chapter, the commission shall prescribe by regulation or order, the reasonable, safe, adequate, sufficient service or facilities to be observed, furnished, enforced, or employed, including all repairs, changes, alterations, extensions, substitutions, or improvements in facilities that are reasonably necessary and proper for the safety, accommodation, and convenience

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of the public and the users. Regulations or orders issued under this subsection shall conform to accepted industry standards and practices.

Sec. 42.06.320. DISCRIMINATION IN SERVICE. No oil or gas pipeline carrier may, as to service, make or grant an unreasonable preference or advantage to any person or subject any person to an unreasonable prejudice or disadvantage. No oil or gas pipeline facility which is owned by more than one owner may require that users make separate requests of each separate owner in order to obtain a reasonable share of the service provided by the oil or gas pipeline facility.

Sec. 42.06.330. POWER OF COMMISSION TO ALLOCATE USAGE. If the commission, upon its own motion or upon complaint, after providing reasonable notice and opportunity for hearing, finds that an oil or gas pipeline facility is making or granting an unreasonable preference or advantage to any person or subjecting any person to an unreasonable prejudice or discrimination, the commission may prescribe rules to end the discrimination or the commission may itself prescribe the allocation of the service until it determines the discrimination can be avoided by appropriate rules or agreements.

Sec. 42.06.340. ORDER FOR JOINT USE OR CONNECTION. When there is failure to agree upon the joint use or interconnection of oil or gas pipeline facilities or the conditions or compensation for joint use or interconnections, any interested person may apply to the commission for an order requiring the interconnection. If, after investigation and opportunity for hearing, the commission finds that public convenience and necessity require the joint use or connection, and that the use or connection will not result in substantial injury to the oil or gas pipeline facility or its customers, or in substantial detriment to the services furnished by the oil or gas pipeline facility, or in the creation of safety hazards, it shall

(1) order that the use be permitted;

(2) prescribe reasonable conditions and compensation for the joint use;

(3) order the interconnection to be made;

(4) determine the time and manner of the interconnection;

(5) determine the apportionment of costs and responsibility for operation and maintenance of the interconnection.

Sec. 42.06.350. TARIFFS, CONTRACTS, FILING AND PUBLIC INSPECTION. (a) Under such regulations as the commission shall prescribe, every intrastate oil or gas pipeline carrier shall file with the commission, within the time and in the form designated by the commission, all rates, tariffs, charges, classifications, rules, regulations, terms, and conditions pertaining to service provided under the

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certificate, and shall maintain copies on file at its principal business office and at places designated by the commission, available to, and subject to inspection by, the general public on demand.

(b) The commission may reject the filing of all or part of a tariff which does not comply with the form or filing regulations of the commission or which is not consistent with this chapter or the regulations of the commission. A tariff or provision so rejected is void.

Sec. 42.06.360. ADHERENCE TO TARIFFS. The terms and conditions under which a pipeline carrier offers its services and facilities to the public shall be governed strictly by the provisions of its currently effective tariffs. No legally filed and effective tariff rate, charge, rule, regulation or condition of service may be changed except in the manner provided in this chapter. If more than one tariff rate or charge can reasonably be applied for billing purposes the one most advantageous to the customer shall be used.

Sec. 42.06.370. RATES TO BE JUST AND REASONABLE. (a) All rates demanded or received by a pipeline carrier, or by any two or more pipeline carriers jointly, for a service furnished or to be furnished shall be just and reasonable.

(b) Additional regulations and rules governing determination of a reasonable tariff shall be published by the commission.

Sec. 42.06.380. DISCRIMINATION IN RATES. (a) No pipeline carrier may, as to rates, grant a preference or advantage to any customer or subject a customer to an unreasonable prejudice or disadvantage. No pipeline carrier may establish or maintain an unreasonable difference as to rates, either as between localities served or between classes of service provided under the certificate.

(b) No pipeline carrier may directly or indirectly refund, rebate or remit in any manner, or by any device, any portion of the rates and charges or charge, demand or receive a greater or lesser compensation for service than is specified in its effective tariff nor extend to any customer served under the certificate any form of contract, agreement, inducement, privilege or facility, or apply any rule, regulation or condition of service except as are extended or applied to all customers under like circumstances.

Sec. 42.06.390. NEW OR REVISED TARIFFS. (a) No pipeline carrier may establish or place in effect any new or revised rates, charges, rules, regulations, conditions of service or practices except after 30 days notice to the commission and to the public. Notice shall be given by filing with the commission and keeping open for public inspection the revised tariff provisions which shall plainly indicate the changes to be made in the schedules then in force and the time when the changes will go into effect. The commission may prescribe additional means of giving notice. The commission, for good cause shown, may allow changes to take effect on less than 30 days notice under conditions the commission prescribes.

(b) New and revised tariffs shall be filed in the manner provided in sec. 350 of this chapter.

Sec. 42.06.400. SUSPENSION OF TARIFF FILING. (a) When a tariff filing is made containing a new or revised

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rate, classification, rule, regulation, practice, or condition of service the commission may, either upon written complaint or upon its own motion, after reasonable notice, conduct a hearing to determine the reasonableness and propriety of the filing. Pending a hearing the commission may, by order stating the reasons for its action, suspend the operation of the tariff filing for an initial period not longer than six months beyond the time when it would otherwise go into effect.

(b) An order suspending a tariff filing may be vacated if, after investigation, the commission finds that it is in all respects proper. Otherwise the commission shall hold a hearing on the suspended filing and issue its order, before the end of the suspension period, granting, denying or modifying the suspended tariff in whole or in part.

(c) In the case of a proposed increased rate, the commission may by order require the interested pipeline carrier to place in escrow in a financial institution approved by the commission and keep accurate account of all amounts received by reason of the increase, specifying by whom and in whose behalf the amounts are paid. Upon completion of the hearing and decision the commission may by order require the pipeline carrier to refund to the persons in whose behalf the amounts were paid, that portion of the increase in rates which was found to be unreasonable or unlawful. No funds may be released from escrow without the commission's prior written consent and the escrow agent shall be so instructed by the pipeline carrier, in writing, with a copy to the commission. The pipeline carrier, at its expense, may substitute a bond in lieu of the escrow requirement.

(d) One who initiates a change in existing tariffs bears the burden of proving the reasonableness of the change.

Sec. 42.06.410. POWER OF COMMISSION TO FIX RATES. When the commission, after an investigation and hearing, finds that a rate demanded, observed, charged or collected by a pipeline carrier for a service, subject to the jurisdiction of the commission, or that a classification, rule, regulation, practice, or contract affecting the rate, is unjust, unreasonable, unduly discriminatory or preferential, the commission shall determine a just and reasonable rate, classification, rule, regulation, practice, or contract to be observed or allowed and shall establish it by order.

Sec. 42.06.420. VALUATION OF PROPERTY OF A PIPELINE CARRIER. The commission may, after providing reasonable notice and opportunity to be heard, ascertain and set the fair value of the whole or any part of the property of a pipeline carrier, insofar as it is material to the exercise of the jurisdiction of the commission. The commission may make revaluations from time to time and ascertain the fair value of all new construction, extensions, and additions to the property of a pipeline carrier.

Sec. 42.06.430. GENERAL PROVISIONS AS TO ACCOUNTS, RECORDS AND REPORTS. To the extent necessary to the

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performance of the duties of the commission as provided in this chapter:

(1) The commission by regulation shall, for the purposes of this section, classify pipeline facilities, and may designate the pipeline facilities or groups of pipeline facilities within this state that constitute a pipeline system for the purposes of this section.

(2) The commission may by regulation prescribe a uniform system of accounts for any classification of pipeline facilities which best represents and clearly reveals the investment, revenues, direct operating costs and other expenses of the subject classification of facilities, and may prescribe the manner in which the accounts and supporting records are kept in order to clearly show the investment, revenues and costs pertaining to the subject facilities or to a pipeline system constituting a part of it. Accounts shall be maintained on a calendar year basis unless the commission specifically authorizes the maintenance of accounts on the basis of a fiscal year other than the calendar year.

(3) The commission may by regulation require a pipeline carrier to establish and maintain as part of its system of accounts continuing property records showing, as to property units in this state, the year of placement in service, original cost and current location, and, as to a pipeline system, accounts and records in a manner showing, on a current basis, the original cost of the system in this state and related reserves for depreciation. From time to time the commission shall determine the proper and adequate rates of depreciation for each major class of property of an oil or gas pipeline facility.

(4) The pipeline carrier shall keep its accounts for its pipeline facilities located in this state separate from any accounts relating to any other business (including another pipeline facilities business, or a subsidiary business) it engages in, directly or indirectly. Except as the commission provides, no property, expense or revenue used in or derived from the other business may be considered in establishing the rates and charges of the facility.

(5) The pipeline carrier shall keep books, accounts, papers and records required by this chapter or by regulations adopted by the commission under this chapter in an office in this state and may not remove them from the state except upon written authority by the commission.

(6) For pipelines subject to the Interstate Commerce Act or the Natural Gas Act, the uniform system of accounts and manner of maintaining the same and the property records kept and maintained under this section shall, wherever considered practicable by the commission, be the same as required under regulations prescribed by the applicable federal agency.

(7) Within 90 days after the close of its authorized annual accounting period, or within additional time granted by the commission for good cause shown, a pipeline carrier shall file a verified annual report with

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the commission. This annual report shall consist of,

(A) for a pipeline subject to the Interstate Commerce Act or the Natural Gas Act, a copy of the annual report as filed with the appropriate federal agency pursuant to the applicable Act, and for other pipelines a report of general corporation information and financial statements in the same general format as the report of pipelines of the same classification subject to the jurisdiction of the appropriate federal agency; and

(B) in the same general format as the report referred to in (7)(A) of this section, a statement of income and investment applicable to pipelines in this state, and a statement of investment, revenues, direct operating costs and other expenses, detailed in accordance with the uniform system of accounts to be applied under this chapter, for each pipeline system designated by the commission under (1) of this section; and

(C) such additional accounts and information as may be required under (2) of this section.

Sec. 42.06.440. INSPECTION OF RECORDS. Subject to AS 31.05.035(c), the commission shall at all reasonable times have access to, and may designate any of its employees, agents or consultants to inspect and examine, the accounts, records, books, maps, inventories, appraisals, valuations, or other reports and documents, kept by an oil or gas pipeline carrier or its affiliated interests, or prepared or kept for it by others, which relate to any contract or transaction between them. The commission may require an oil or gas pipeline carrier or its affiliated interest to file with the commission copies of any or all of these accounts, records, books, maps, inventories, appraisals, valuations, or other reports and documents.

Sec. 42.06.450. INVESTIGATION OF MANAGEMENT PRACTICES. (a) The commission may investigate the management practices of a pipeline carrier to determine how they affect the cost or quality of its transportation in this state of oil or gas or both or other related service. The commission's investigation may include, but is not limited to, staffing patterns, compensation policies and practices, investment policy and practice, purchasing and billing practices, accounting, record keeping, and reporting practices, and relations with affiliates.

(b) When unreasonable practices are found to exist, the commission may, after providing reasonable notice and opportunity for hearing, take appropriate action to insure that neither the direct nor the indirect costs of the practices are borne by the public.

(c) In a rate proceeding the oil or gas pipeline carrier has the burden of proving that any written or unwritten contract or arrangement it may have with any of its affiliated interests for the furnishing of any services or for the purchase, sale, lease or exchange of any property is necessary and consistent with the public interest and

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that the payment made for it, or consideration given, is reasonably based, in part, upon the submission of satisfactory proof as to the cost to the affiliated interest of furnishing the service or property and, in part, upon the estimated cost the oil or gas pipeline carrier would have incurred if it furnished the service or property with its own personnel and capital.

Sec. 42.06.460. DESIGNATION OF SERVICE AGENTS. Each pipeline carrier shall file with the commission a written appointment of a named permanent resident (which may be a corporation) of this state as its registered agent in this state upon whom service of all notices, regulations, and requests of the commission may be made. The appointment shall specify an address in this state of such appointed agent, which address may be changed from time to time by filing a new Alaskan address with the commission. If a pipeline carrier fails to appoint an agent, service of notices, regulations and requests may be made by posting a copy in the main office of the commission and filing a copy in the office of the lieutenant governor.

Sec. 42.06.470. EFFECT OF REGULATIONS. Regulations adopted and issued by the commission in accordance with this chapter have the effect of law.

Sec. 42.06.480. REVIEW AND ENFORCEMENT. (a) All final orders of the commission are subject to judicial review in accordance with AS 44.62.560 - 44.62.570.

(b) If an appeal is not taken from a final order of the commission, the commission may apply to the superior court for enforcement of this chapter, the regulations adopted under it and the orders of the commission. The court shall enforce the order by injunction or other process.

Sec. 42.06.490. COMPLAINT AGAINST PIPELINE CARRIER. (a) Any person (including a commissioner or employee of the commission) may file a complaint with the commission under AS 44.62.360 alleging that a rate, price, service, practice or action of a pipeline carrier violates this chapter or regulations hereunder, or that a pipeline carrier has not complied with the certificate issued under this chapter.

(b) The content, service, and amendment requirements of a complaint filed with the commission under this section shall be as specified in AS 44.62.360, 44.62.380 and 44.62.400.

Sec. 42.06.500. ADJUDICATION BY COMMISSION UNDER ADMINISTRATIVE PROCEDURE ACT. The commission shall adjudicate and decide cases initiated by complaint filed under sec. 490 of this chapter in accordance with AS 44.62.330 - 44.62.630.

Sec. 42.06.510. PUBLIC RECORDS. The records, including the facts and information in them, of and in the possession of the commission, except records which by law or by regulation of the commission are designated to be a nonpublic or privileged nature, are public records open

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to public inspection at reasonable times; however, any documents filed with the commission and relating to the finances or operations of a pipeline subject to the Interstate Commerce Act or the Natural Gas Act and being in addition to or other than copies of documents required to be filed with the appropriate federal agency, shall be open to inspection only by appropriate officers and officials of the state for relevant purposes of the state. A person may make written objections to the public disclosure of any information filed with or obtained by the commission under the provisions of this chapter, stating the grounds for the objection; when an objection is made, the commission shall order the information withheld from public disclosure if in the judgment of the commission the information could adversely affect the interest of that person and is not required in the interest of the public. Any commissioner, and the executive director, may certify as to all official acts and records of the commission.

Sec. 42.06.520. APPLICATION FEES. The commission may establish reasonable fees to cover the costs of initial processing of applications for certificates or amendments to certificates.

Sec. 42.06.530. INJUNCTIVE AND MONETARY SANCTIONS. (a) The full amount of damages determined by a civil action may be compromised by the commission. In determining the amount of the damages, or the amount agreed upon in compromise, the gravity of the violation, and the good faith of the person charged in attempting to achieve compliance, after notification of a violation, shall be considered. The amount of the damages, when finally determined, or the amount agreed upon in compromise, may be deducted from any sums owing by the state to the person charged or may be recovered in a civil action in the state courts.

(b) A person may be enjoined by the superior court from committing a violation mentioned in this section.

Sec. 42.06.540. CIVIL PENALTIES. (a) In addition to all other penalties and remedies provided by law, every person subject to the provisions of this chapter, together with their officers, managers, agents or employees that either violates or procures, aids, or abets the violation of any provision of this chapter, or of an order, rule, regulation or written requirement of the commission is subject to a maximum penalty of $500 for each violation.

(b) No penalty may be assessed unless the commission first issues an order to show cause why the penalty should not be levied. The order shall describe the violation with reasonable particularity and designate the maximum penalty which may be assessed for the violation. The order shall be served on the alleged violator named in the order. The order shall state a time and place for the hearing.

(c) After a hearing the commission shall enter its findings of fact and final order which shall state when the penalties, if any, are payable.

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Sec. 42.06.550. EACH VIOLATION A SEPARATE OFFENSE. Each violation of a provision of this chapter or of an order, decision, regulation or written requirement of the commission is a separate and distinct offense and in case of a continuing violation each day the violation continues constitutes a separate offense.

Sec. 42.06.560. ACTIONS TO RECOVER DAMAGES AND PENALTIES; DISPOSITION. (a) Actions to recover damages and penalties under this chapter shall be brought by the attorney general in a court of competent jurisdiction.

(b) All damages and penalties recovered under the provisions of this chapter shall be paid to the commission and deposited by it in the general fund of the state.

Sec. 42.06.570. PENALTIES CUMULATIVE. (a) All penalties imposed under this chapter are cumulative.

(b) An action to recover a civil penalty is not a bar to an enforcement proceeding to require compliance, or to any other remedy provided by this chapter.

Sec. 42.06.580. JOINDER OF ACTIONS. Under the applicable court rules, appeals from orders of the commission, applications for enforcement of commission orders and actions for recovery of damages or penalties may be joined. The court may in the interests of justice separate the actions.

Sec. 42.06.590. PRIVATE CAUSE OF ACTION. (a) A person subjected to an unlawful rate, price, service, or practice, in violation of this chapter, may sue in a state court of appropriate jurisdiction for damages resulting from the unlawful rate, price, service, or practice.

(b) If the violation described in (a) of this section resulted in the overcharge of rate or price, the person paying the unlawful rate or price is entitled to recover as damages at least double the amount of the overcharge.

(c) A person recovering damages under this section is entitled to a reasonable attorney fee, fixed by the court, to be taxed and collected as costs of the suit.

Sec. 42.06.600. REGULATION BY MUNICIPALITY. The commission's jurisdiction and authority extend to an oil or gas pipeline facility operating in a city or borough, whether home rule or otherwise. If a conflict between a certificate, order, decision or regulation of the commission and a charter, permit, franchise, ordinance, rule or regulation of such a local governmental entity occurs, the certificate, order, decision or regulation of the commission prevails.

Sec. 42.06.610. EXPENSES OF INVESTIGATION OR HEARING. After completion of a hearing or investigation held under this chapter, the commission shall allocate the costs of the hearing or investigation among the parties, including the commission, as is just under the circumstances. The costs allocated may include the costs of any time devoted

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to the investigation or hearing by hired consultants, whether or not the consultants appear as witnesses or participants. The commission shall provide an opportunity for any person objecting to an allocation to be heard before the allocation becomes final.

Sec. 42.06.620. CLASSIFICATION. The commission may by regulation provide for the classification of oil or gas pipeline facilities based upon differences in annual revenue, assets, nature of ownership and other appropriate distinctions and as between these classifications, by regulation, provide for different reporting, accounting and other regulatory requirements.

Sec. 42.06.630. DEFINITIONS. As used in this chapter

(1) "commission" means the Alaska Pipeline Commission;

(2) "commissioner" means a member of the commission;

(3) "duties" means duties, powers, obligations and functions;

(4) "gas" means natural gas, including bradenhead gas, casinghead gas, gas produced from an oil or gas well, and any mixture of natural and artificial gas, and includes liquid products and by-products of gas;

(5) "Interstate Commerce Act" means the Interstate Commerce Act of 1906, 34 Stat. 584, as amended;

(6) "municipality" means an organized borough or incorporated city;

(7) "Natural Gas Act" means the Natural Gas Act of 1938, 52 Stat. 821, as amended;

(8) "oil" means crude petroleum oil in its natural state, and crude petroleum oil from which only basic sediment and water have been removed;

(9) "pipeline" or "pipeline facility" means all the facilities of a total system of pipe (whether owned or operated by a pipeline carrier under a contract, agreement, or lease) in this state used by a pipeline carrier for transportation, for hire and as a common carrier, of oil or gas for delivery, for storage, or for further transportation, and including all pipe, pump and compressor stations, station equipment, and all other facilities used or necessary for an integral line of pipe to effectuate such transportation from point to point, excluding, however, gas processing plants, treaters and separators;

(10) "pipeline carrier" means the owner, including corporations organized under the laws of the United States or of other states, of any pipeline, as said term is defined in this section, or any interest therein;

(11) "regulation" includes rules;

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(12) "tariff" means a rate, charge, toll, rule or regulation of an oil or gas pipeline facility relating to services furnished by the facility to the general public or other users for compensation.

Sec. 42.06.640. SHORT TITLE. This chapter may be cited as the Alaska Pipeline Commission Act.

* Sec. 2. Notwithstanding the provisions of AS 42.06.030 - 42.06.040, until July 1, 1973 the duties and functions of the Alaska Pipeline Commission under AS 42.06 may, by executive order of the governor, be carried out by a single commissioner appointed and paid pursuant to the provisions of AS 42.06 and two temporary commissioners who shall be appointed for terms expiring July 1, 1973. Temporary commissioners shall receive no compensation except per diem and travel authorized by law for other state boards and commissions and shall not be subject to the provisions of AS 42.06.060.

* Sec. 3. This Act takes effect on the day after its passage and approval or on the day it becomes law without approval.

Approved by governor: June 20, 1972
Actual effective date: June 21, 1972

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FEDERAL
STATUTE
NATURAL
GAS

BRADNER

§ 715*l*. Repealed. June 25, 1942, ch. 435, 56 Stat. 351.

Section, acts Feb. 22, 1935, ch. 18, § 13, 49 Stat. 33; June 14, 1937, ch. 335, 50 Stat. 257; June 29, 1939, ch. 250, 53 Stat. 927, provided for expiration of this chapter on June 30, 1942.

§ 715m. Cooperation between Secretary of Interior and Federal and State authorities.

The Secretary of the Interior, in carrying out this chapter, is authorized to cooperate with Federal and State authorities. (June 25, 1946, ch. 472, § 3, 60 Stat. 307.)

CODIFICATION

Section was not enacted as a part of the Connolly Hot Oil Act which comprises this chapter.

DELEGATION OF POWERS

Delegation of President's authority to the Secretary of the Interior, see note set out under section 715*l* of this title.

Chapter 15B.—NATURAL GAS

Sec.
717 Necessity for regulation of natural gas companies.
717a Definitions.
717b Exportation or importation of natural gas.
717c Rates and charges; schedules; suspension of new rates.
717d Fixing rates and charges; determination of cost of production or transportation.
717e Ascertainment of cost of property.
717f Construction, extension, or abandonment of facilities; certificate of convenience and necessity; condemnation proceedings.
717g Accounts; records; memoranda.
717h Rates of depreciation.
717i Periodic and special reports.
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717l Complaints.
717m Investigations by Commission; attendance of witnesses; depositions.
717n Hearings; rules of procedure.
717o Administrative powers of Commission; rules, regulations, and orders.
717p Use of joint boards; cooperation with State commissions.
717q Appointment of officers and employees.
717r Rehearings; court review of orders.
717s Enforcement of chapter; regulations and orders.
717t General penalties.
717u Jurisdiction of offenses; enforcement of liabilities and duties.
717v Separability of provisions.
717w Short title.

§ 717. Necessity for regulation of natural gas companies.

(a) As disclosed in reports of the Federal Trade Commission made pursuant to S. Res. 83 (Seventieth Congress, first session) and other reports made pursuant to the authority of Congress, it is declared that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest.

(b) The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

(c) The provisions of this chapter shall not apply to any person engaged in or legally authorized to engage in the transportation in interstate commerce or the sale in interstate commerce for resale of natural gas received by such person from another person within or at the boundary of a State if all such natural gas so received is ultimately consumed within such State, or to any facilities used by such person for such transportation or sale, provided that the rates and service of such person and facilities be subject to regulation by a State commission. The matters exempted from the provisions of this chapter by this subsection are declared to be matters primarily of local concern and subject to regulation by the several States. A certificate from such State commission to the Federal Power Commission that such State commission has regulatory jurisdiction over rates and service of such person and facilities and is exercising such [illegible] regulatory power or jurisdiction. (June 21, 1938, ch. 556, § 1, 52 Stat. 821; Mar. 27, 1954, ch. 115, 68 Stat. 36.)

AMENDMENTS

1954—Subsec. (c). Act Mar. 27, 1954, added subsec. (c).

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in title 49 section 1476.

§ 717a. Definitions.

When used in this chapter, unless the context otherwise requires—

(1) "Person" includes an individual or a corporation.

(2) "Corporation" includes any corporation, joint-stock company, partnership, association, business trust, organized group of persons, whether incorporated or not, receiver or receivers, trustee or trustees of any of the foregoing, but shall not include municipalities as hereinafter defined.

(3) "Municipality" means a city, county, or other political subdivision or agency of a State.

(4) "State" means a State admitted to the Union, the District of Columbia, and any organized Territory of the United States.

(5) "Natural gas" means either natural gas unmixed, or any mixture of natural and artificial gas.

(6) "Natural-gas company" means a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale.

(7) "Interstate commerce" means commerce between any point in a State and any point outside thereof, or between points within the same State but through any place outside thereof, but only insofar as such commerce takes place within the United States.

(8) "State commission" means the regulatory body of the State or municipality having jurisdiction to regulate rates and charges for the sale of natural gas to consumers within the State or municipality.

(9) "Commission" and "Commissioner" means the Federal Power Commission, and a member thereof, respectively.

(June 21, 1938, ch. 556, § 2, 52 Stat. 821.)

CROSS REFERENCES

Federal Power Commission, creation of, see section 792 of Title 16, Conservation.

§ 717b. Exportation or importation of natural gas.

After six months from June 21, 1938, no person shall export any natural gas from the United States to a foreign country or import any natural gas from a foreign country without first having secured an order of the Commission authorizing it to do so. The Commission shall issue such order upon application, unless, after opportunity for hearing, it finds that the proposed exportation or importation will not be consistent with the public interest. The Commission may by its order grant such application, in whole or in part, with such modification and upon such terms and conditions as the Commission may find necessary or appropriate, and may from time to time, after opportunity for hearing and for good cause shown, make such supplemental order in the premises as it may find necessary or appropriate. (June 21, 1938, ch. 556, § 3, 52 Stat. 822.)

TRANSFER OF FUNCTIONS

All executive and administrative functions of the Federal Power Commission were, with certain reservations, transferred to the Chairman of such Commission, with authority vested in him to authorize their performance by any officer, employee, or administrative unit under his jurisdiction, by 1950 Reorg. Plan No. 9, §§ 1, 2, eff. May 24, 1950, 15 F.R. 3175, 64 Stat. 1263, set out in the Appendix to Title 5, Government Organization and Employees.

DELEGATION OF FUNCTIONS

Functions of the President respecting certain facilities constructed and maintained on United States borders delegated to the Secretary of State, see Ex. Ord. No. 11423, Aug. 10, 1968, 33 F.R. 11741, set out as a note under section 301 of Title 3, The President.

EX. ORD. NO. 10485. PERFORMANCE OF FUNCTIONS RESPECTING ELECTRIC POWER AND NATURAL GAS FACILITIES LOCATED ON UNITED STATES BORDERS

Ex. Ord. No. 10485, Sept. 3, 1953, 18 F.R. 5397, provided: SECTION 1. (a) The Federal Power Commission is hereby designated and empowered to perform the following-described functions:

(1) To receive all applications for permits for the construction, operation, maintenance, or connection, at the borders of the United States, of facilities for the transmission of electric energy between the United States and a foreign country.

(2) To receive all applications for permits for the construction, operation, maintenance, or connection, at the borders of the United States, of facilities for the exportation or importation of natural gas to or from a foreign country.

(3) Upon finding the issuance of the permit to be consistent with the public interest, and, after obtaining the favorable recommendations of the Secretary of State and the Secretary of Defense thereon, to issue to the applicant, as appropriate, a permit for such construction, operation, maintenance, or connection. The Commission shall have the power to attach to the issuance of the permit and to the exercise of the rights granted thereunder such conditions as the public interest may in its judgment require.

(b) In any case wherein the Federal Power Commission, the Secretary of State, and the Secretary of Defense cannot agree as to whether or not a permit should be issued, the Commission shall submit to the President for approval or disapproval the application for a permit with the respective views of the Commission, the Secretary of State and the Secretary of Defense.

SEC. 2. The Chairman or Acting Chairman of the Federal Power Commission is hereby designated and empowered to sign any permits issued by the Federal Power Commission pursuant to section 1 (a) (3) hereof.

SEC. 3. The Federal Power Commission is authorized to issue such rules and regulations, and to prescribe such procedures, as it may from time to time deem necessary or desirable for the exercise of the authority delegated to it by this order.

SEC. 4. All Presidential Permits heretofore issued pursuant to Executive Order No. 8202 of July 13, 1939, and in force at the time of the issuance of this order, and all permits issued hereunder, shall remain in full force and effect until modified or revoked by the President or by the Federal Power Commission.

SEC. 5. Executive Order No. 8202 of July 13, 1939, is hereby revoked.

§ 717c. Rates and charges; schedules; suspension of new rates.

(a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.

(b) No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from June 21, 1938) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon com-

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§ 717f. Construction, extension, or abandonment of facilities; certificate of convenience and necessity; condemnation proceedings.

(a) Whenever the Commission, after notice and opportunity for hearing, finds such action necessary or desirable in the public interest, it may by order direct a natural-gas company to extend or improve its transportation facilities, to establish physical connection of its transportation facilities with the facilities of, and sell natural gas to, any person or municipality engaged or legally authorized to engage in the local distribution of natural or artificial gas to the public, and for such purpose to extend its transportation facilities to communities immediately adjacent to such facilities or to territory served by such natural-gas company, if the Commission finds that no undue burden will be placed upon such natural-gas company thereby: *Provided*, That the Commission shall have no authority to compel the enlargement of transportation facilities for such purposes, or to compel such natural-gas company to establish physical connection or sell natural gas when to do so would impair its ability to render adequate service to its customers.

(b) No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

(c) No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations: *Provided, however*, That if any such natural-gas company or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on February 7, 1942, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after February 7, 1942. Pending the determination of any such application, the continuance of such operation shall be lawful.

In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: *Provided, however*, That the Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice or hearing, pending the determination of an application for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest.

(d) Application for certificates shall be made in writing to the Commission, be verified under oath, and shall be in such form, contain such information, and notice thereof shall be served upon such interested parties and in such manner as the Commission shall, by regulation, require.

(e) Except in the cases governed by the provisos contained in subsection (c) of this section, a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of this chapter and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require.

(f) The Commission, after a hearing had upon its own motion or upon application, may determine the service area to which each authorization under this section is to be limited. Within such service area as determined by the Commission a natural-gas company may enlarge or extend its facilities for the purpose of supplying increased market demands in such service area without further authorization.

(g) Nothing contained in this section shall be construed as a limitation upon the power of the Commission to grant certificates of public convenience and necessity for service of an area already being served by another natural-gas company.

(h) When any holder of a certificate of public convenience and necessity cannot acquire by contract, or is unable to agree with the owner of property to the compensation to be paid for, the necessary right-of-way to construct, operate, and maintain a pipe line or pipe lines for the transportation of natural gas, and the necessary land or other property, in addition to right-of-way, for the location of compressor stations, pressure apparatus, or other stations or equipment necessary to the proper operation of such pipe line or pipe lines, it may acquire the same by the exercise of the right of eminent domain in the district court of the United States for the district in which such property may be located, or in the State courts. The practice and procedure in any action or proceeding for that purpose

in the district court of the United States shall conform as nearly as may be with the practice and procedure in similar action or proceeding in the courts of the State where the property is situated: *Provided*, That the United States district courts shall only have jurisdiction of cases when the amount claimed by the owner of the property to be condemned exceeds $3,000. (June 21, 1938, ch. 556, § 7, 52 Stat. 824; Feb. 7, 1942, ch. 49, 56 Stat. 83; July 25, 1947, ch. 33, 61 Stat. 459.)

AMENDMENTS

1947—Subsec. (b). Act July 25, 1947, added subsec. (b).

1942—Subsecs. (c)—(g). Act Feb. 7, 1942, struck out former subsec. (c), and added subsecs. (c)—(g).

TRANSFER OF FUNCTIONS

All executive and administrative functions of the Federal Power Commission were, with certain reservations, transferred to the Chairman of such Commission, with authority vested in him to authorize their performance by any officer, employee, or administrative unit under his jurisdiction, by 1950 Reorg. Plan No. 9, §§ 1, 2, eff. May 24, 1950, 15 F. R. 3175, 64 Stat. 1265, set out in the Appendix to Title 5, Government Organization and Employees.

FEDERAL RULES OF CIVIL PROCEDURE

Condemnation of property, see rule 71A, Title 28, Appendix, Judiciary and Judicial Procedure.

§ 717g. Accounts; records; memoranda.

(a) Every natural-gas company shall make, keep, and preserve for such periods, such accounts, records of cost-accounting procedures, correspondence, memoranda, papers, books, and other records as the Commission may by rules and regulations prescribe as necessary or appropriate for purposes of the administration of this chapter: *Provided, however*, That nothing in this chapter shall relieve any such natural-gas company from keeping any accounts, memoranda, or records which such natural-gas company may be required to keep by or under authority of the laws of any State. The Commission may prescribe a system of accounts to be kept by such natural-gas companies, and may classify such natural-gas companies and prescribe a system of accounts for each class. The Commission, after notice and opportunity for hearing, may determine by order the accounts in which particular outlays or receipts shall be entered, charged, or credited. The burden of proof to justify every accounting entry questioned by the Commission shall be on the person making, authorizing, or requiring such entry, and the Commission may suspend a charge or credit pending submission of satisfactory proof in support thereof.

(b) 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.

(c) The books, accounts, memoranda, and records of any person who controls directly or indirectly a natural-gas company subject to the jurisdiction of the Commission and of any other company controlled by such person, insofar as they relate to transactions with or the business of such natural-gas company, shall be subject to examination on the order of the Commission. (June 21, 1938, ch. 556, § 8, 52 Stat. 825.)

TRANSFER OF FUNCTIONS

All executive and administrative functions of the Federal Power Commission were, with certain reservations, transferred to the Chairman of such Commission, with authority vested in him to authorize their performance by any officer, employee or administrative unit under his jurisdiction by 1950 Reorg. Plan No. 9, §§ 1, 2, eff. May 24, 1950, 15 F. R. 3175, 64 Stat. 1265, set out in the Appendix to Title 5, Government Organization and Employees.

§ 717h. Rates of depreciation.

(a) The Commission may, after hearing, require natural-gas companies to carry proper and adequate depreciation and amortization accounts in accordance with such rules, regulations, and forms of account as the Commission may prescribe. The Commission may from time to time ascertain and determine, and by order fix, the proper and adequate rates of depreciation and amortization of the several classes of property of each natural-gas company used or useful in the production, transportation, or sale of natural gas. Each natural-gas company shall conform its depreciation and amortization accounts to the rates so ascertained, determined, and fixed. No natural-gas company subject to the jurisdiction of the Commission shall charge to its operating expenses any depreciation or amortization charges on classes of property other than those prescribed by the Commission, or charge with respect to any class of property a percentage of depreciation or amortization other than that prescribed therefor by the Commission. No such natural-gas company shall in any case include in any form under its operating or other expenses any depreciation, amortization, or other charge or expenditure included elsewhere as a depreciation or amortization charge or otherwise under its operating or other expenses. Nothing in this section shall limit the power of a State commission to determine in the exercise of its jurisdiction, with respect to any natural-gas company, the percentage rates of depreciation or amortization to be allowed, as to any class of property of such natural-gas company, or the composite depreciation or amortization rate, for the purpose of determining rates or charges.

(b) The Commission, before prescribing any rules or requirements as to accounts, records, or memoranda, or as to depreciation or amortization rates, shall notify each State commission having jurisdiction with respect to any natural-gas company involved and shall give reasonable opportunity to each such commission to present its views and shall receive and consider such views and recommendations. (June 21, 1938, ch. 556, § 9, 52 Stat. 826.)

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plaint of any State, municipality, State commission, or gas distributing company, or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible. (June 21, 1938, ch. 556, § 4, 52 Stat. 822; May 21, 1962, Pub. L. 87-454, 76 Stat. 72.)

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1962—Subsec. (e). Pub. L. 87-454 inserted "or gas distributing company" following "State commission", and deleted a proviso which denied authority to the Commission to suspend the rate, charge, classification, or service for the sale of natural gas for resale for industrial use only.

TRANSFER OF FUNCTIONS

All executive and administrative functions of the Federal Power Commission were, with certain reservations, transferred to the Chairman of such Commission, with authority vested in him to authorize their performance by any officer, employee, or administrative unit under his jurisdiction, by 1950 Reorg. Plan No. 9, §§ 1, 2, eff. May 24, 1950, 15 F. R. 3178, 64 Stat. 1265, set out in the Appendix to Title 5, Government Organization and Employees.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in title 50 section 1671.

§ 717d. Fixing rates and charges; determination of cost of production or transportation.

(a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

(b) The Commission upon its own motion, or upon the request of any State commission, whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transportation of natural gas by a natural-gas company in cases where the Commission has no authority to establish a rate governing the transportation or sale of such natural gas. (June 21, 1938, ch. 556, § 5, 52 Stat. 822.)

TRANSFER OF FUNCTIONS

All executive and administrative functions of the Federal Power Commission were, with certain reservations, transferred to the Chairman of such Commission, with authority vested in him to authorize their performance by any officer, employee, or administrative unit under his jurisdiction, by 1950 Reorg. Plan No. 9, § 1, eff. May 24, 1950, 15 F. R. 3178, 64 Stat. 1265, set out in the Appendix to Title 5, Government Organization and Employees.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in title 50 section 1671.

§ 717e. Ascertainment of cost of property.

(a) The Commission may investigate and ascertain the actual legitimate cost of the property of every natural-gas company, the depreciation therein, and, when found necessary for rate-making purposes, other facts which bear on the determination of such cost or depreciation and the fair value of such property.

(b) Every natural-gas company upon request shall file with the Commission an inventory of all or any part of its property and a statement of the original cost thereof, and shall keep the Commission informed regarding the cost of all additions, betterments, extensions, and new construction. (June 21, 1938, ch. 556, § 6, 52 Stat. 824.)

TRANSFER OF FUNCTIONS

All executive and administrative functions of the Federal Power Commission were, with certain reservations, transferred to the Chairman of such Commission, with authority vested in him to authorize their performance by any officer, employee, or administrative unit under his jurisdiction, by 1950 Reorg. Plan No. 9, §§ 1, 2, eff. May 24, 1950, 15 F. R. 3178, 64 Stat. 1265, set out in the appendix to Title 5, Government Organization and Employees.

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TRANSFER OF FUNCTIONS

All executive and administrative functions of the Federal Power Commission were, with certain reservations, transferred to the Chairman of such Commission, with authority vested in him to authorize their performance by any officer, employee, or administrative unit under his jurisdiction, by 1950 Reorg. Plan No. 9, §§ 1, 2, eff. May 24, 1950, 15 F. R. 3175, 64 Stat. 1265, set out in the Appendix to Title 5, Government Organization and Employees.

§ 717i. Periodic and special reports.

(a) Every natural-gas company shall file with the Commission such annual and other periodic or special reports as the Commission may by rules and regulations or order prescribe as necessary or appropriate to assist the Commission in the proper administration of this chapter. The Commission may prescribe the manner and form in which such reports shall be made, and require from such natural-gas companies specific answers to all questions upon which the Commission may need information. The Commission may require that such reports shall include, among other things, full information as to assets and liabilities, capitalization, investment and reduction thereof, gross receipts, interest due and paid, depreciation, amortization, and other reserves, cost of facilities, cost of maintenance and operation of facilities for the production, transportation, or sale of natural gas, cost of renewal and replacement of such facilities, transportation, delivery, use, and sale of natural gas. The Commission may require any such natural-gas company to make adequate provision for currently determining such costs and other facts. Such reports shall be made under oath unless the Commission otherwise specifies.

(b) It shall be unlawful for any natural-gas company willfully to hinder, delay, or obstruct the making, filing, or keeping of any information, document, report, memorandum, record, or account required to be made, filed, or kept under this chapter or any rule, regulation, or order thereunder. (June 21, 1938, ch. 556, § 10, 52 Stat. 826.)

TRANSFER OF FUNCTIONS

All executive and administrative functions of the Federal Power Commission were, with certain reservations, transferred to the Chairman of such Commission, with authority vested in him to authorize their performance by any officer, employee, or administrative unit under his jurisdiction, by 1950 Reorg. Plan No. 9, §§ 1, 2, eff. May 24, 1950, 15 F. R. 3175, 64 Stat. 1265, set out in the Appendix to Title 5, Government Organization and Employees.

§ 717j. State compacts; reports on.

(a) In case two or more States propose to the Congress compacts dealing with the conservation, production, transportation, or distribution of natural gas it shall be the duty of the Commission to assemble pertinent information relative to the matters covered in any such proposed compact to make public and to report to the Congress information so obtained, together with such recommendations for further legislation as may appear to be appropriate or necessary to carry out the purposes of such proposed compact and to aid in the conservation of natural-gas resources within the United States and in the orderly, equitable, and economic production, transportation, and distribution of natural gas.

(b) It shall be the duty of the Commission to assemble and keep current pertinent information relative to the effect and operation of any compact between two or more States heretofore or hereafter approved by the Congress, to make such information public, and to report to the Congress, from time to time, the information so obtained, together with such recommendations as may appear to be appropriate or necessary to promote the purposes of such compact.

(c) In carrying out the purposes of this chapter, the Commission shall, so far as practicable, avail itself of the services, records, reports, and information of the executive departments and other agencies of the Government, and the President may, from time to time, direct that such services and facilities be made available to the Commission. (June 21, 1938, ch. 556, § 11, 52 Stat. 827.)

TRANSFER OF FUNCTIONS

All executive and administrative functions of the Federal Power Commission were with certain reservations, transferred to the Chairman of such Commission, with authority vested in him to authorize their performance by any officer, employee, or administrative unit under his jurisdiction, by 1950 Reorg. Plan No. 9, §§ 1, 2, eff. May 24, 1950, 15 F. R. 3175, 64 Stat. 1265, set out in the Appendix to Title 5, Government Organization and Employees.

§ 717k. Officials dealing in securities.

It shall be unlawful for any officer or director of any natural-gas company to receive for his own benefit, directly or indirectly, any money or thing of value in respect to the negotiation, hypothecation, or sale by such natural-gas company of any security issued, or to be issued, by such natural-gas company, or to share in any of the proceeds thereof, or to participate in the making or payment of any dividends, other than liquidating dividends, of such natural-gas company from any funds properly included in capital account. (June 21, 1938, ch. 556, § 12, 52 Stat. 827.)

§ 717l. Complaints.

Any State, municipality, or State commission complaining of anything done or omitted to be done by any natural-gas company in contravention of the provisions of this chapter may apply to the Commission by petition, which shall briefly state the facts, whereupon a statement of the complaint thus made shall be forwarded by the Commission to such natural-gas company, which shall be called upon to satisfy the complaint or to answer the same in writing within a reasonable time to be specified by the Commission. (June 21, 1938, ch. 556, § 13, 52 Stat. 827.)

TRANSFER OF FUNCTIONS

All executive and administrative functions of the Federal Power Commission were with certain reservations, transferred to the Chairman of such Commission, with authority vested in him to authorize their performance by any officer, employee, or administrative unit under his jurisdiction, by 1950 Reorg. Plan No. 9, §§ 1, 2, eff. May 24, 1950, 15 F. R. 3175, 64 Stat. 1265, set out in the Appendix to Title 5, Government Organization and Employees.

§ 717m. Investigations by Commission; attendance of witnesses; depositions.

(a) The Commission may investigate any facts, conditions, practices, or matters which it may find

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order made or imposed by the Commission under authority of this chapter, shall, in addition to any other penalties provided by law, be punished upon conviction thereof by a fine of not exceeding $500 for each and every day during which such offense occurs. (June 21, 1938, ch. 556, § 21, 52 Stat. 833.)

TRANSFER OF FUNCTIONS

All executive and administrative functions of the Federal Power Commission were, with certain reservations, transferred to the Chairman of such Commission, with authority vested in him to authorize their performance by any officer, employee, or administrative unit under his jurisdiction, by 1950 Reorg. Plan No. 9, §§ 1, 2, eff. May 24, 1950, 15 F. R. 3175, 64 Stat. 1265, set out in the Appendix to Title 5, Government Organization and Employees.

§ 717u. Jurisdiction of offenses; enforcement of liabilities and duties.

The District Courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules, regulations, and orders thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this chapter or any rule, regulation, or order thereunder. Any criminal proceeding shall be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by, or to enjoin any violation of, this chapter or any rule, regulation, or order thereunder may be brought in any such district or in the district wherein the defendant is an inhabitant, and process in such cases may be served wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 225 and 347 of Title 28. No costs shall be assessed against the Commission in any judicial proceeding by or against the Commission under this chapter. (June 21, 1938, ch. 556, § 22, 52 Stat. 833; June 25, 1948, ch. 646, § 1, 62 Stat. 875, 895.)

REFERENCES IN TEXT

Sections 225 and 347 of Title 28, referred to in the text, were repealed by act June 25, 1948, ch. 646, § 39, 62 Stat. 992, eff. Sept. 1, 1948.

Former section 225 is now covered by sections 1291—1294 of Title 28, Judiciary and Judicial Procedure; see Title 11, Bankruptcy, sections 21 and 45 of this title, and section 3731 of Title 18, Crimes and Criminal Procedure.

Former section 347 is now covered by section 1254 of Title 28, Judiciary and Judicial Procedure.

CODIFICATION

The words "the District Court of the United States for the District of Columbia" following "The District Courts of the United States" have been deleted as superfluous in view of section 132 (a) of Title 28, Judiciary and Judicial Procedure, which states that "There shall be in each judicial district a district court which shall be a court of record known as the United States District Court for the district" and section 88 of Title 28 which states that "The District of Columbia constitutes one judicial district".

TRANSFER OF FUNCTIONS

All executive and administrative functions of the Federal Power Commission were, with certain reservations, transferred to the Chairman of such Commission, with authority vested in him to authorize their performance by any officer, employee, or administrative unit under his jurisdiction, by 1950 Reorg. Plan No. 9, §§ 1, 2, eff. May 24, 1950, 15 F. R. 3175, 64 Stat. 1265, set out in the Appendix to Title 5, Government Organization and Employees.

CROSS REFERENCES

Venue of district courts, see section 1391 et seq. of Title 28, Judiciary and Judicial Procedure.

FEDERAL RULES OF CIVIL PROCEDURE

Rules as governing the procedure in all suits of a civil nature whether cognizable as cases at law or in equity see rule 1, Title 28, Appendix, Judiciary and Judicial Procedure.

Injunctions, see rule 65.

One form of action, see rule 2.

Process, see rule 4.

FEDERAL RULES OF CRIMINAL PROCEDURE

Continuation of section under rule 18, see note by Advisory Committee under rule 18, Title 18, Appendix, Crimes and Criminal Procedure.

§ 717v. Separability of provisions.

If any provision of this chapter, or the application of such provision to any person or circumstance, shall be held invalid, the remainder of the chapter, and the application of such provision to persons or circumstances other than those as to which it is held invalid shall not be affected thereby. (June 21, 1938, ch. 556, § 23, 52 Stat. 833.)

§ 717w. Short title.

This chapter may be cited as the "Natural Gas Act." (June 21, 1938, ch. 556, § 24, 52 Stat. 833.)

Chapter 16.—EMERGENCY RELIEF

§§ 721, 722. Omitted.

CODIFICATION

Sections, acts May 12, 1933, ch. 30, §§ 1, 2, 48 Stat. 55, 56; Feb. 15, 1934, ch. 13, § 1, 48 Stat. 351, were enacted as temporary legislation during the economic emergency in 1933.

§ 723. Repealed. Pub. L. 89-554, § 8(a), Sept. 6, 1966, 80 Stat. 618.

Section, acts May 12, 1933, ch. 30, § 1, 48 Stat. 56; Feb. 15, 1934, ch. 13, § 1, 48 Stat. 351, was enacted as temporary legislation during the economic emergency in 1933.

§§ 724 to 728. Omitted.

CODIFICATION

Sections, acts May 12, 1933, ch. 30, §§ 4–8, 48 Stat. 56–58; Feb. 15, 1934, ch. 13, § 1, 48 Stat. 351, were enacted as temporary legislation during the economic emergency in 1933.

SUPPLEMENTARY LEGISLATION

Legislation supplementary to the Federal Emergency Relief Act of 1933 was contained in the following acts, executive orders, and reorganization plans: Res. Apr. 8, 1935, ch. 48, 49 Stat. 115; Aug. 12, 1935, ch. 508, § 3, 49 Stat. 596; Aug. 24, 1935, ch. 641, § 55, 49 Stat. 781; Feb. 11, 1936, ch. 49, § 7, 49 Stat. 1134; Feb. 11, 1936, ch. 51, 49 Stat. 1135; June 22, 1936, ch. 689, title II, 49 Stat. 1608; Res. Feb. 24, 1937, ch. 17, 50 Stat. 21; June 29, 1937, 11 p. m., ch. 401, 50 Stat. 357; Mar. 2, 1938, ch. 38, 52 Stat. 83; June 21, 1938, ch. 554, 52 Stat. 817; Feb. 4, 1939, ch. 1, 53 Stat. 568; Res. Apr. 1, 1939, ch. 34, 53 Stat. 565; Apr. 13, 1939, ch. 62, 53 Stat. 578; Res. June 30, 1939, ch. 251, 53 Stat. 927; Apr. 6, 1940, ch. 77, 54 Stat. 99; June 26, 1940, ch. 428, title II, 54 Stat. 690; Res. June 26, 1940, ch. 432, 54 Stat. 811; June 27, 1940, ch. 437, title I, 54 Stat. 633; Oct. 9, 1940, ch. 780, title I, 54 Stat. 1035; Mar. 1, 1941, ch. 9, § 1, 55 Stat. 15; Apr. 5, 1941, ch. 40, § 1, 55 Stat. 110; July 1, 1941, ch. 266, 55 Stat. 396; July 1, 1941, ch. 269, title II, 55 Stat. 487; Dec. 17, 1941, ch. 591, 55 Stat. 810; June 27, 1942, ch. 450, § 1, 56 Stat. 410; July 2, 1942, ch. 475, title II, 56 Stat. 571; Res. July 2, 1942, ch. 479, 56 Stat. 634; June 30, 1943, ch. 130, 57 Stat. 161; June 26, 1943, ch. 145, title I,

findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 346 and 347 of Title 28.

(c) The filing of an application for rehearing under subsection (a) of this section shall not, unless specifically ordered by the Commission, operate as a stay of the Commission's order. The commencement of proceedings under subsection (b) of this section shall not, unless specifically ordered by the court, operate as a stay of the Commission's order. (June 21, 1938, ch. 556, § 19, 52 Stat. 831; June 25, 1948, ch. 646, § 32 (a), 62 Stat. 991; May 24, 1949, ch. 139, § 127, 63 Stat. 107; Aug. 28, 1958, Pub. L. 85–791, § 19, 72 Stat. 947.)

REFERENCES IN TEXT

Sections 346 and 347 of Title 28 referred to in subsec. (b), were repealed by act June 25, 1948, ch. 646, § 39, 62 Stat. 992, eff. Sept. 1, 1948, and are now covered by section 1254 of Title 28, Judiciary and Judicial Procedure.

AMENDMENTS

1958—Subsec. (a). Pub. L. 85–791, § 19 (a), added sentence providing that upon record in a proceeding has been filed in a court of appeals, Commission may modify or set aside any finding or order issued by it.

Subsec. (b). Pub. L. 85–791, § 19(b), in second sentence, substituted "transmitted by the clerk of the court to" for "served upon", substituted "file with the court" for "certify and file with the court a transcript of", and inserted "as provided in section 2112 of Title 28", and, in third sentence, substituted "petition" for "transcript", and "jurisdiction, which upon the filing of the record with it shall be exclusive" for "exclusive jurisdiction."

CHANGE OF NAME

Subsec. (b) amended by act June 25, 1948, eff. Sept. 1, 1948, as amended by act May 24, 1949, which substituted "court of appeals" for "circuit court of appeals".

TRANSFER OF FUNCTIONS

All executive and administrative functions of the Federal Power Commission were, with certain reservations, transferred to the Chairman of such Commission, with authority vested in him to authorize their performance by any officer, employee, or administrative unit under his jurisdiction, by 1950 Reorg. Plan No. 9, §§ 1, 2, eff. May 24, 1950, 15 F.R. 3175, 64 Stat. 1265, set out in the Appendix to Title 5, Government Organization and Employees.

§ 717s. Enforcement of chapter; regulations and orders.

(a) Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this chapter, or of any rule, regulation, or order thereunder, it may in its discretion bring an action in the proper district court of the United States, or the United States courts of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices and to enforce compliance with this chapter or any rule, regulation, or order thereunder, and upon a proper showing a permanent or temporary injunction or decree or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices or concerning apparent violations of the Federal antitrust laws to the Attorney General, who, in his discretion, may institute the necessary criminal proceedings.

(b) Upon application of the Commission the district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction to issue writs of mandamus commanding any person to comply with the provisions of this chapter or any rule, regulation, or order of the Commission thereunder.

(c) The Commission may employ such attorneys as it finds necessary for proper legal aid and service of the Commission or its members in the conduct of their work, or for proper representation of the public interest in investigations made by it, or cases or proceedings pending before it, whether at the Commission's own instance or upon complaint, or to appear for or represent the Commission in any case in court; and the expenses of such employment shall be paid out of the appropriation for the Commission. (June 21, 1938, ch. 556, § 20, 52 Stat. 832; June 25, 1948, ch. 646, § 1, 62 Stat. 875, 895.)

REFERENCES IN TEXT

The Federal antitrust laws, referred to in subsection (a), are classified generally to this title.

CODIFICATION

The words "the District Court of the United States for the District of Columbia" in subsec. (a) following "district court of the United States" and in subsec. (b) following "district courts of the United States" have been deleted as superfluous in view of section 132 (a) of Title 28, Judiciary and Judicial Procedure, which states that "There shall be in each judicial district a district court which shall be a court of record known as the United States District Court for the district", and section 88 of Title 28 which states that "The District of Columbia constitutes one judicial district".

TRANSFER OF FUNCTIONS

All executive and administrative functions of the Federal Power Commission were, with certain reservations, transferred to the Chairman of such Commission, with authority vested in him to authorize their performance by any officer, employee, or administrative unit under his jurisdiction, by 1950 Reorg. Plan No. 9, §§ 1, 2, eff. May 24, 1950, 15 F.R. 3175, 64 Stat. 1265, set out in the Appendix to Title 5, Government Organization and Employees.

FEDERAL RULES OF CIVIL PROCEDURE

Injunctions, see rule 65, Title 28, Appendix, Judiciary and Judicial Procedure.

Judgments, see rule 54.

Mandamus as abolished but relief yet available by appropriate action or motion under the rules, see rule 81 (b).

§ 717t. General penalties.

(a) Any person who willfully and knowingly does or causes or suffers to be done any act, matter, or thing in this chapter prohibited or declared to be unlawful, or who willfully and knowingly omits or fails to do any act, matter, or thing in this chapter required to be done, or willfully and knowingly causes or suffers such omission or failure, shall, upon conviction thereof, be punished by a fine of not more than $5,000 or by imprisonment for not more than two years, or both.

(b) Any person who willfully and knowingly violates any rule, regulation, restriction, condition, or

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(c) The Commission shall make available to the several State commissions such information and reports as may be of assistance in State regulation of natural-gas companies. Whenever the Commission can do so without prejudice to the efficient and proper conduct of its affairs, it may, upon request from a State commission, make available to such State commission as witnesses any of its trained rate, valuation, or other experts, subject to reimbursement of the compensation and traveling expenses of such witnesses. All sums collected hereunder shall be credited to the appropriation from which the amounts were expended in carrying out the provisions of this subsection. (June 21, 1938, ch. 556, § 17, 52 Stat. 830.)

TRANSFER OF FUNCTIONS

All executive and administrative functions of the Federal Power Commission were, with certain reservations, transferred to the Chairman of such Commission, with authority vested in him to authorize their performance by any officer, employee, or administrative unit under his jurisdiction, by 1950 Reorg. Plan No. 9, §§ 1, 2, eff. May 24, 1950, 15 F. R. 3175, 64 Stat. 1265, set out in the Appendix to Title 5, Government Organization and Employees.

§ 717q. Appointment of officers and employees.

The Commission may, subject to civil-service laws, appoint such officers and employees as are necessary for carrying out its functions under this chapter and fix their salaries in accordance with chapter 51 and subchapter III of chapter 53 of Title 5. (June 21, 1938, ch. 556, § 18, 52 Stat. 831; Oct. 28, 1949, ch. 782, title XI, § 1106(a), 63 Stat. 972.)

REFERENCES IN TEXT

The civil-service laws, referred to in the text, are classified generally to Title 5, Government Organization and Employees.

CODIFICATION

Provisions which authorized the Commission to appoint and fix the compensation of such officers, attorneys, examiners, and experts as may be necessary to carry out its functions without regard to the provisions of other laws applicable to the employment and compensation of officers and employees of the United States were omitted since the positions referred to are now in the classified civil service and subject to the applicable compensation schedules.

The authority for covering excepted positions into the classified civil service was given the President by former section 631a of Title 5, Executive Departments and Government Officers and Employees.

For positions now covered by the Classification Act of 1949, see sections 305 and 5102 of Title 5. For the power of the Civil Service Commission to determine the applicability of those sections to specific positions, see section 5102 of Title 5.

AMENDMENTS

1949—Act Oct. 28, 1949, struck out the "Classification Act of 1923" and inserted in lieu thereof "Classification Act of 1949", which, for purposes of codification, was translated as "chapter 51 and subchapter III of chapter 53 of Title 5".

TRANSFER OF FUNCTIONS

All executive and administrative functions of the Federal Power Commission were, with certain reservations, transferred to the Chairman of such Commission, with authority vested in him to authorize their performance by any officer, employee, or administrative unit under his jurisdiction, by 1950 Reorg. Plan No. 9, §§ 1, 2, eff. May 24, 1950, 15 F. R. 3175, 64 Stat. 1265, set out in the Appendix to Title 5, Government Organization and Employees.

§ 717r. Rehearings; court review of orders.

(a) Any person, State, municipality, or State commission aggrieved by an order issued by the Commission in a proceeding under this chapter to which such person, State, municipality, or State commission is a party may apply for a rehearing within thirty days after the issuance of such order. The application for rehearing shall set forth specifically the ground or grounds upon which such application is based. Upon such application the Commission shall have power to grant or deny rehearing or to abrogate or modify its order without further hearing. Unless the Commission acts upon the application for rehearing within thirty days after it is filed, such application may be deemed to have been denied. No proceeding to review any order of the Commission shall be brought by any person unless such person shall have made application to the Commission for a rehearing thereon. Until the record in a proceeding shall have been filed in a court of appeals, as provided in subsection (b) of this section, the Commission may at any time, upon reasonable notice and in such manner as it shall deem proper, modify or set aside, in whole or in part, any finding or order made or issued by it under the provisions of this chapter.

(b) Any party to a proceeding under this chapter aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of Title 28. Upon the filing of the petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new

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SAVINGS PROVISION

Amendment by Pub. L. 91-452 not to affect any immunity to which any individual is entitled under this section by reason of any testimony given before the sixtieth day following Oct. 15, 1970, see section 260 of Pub. L. 91-452, set out as a note under section 6001 of Title 18, Crimes and Criminal Procedure.

CROSS REFERENCES

Contempt proceedings, see sections 401, 402, 3285, 3691 and 3771 of Title 18, Crimes and Criminal Procedure.

Fees and mileage of witnesses, see chapter 119 of Title 28, Judiciary and Judicial Procedure.

Immunity of witnesses, see section 6001 et seq. of Title 18, Crimes and Criminal Procedure.

Misdemeanor, offense punishable by imprisonment not exceeding one year as, see section 1 of Title 18, Crimes and Criminal Procedure.

FEDERAL RULES OF CIVIL PROCEDURE

Process, see rule 4, Title 28, Appendix, Judiciary and Judicial Procedure.

FEDERAL RULES OF CRIMINAL PROCEDURE

Criminal contempt, see rule 42 and note by Advisory Committee under the rule, Title 18, Appendix, Crimes and Criminal Procedure.

§ 717n. Hearings; rules of procedure.

(a) Hearings under this chapter may be held before the Commission, any member or members thereof, or any representative of the Commission designated by it, and appropriate records thereof shall be kept. In any proceeding before it, the Commission in accordance with such rules and regulations as it may prescribe, may admit as a party any interested State, State commission, municipality or any representative of interested consumers or security holders, or any competitor of a party to such proceeding, or any other person whose participation in the proceeding may be in the public interest.

(b) All hearings, investigations, and proceedings under this chapter shall be governed by rules of practice and procedure to be adopted by the Commission, and in the conduct thereof the technical rules of evidence need not be applied. No informality in any hearing, investigation, or proceeding or in the manner of taking testimony shall invalidate any order, decision, rule, or regulation issued under the authority of this chapter. (June 21, 1938, ch. 556, § 15, 52 Stat. 829.)

TRANSFER OF FUNCTIONS

All executive and administrative functions of the Federal Power Commission were, with certain reservations, transferred to the Chairman of such Commission, with authority vested in him to authorize their performance by any officer, employee, or administrative unit under his jurisdiction, by 1950 Reorg. Plan No. 9, §§ 1, 2, eff. May 24, 1950, 15 F. R. 3175, 64 Stat. 1265, set out in the Appendix to Title 5, Government Organization and Employees.

§ 717o. Administrative powers of Commission; rules, regulations, and orders.

The Commission shall have power to perform any and all acts, and to prescribe, issue, make, amend, and rescind such orders, rules, and regulations as it may find necessary or appropriate to carry out the provisions of this chapter. Among other things, such rules and regulations may define accounting, technical, and trade terms used in this chapter; and may prescribe the form or forms of all statements, declarations, applications, and reports to be filed with the Commission, the information which they shall contain, and the time within which they shall be filed. Unless a different date is specified therein, rules and regulations of the Commission shall be effective thirty days after publication in the manner which the Commission shall prescribe. Orders of the Commission shall be effective on the date and in the manner which the Commission shall prescribe. For the purposes of its rules and regulations, the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters. All rules and regulations of the Commission shall be filed with its secretary and shall be kept open in convenient form for public inspection and examination during reasonable business hours. (June 21, 1938, ch. 556, § 16, 52 Stat. 830.)

TRANSFER OF FUNCTIONS

All executive and administrative functions of the Federal Power Commission were, with certain reservations, transferred to the Chairman of such Commission, with authority vested in him to authorize their performance by any officer, employee, or administrative unit under his jurisdiction, by 1950 Reorg. Plan No. 9, §§ 1, 2, eff. May 24, 1950, 15 F. R. 3175, 64 Stat. 1265, set out in the Appendix to Title 5, Government Organization and Employees.

§ 717p. Use of joint boards; cooperation with State commissions.

(a) The Commission may refer any matter arising in the administration of this chapter to a board to be composed of a member or members, as determined by the Commission, from the State or each of the States affected or to be affected by such matter. Any such board shall be vested with the same power and be subject to the same duties and liabilities as in the case of a member of the Commission when designated by the Commission to hold any hearings. The action of such board shall have such force and effect and its proceedings shall be conducted in such manner as the Commission shall by regulations prescribe. The Board shall be appointed by the Commission from persons nominated by the State commission of each State affected, or by the Governor of such State if there is no State commission. Each State affected shall be entitled to the same number of representatives on the board unless the nominating power of such State waives such right. The Commission shall have discretion to reject the nominee from any State, but shall thereupon invite a new nomination from that State. The members of a board shall receive such allowances for expenses as the Commission shall provide. The Commission may, when in its discretion sufficient reason exists therefor, revoke any reference to such a board.

(b) The Commission may confer with any State commission regarding rate structures, costs, accounts, charges, practices, classifications, and regulations of natural-gas companies; and the Commission is authorized, under such rules and regulations as it shall prescribe, to hold joint hearings with any State commission in connection with any matter with respect to which the Commission is authorized to act. The Commission is authorized in the administration of this chapter to avail itself of such cooperation, services, records, and facilities as may be afforded by any State commission.

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necessary or proper in order to determine whether any person has violated or is about to violate any provision of this chapter or any rule, regulation, or order thereunder, or to aid in the enforcement of the provisions of this chapter or in prescribing rules or regulations thereunder, or in obtaining information to serve as a basis for recommending further legislation to the Congress. The Commission may permit any person to file with it a statement in writing, under oath or otherwise, as it shall determine, as to any or all facts and circumstances concerning a matter which may be the subject of investigation. The Commission, in its discretion, may publish in the manner authorized by section 825k of Title 16, and make available to State commissions and municipalities, information concerning any such matter.

(b) The Commission may, after hearing, determine the adequacy or inadequacy of the gas reserves held or controlled by any natural-gas company, or by anyone on its behalf, including its owned or leased properties or royalty contracts; and may also, after hearing, determine the propriety and reasonableness of the inclusion in operating expenses, capital, or surplus of all delay rentals or other forms of rental or compensation for unoperated lands and leases. For the purpose of such determinations, the Commission may require any natural-gas company to file with the Commission true copies of all its lease and royalty agreements with respect to such gas reserves.

(c) For the purpose of any investigation or any other proceeding under this chapter, any member of the Commission, or any officer designated by it, is empowered to administer oaths and affirmations, subpena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, contracts, agreements, or other records which the Commission finds relevant or material to the inquiry. Such attendance of witnesses and the production of any such records may be required from any place in the United States or at any designated place of hearing. Witnesses summoned by the Commission to appear before it shall be paid the same fees and mileage that are paid witnesses in the courts of the United States.

(d) In case of contumacy by, or refusal to obey a subpena issued to, any person, the Commission may invoke the aid of any court of the United States within the jurisdiction of which such investigation or proceeding is carried on, or where such person resides or carries on business, in requiring the attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda, contracts, agreements, and other records. Such court may issue an order requiring such person to appear before the Commission or member or officer designated by the Commission, there to produce records, if so ordered, or to give testimony touching the matter under investigation or in question; and any failure to obey such order of the court may be punished by such court as a contempt thereof. All process in any such case may be served in the judicial district whereof such person is an inhabitant or wherever he may be found or may be doing business. Any person who wilfully shall fail or refuse to attend and testify or to answer any lawful inquiry or to produce books, papers, correspondence, memoranda, contracts, agreements, or other records, if in his or its power so to do, in obedience to the subpena of the Commission, shall be guilty of a misdemeanor and upon conviction shall be subject to a fine of not more than $1,000 or to imprisonment for a term of not more than one year, or both.

(e) The testimony of any witness may be taken, at the instance of a party, in any proceeding or investigation pending before the Commission, by deposition at any time after the proceeding is at issue. The Commission may also order testimony to be taken by deposition in any proceeding or investigation pending before it at any stage of such proceeding or investigation. Such depositions may be taken before any person authorized to administer oaths not being of counsel or attorney to either of the parties, nor interested in the proceeding or investigation. Reasonable notice must first be given in writing by the party or his attorney proposing to take such deposition to the opposite party or his attorney of record, as either may be [illegible] which notice shall state the name of the witness and the time and place of the taking of his deposition. Any person may be compelled to appear and depose, and to produce documentary evidence, in the same manner as witnesses may be compelled to appear and testify and produce documentary evidence before the Commission, as hereinbefore provided. Such testimony shall be reduced to writing by the person taking deposition, or under his direction, and shall, after it has been reduced to writing, be subscribed by the deponent.

(f) If a witness whose testimony may be desired to be taken by deposition be in a foreign country, the deposition may be taken before an officer or person designated by the Commission, or agreed upon by the parties by stipulation in writing to be filed with the Commission. All depositions must be promptly filed with the Commission.

(g) Witnesses whose depositions are taken as authorized in this chapter, and the person or officer taking the same, shall be entitled to the same fees as are paid for like services in the courts of the United States. (June 21, 1938, ch. 556, § 14, 52 Stat. 827; Oct. 15, 1970, Pub. L. 91-452, title II, § 218, 84 Stat. 929.)

AMENDMENTS

1970—Subsec. (b). Pub. L. 91-452 struck out subsec. (b) which related to the immunity from prosecution of any individual compelled to testify or produce evidence, documentary or otherwise, after claiming his privilege against self-incrimination.

EFFECTIVE DATE OF 1970 AMENDMENT

Amendment by Pub. L. 91-452 effective on the sixtieth day following Oct. 15, 1970, see section 260 of Pub. L. 91-452, set out as a note under section 3001 of Title 18, Crimes and Criminal Procedure.

TRANSFER OF FUNCTIONS

All executive and administrative functions of the Federal Power Commission were, with certain reservations, transferred to the Chairman of such Commission, with authority vested in him to authorize their performance by any officer, employee, or administrative unit under his jurisdiction, by 1950 Reorg. Plan. No. 9, § 1, eff. Sept. 24, 1950, 15 F. R. 3175, 64 Stat. 1265, set out in the Appendix to Title 5, Government Organization and Employees.

FREE CONFERENCE COMMITTEE REPORT ON SEVERENCE SB 4

SENATE/HOUSE/FREE CONFERENCE SEVERANCE TAX COMPARISON

Oil based upon the average daily production for each well for the calendar month in barrels, the tax is:

	PER CENT OF VALUE	CENTS PER BARREL FLOOR (27 Degree Gravity)
SENATE	3% on the first 300 barrels; 5% on the next 700 barrels; 6% on the next 1,500 barrels; and 8% on all production in excess of 2,500 barrels.	$.10125 on each of the first 300 barrels; $.16875 on each of the next 700 barrels; $.2025 on each of the next 1,500 barrels; $.2700 on each barrel of production in excess of 2,500 barrels.
HOUSE		$.113 on wells producing 100 BPD or less; $.226 on wells producing 101-1000 BPD; $.301 on wells producing 1001-2000 BPD; $.376 on wells producing 2001 BPD or more
FREE CONFERENCE	5% on the first 300 barrels; 6% on the next 700 barrels; 8% on all production in excess of 1,000 barrels.	$.16375 on each of the first 300 barrels; $.2025 on each of the next 700 barrels; $.2700 on each barrel of production in excess of 1,000 barrels.

	SENATE	HOUSE	FREE CONFERENCE	"SPLITS" (Current Law/House)
Effective Cook Inlet Tax Rate (1,000 BPD of 35 degree API Oil)				
Per Cent of Value	4.4%	8.69%*	5.72 %	6.5%
Cents Per Barrel	$.1716	$.339	$.2232	$.2553

* This is the percentage equivalent of $.339 cents per barrel tax on $3.90 wellhead value.

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COOK INLET CRUDE

% of Cook Inlet Production	Gravity	1st 300	Next 700	Balance
-0-	27°	$.16875	$.2025	$.27
7.4	29	.1755	.2106	.2808
3.0	31.7	.18225	.2187	.2916
55.1	34.5	.192375	.23085	.3078
13.7	35.	.19875	.2349	.3132
11.6	36.	.199125	.23895	.3186
6.	38.5	.205875	.24705	.3294
2.9	42.	.219375	.26325	.351

Current Average: $.159 per bbl.

New Average: .2454

Rates go up 1 for 1 with U.S. Wholesale Index on crude oil.

Tom Fink

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NEW LAW

Average	27°	35°
1,000 bbl.	$.195175	$.2232
2,000 bbl.	.2325875	.2676
10,000 bbl.	.2625175	

Cook Inlet Average: $.2454

Escalating Clause: % of crude increase based on Wholesale Crude Index

- -

Current	New Law	
$.159	Cook Inlet Average	$.2454
.18	North Slope Crude	.2625
No escalator	Full 1 for 1 escalator	

Tom Fink

Alaska State Legislature

SENATOR
LOWELL THOMAS, Jr.
7054 TANAINA DRIVE
ANCHORAGE, ALASKA 99502

WHILE IN JUNEAU
POUCH V
JUNEAU, ALASKA 99801

MAJORITY LEADER

COMMITTEES
HEALTH, WELFARE AND
EDUCATION - CHAIRMAN

RESOURCES
RULES

Senate

November 10, 1973

The Hon. Terry Miller, Senate President
The Hon. Tom Fink, Speaker of the House
Alaska State Legislature

Mr. President:
Mr. Speaker:

In making this Free Conference Committee Report, the conferees wish to declare no intention whatsoever to set a lasting tax schedule as regards production of oil and gas from either Cook Inlet or the North Slope, and in fact, we wish to state our firm belief that substantial changes will be required in the future.

The compromise that we have reached represents basically no change in the ultimate impact to the North Slope future production, different than that contained in the Governor's bill presented to us during the early stages of this session.

We understand that the changes which we have made insofar as they relate to Cook Inlet production represent a compromise in which the level proposed by this bill will be less than one-half the difference between the existing law and that suggested by the House Finance Committee Substitute proposal.

Respectfully submitted,

Senator Lowell Thomas, Jr.
Chairman

Representative Andrew Warwick
Vice Chairman

Senator C. R. Lewis

Representative Robert Hartig

Senator John Rader

Representative Russ Meekins

AGO 534029

CONFERENCE COMMITTEE
REPORT

Mar. 17 '93
Date

Mr. President
Mr. Speaker

The Conference Committee [with powers of free conference]

which has had CSSB 4 (Fin) am and HCSCSSB 4, Oil and gas properties production tax

under consideration, recommends that It be replaced with FCC for CSSB4(FIN)am and HCSCSSB 4,

Senate members	House members
Senator Thomas, Chairman	Mr. Marchi, Chairman
Senator Lewis	Mr. Hartin
Senator Rader	Mr. Keeling

AGO 534030

FREE
CONFERENCE
REP.
AD VALOREM
HB1

Alaska State Legislature

Senate

JUNEAU, ALASKA

NOVEMBER 11, 1973

Honorable Terry Miller,
President of the Senate
Honorable Tom Fink,
Speaker of the House of Representatives

Gentlemen and Members of the Senate and House:

You have directed the attention of the members of the Free Conference Committee that considered Free Conference Committee Substitute for Senate Committee Substitute for Committee Substitute for House Bill No. 1 (ad valorem tax on oil and gas exploration, production and pipeline transportation property) to Section 5 of the bill.

Section 5 of the bill amends AS 29.53.055 to provide that the limitations on municipal taxation proposed in Section 45 as well as those existing limitations in Section 50 of AS 29.53 do not apply to taxes levied or pledged to pay or secure the payment of the principal and interest on bonded indebtedness.

The language of Sec. 55 originally was adopted to avoid general obligation bonds being denominated as limited tax bonds which would result in higher interest costs. It is the intent of the Committee that Section 5 of the bill is not intended to expand local governments' right to tax facilities covered by this act but only to give local governments the right in case of default or pending default on bonds to exceed the limits in Sec. 45 and 50 of AS 29.53.

Sen. Bill Ray, Chairman

Rep. Orah Freeman, Chairman

Sen. John Butrovich

Rep. Bud Saylor

Sen. W. R. Ed Palmer

Rep. Glenn Hackney

AGO 534065

FREE CONFERENCE COMMITTEE REPORT

ON

FREE CONFERENCE CS FOR SENATE CS FOR
CS FOR HOUSE BILL NO. 1

The Free Conference Committee has had Senate CS for CS for HB 1 under consideration and recommends it be replaced with Free Conference Committee Substitute for Senate CS for CS for House Bill No. 1. The principal changes in the Free Conference Committee Substitute from the Governor's bill as introduced are as follows:

1. Sec. 43.56.010 (b) includes language stating "No municipality may exempt from taxation property authorized to be taxed under this chapter." The effect of this is to require Valdez and the North Star Borough to levy a personal property tax on pipeline related property. The same paragraph limits exemptions from municipal taxation to those currently allowed under the municipal code.

2. Sec. 29.53.045 The bill as introduced limited political subdivisions to levying a tax not to exceed 7 mills on the value of taxable property taxable under the Act. The Free Conference Committee Substitute changes this limitation to allow municipal flexibility in levying up to an amount equivalent to $1,000 in total revenue per person residing within its boundaries or a tax on an amount up to 20% of the average per capita assessed valuation in the state multiplied by the number of residents in the taxing municipality. Assessment of the "taxable property" will be done on a state-wide basis by the Board established in the Act.

3. Sec. 43.056.030 (b) A definition of the word "properties" as relating to mineral interests was inserted to make it clear that things such as office buildings and other similar property not related to production could not be "interpreted" as being exempt from this tax.

4. Sec. 43.056.030 (7) and (8) allow municipalities to continue to tax property under existing law subject to the $1,000 per person or 20% per capita assessed valuation limitations through the period preceding the "construction commencement date." Without this change it was the committee's fear that municipalities might be precluded from taxing property during this period. The committee left taxation of construction equipment to municipalities.

5. Sec. 43.056.040 (a) (A) and (C) The committee adopted both the House and Senate concepts of authorizing municipalities to levy a retail sales or use tax on the first $1,000 of each sale.

6. Sec. 43.056.060 Members of the Assessment Review Board were required to be knowledgeable of assessment procedures and are subject to confirmation by the legislature.

7. Throughout the Committee Substitute, certain consistent language changes have been made to clearly divide the taxing authorities contained in this legislation. Thus you will find inserted specific references to "Sec. 10 (a)" of this chapter which means that the committee substitute restricts the particular provision to dealing with state assessment and taxing matters. The other consistent change is to delete the words "political subdivision" and substitute "municipality." "Municipality" is a more precise reference to a taxing entity of local government.

8. Sec. 43.056.060 (d) The Free Conference Committee Substitute would value production equipment on the basis of replacement cost. It was the feeling of the committee that the original proposed "actual cost" reduced by depreciation might preclude assessment on an appreciating value of the equipment. Depreciation of production equipment was changed from "units of production" to "economic life of proven reserves." This change would tie depreciation directly to the estimated useful life of the production equipment.

9. Sec. 43.056.210 (2) The definition of "construction commencement date" has been changed to provide two options. The construction commencement date for state taxing purposes is to be either April 1, 1974, or the date necessary permits or approvals, with no preventive injunctions or decrees, are received should this date occur earlier than April 1. The thinking here was that the state would not tax property taxable under this Act until such time as construction actually began. The fixed date was inserted to insure good faith on the part of the companies (if no permit were applied for, obviously none could be granted). Should it be clear by April 1 that further legal problems prevent the start of construction, the legislature would be in session and could amend the April 1 date to any other date of its choosing.

10. Sec. 43.056.210 (6) The definition of "taxable property" deletes reference to equipment used in the construction of the pipeline thus leaving this equipment taxable by municipalities. The definition was clarified to include drilling rigs and wells, whether producing or not. An additional definition of "taxable property" was added excluding "permanent residences, office buildings requiring substantial local government services, or gas pipeline systems operated as utilities and regulated by the Alaska Public Utilities Commission."

11. Sec. 2 amends AS 29.53.025 (a) to read: "Municipalities may exclude or exempt or partially exempt residential property from taxation by ordinance ratified by the voters at a regular or special election. An exclusion or exemption authorized by this section may not exceed $10,000 for any one residence."

12. Sec. 4. Adds a new subsection (b) to AS 29.53.050 to prevent the doubling up of tax receipts in taxing municipalities where municipal boundaries overlap or municipalities occupy the same territory.

13. Sec. 5. Language was added to AS 29.53.055 to make clear that the limitations on municipal taxing authority with respect to oil and gas properties taxable under this chapter do not apply to taxes levied or pledged to pay or secure the payment of principal and interest on bonds.

14. Sec. 6. The effective date is January 1, 1974, rather than immediately as proposed by the bill as introduced.

Bill Ray

Senator Bill Ray

Ora A. Freeman

Representative Ora Freeman

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(3) "department" means the Department of Revenue;

(4) "gas" includes all natural gas and all hydrocarbons produced at the wellhead not defined as oil;

(5) "intangible drilling expenses" means those expenses defined in sec. 263(c) of the United States Internal Revenue Code as defined on the effective date of this paragraph;

(6) "taxable property" means real and tangible personal property used or committed by contract or other agreement for use within this state primarily in the exploration for, production of, or pipeline transportation of gas or unrefined oil (except for property used solely for the retail distribution or liquefication of natural gas), or in the operation or maintenance of facilities used in the exploration for, production of, or pipeline transportation of gas or unrefined oil, including machinery, appliances, supplies, equipment, drilling rigs, wells (whether producing or not), gathering lines and transmission lines, pumping stations, compressor stations, power plants, topping plants, processing units, roads, tank farms, tanker terminals, docks and other port facilities, air strips and communication equipment and facilities, maintenance equipment and facilities, and maintenance camps and other related facilities; "taxable property" does not include permanent residences, office buildings requiring substantial local government services, or gas pipeline systems operated as utilities and regulated by the Alaska Public Utilities Commission;

(7) "unrefined oil" includes crude petroleum oil and other hydrocarbons regardless of gravity which are produced at the wellhead in liquid form and the liquid hydrocarbons known as distillate or condensate recovered or extracted from gas other than gas produced in association with oil and commonly known as casinghead gas.

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* Sec. 2. AS 29.53.025(a) is amended to read:

(a) Municipalities may exclude or exempt or partially exempt residential property from taxation by ordinance ratified by the voters at a regular or special election. An exclusion or exemption authorized by this section may not exceed $10,000 for any one residence.

* Sec. 3. AS 29.53 is amended by adding a new section to read:

Sec. 29.53.045. TAX ON OIL AND GAS PRODUCTION AND PIPELINE PROPERTY. (a) A municipality may levy and collect taxes on taxable property taxable under AS 43.56 only by using one of the methods set out in (b) or (c) of this section.

(b) A municipality may levy and collect a tax on the full and true value of taxable property taxable under AS 43.56 as valued by the Department of Revenue at a rate not to exceed that which produces an amount of revenue from the total municipal property tax equivalent to $1,000 a year for each person residing within its boundaries.

(c) A municipality may levy and collect a tax on the full and true value of that portion of taxable property taxable under AS 43.56 as assessed by the Department of Revenue which, when combined with the value of property otherwise taxable by the municipality, does not exceed the product of 225 per cent of the average per capita assessed full and true value of property in the state multiplied by the number of residents of the taxing municipality.

(d) By February 1 of each assessment year a taxing municipality must inform the Department of Revenue which method of taxation the municipality will use.

(e) For purposes of this section, population shall be determined by the commissioner of community and regional affairs based on the latest statistics of the United States Bureau of the Census or on other reliable population data, and shall advise each municipality of its

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population as so determined by January 15 of each year.

* Sec. 4. AS 29 53.050 is amended by adding a new subsection to read:

(b) No municipality, or combination of municipalities occupying the same geographical area, in whole or in part, may levy taxes which will result in tax revenues from all sources exceeding either (1) $1,000 a year for each person residing within their boundaries or (2) when combined with the value of property otherwise taxable by the municipality, the product of 225 per cent of the average per capita assessed full and true value of property in the state multiplied by the number of residents of the taxing municipality. If two or more municipalities occupying the same geographical area, in whole or in part, attempt to levy a tax the combined levy of which would result in tax revenues from all sources exceeding either (1) $1,000 a year for each person residing within their boundaries or (2) when combined with the value of property otherwise taxable by the municipality, the product of 225 per cent of the average per capita assessed full and true value of property in the state multiplied by the number of residents of the taxing municipality, the commissioner of community and regional affairs shall apportion the lawful levy and equitably divide these revenues on the basis of need, services performed and other considerations in the public interest. For the purpose of this subsection, population shall be determined by the commissioner of community and regional affairs based on the latest statistics of the United States Bureau of the Census or on other reliable population data.

* Sec. 5. AS 29.53.055 is amended to read:

Sec. 29.53.055. NO LIMITATION ON TAXES TO PAY BONDS. The limitations [LIMITATION] provided for in secs. 45 or [SEC.] 50 of this chapter do [DOES] not apply to taxes levied or pledged to pay or secure the payment of the principal and interest on bonds. Taxes

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to pay or secure the payment of principal and interest on bonds may be levied without limitation as to rate or amount.

Sec. 6. This Act takes effect on January 1, 1974.

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(3) "department" means the Department of Revenue;

(4) "gas" includes all natural gas and all hydrocarbons produced at the wellhead not defined as oil;

(5) "intangible drilling expenses" means those expenses defined in sec. 263(c) of the United States Internal Revenue Code as defined on the effective date of this paragraph;

(6) "taxable property" means real and tangible personal property used or committed by contract or other agreement for use within this state primarily in the exploration for, production of, or pipeline transportation of gas or unrefined oil (except for property used solely for the retail distribution or liquefication of natural gas), or in the operation or maintenance of facilities used in the exploration for, production of, or pipeline transportation of gas or unrefined oil, including machinery, appliances, supplies, equipment, drilling rigs, wells (whether producing or not), gathering lines and transmission lines, pumping stations, compressor stations, power plants, topping plants, processing units, roads, tank farms, tanker terminals, docks and other port facilities, air strips and communication equipment and facilities, maintenance equipment and facilities, and maintenance camps and other related facilities; "taxable property" does not include permanent residences, office buildings requiring substantial local government services, or gas pipeline systems operated as utilities and regulated by the Alaska Public Utilities Commission;

(7) "unrefined oil" includes crude petroleum oil and other hydrocarbons regardless of gravity which are produced at the wellhead in liquid form and the liquid hydrocarbons known as distillate or condensate recovered or extracted from gas other than gas produced in association with oil and commonly known as casinghead gas.

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(b) A municipality may levy and collect a tax on the full and true value of taxable property taxable under AS 43.56 as valued by the Department of Revenue at a rate not to exceed that which produces an amount of revenue from the total municipal property tax equivalent to $1,000 a year for each person residing within its boundaries.

(c) A municipality may levy and collect a tax on the full and true value of that portion of taxable property taxable under AS 43.56 as assessed by the Department of Revenue which, when combined with the value of property otherwise taxable by the municipality, does not exceed the product of 225 per cent of the average per capita assessed full and true value of property in the state multiplied by the number of residents of the taxing municipality.

(d) By February 1 of each assessment year a taxing municipality must inform the Department of Revenue which method of taxation the municipality will use.

(e) For purposes of this section, population shall be determined by the commissioner of community and regional affairs based on the latest statistics of the United States Bureau of the Census or on other reliable population data, and shall advise each municipality of its

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population as so determined by January 15 of each year.

* Sec. 4. AS 29.53.050 is amended by adding a new subsection to read:

(b) No municipality, or combination of municipalities occupying the same geographical area, in whole or in part, may levy taxes which will result in tax revenues from all sources exceeding either (1) $1,000 a year for each person residing within their boundaries or (2) when combined with the value of property otherwise taxable by the municipality, the product of 225 per cent of the average per capita assessed full and true value of property in the state multiplied by the number of residents of the taxing municipality. If two or more municipalities occupying the same geographical area, in whole or in part, attempt to levy a tax the combined levy of which would result in tax revenues from all sources exceeding either (1) $1,000 a year for each person residing within their boundaries or (2) when combined with the value of property otherwise taxable by the municipality, the product of 225 per cent of the average per capita assessed full and true value of property in the state multiplied by the number of residents of the taxing municipality, the commissioner of community and regional affairs shall apportion the lawful levy and equitably divide these revenues on the basis of need, services performed and other considerations in the public interest. For the purpose of this subsection, population shall be determined by the commissioner of community and regional affairs based on the latest statistics of the United States Bureau of the Census or on other reliable population data.

* Sec. 5. AS 29.53.055 is amended to read:

Sec. 29.53.055. NO LIMITATION ON TAXES TO PAY BONDS. The limitations [LIMITATION] provided for in secs. 45 or [SEC.] 50 of this chapter do [DOES] not apply to taxes levied or pledged to pay or secure the payment of the principal and interest on bonds. Taxes

to pay or secure the payment of principal and interest on bonds may be levied without limitation as to rate or amount.

Sec. 6. This Act takes effect on January 1, 1974.

FEDERAL TRADE COMMISSION REPORT ON PETROLEUM INDUSTRY

93d Congress
1st Session

COMMITTEE PRINT

PRELIMINARY FEDERAL TRADE COMMISSION STAFF REPORT ON ITS INVESTIGATION OF THE PETROLEUM INDUSTRY

PREPARED AT THE REQUEST OF

HENRY M. JACKSON, *Chairman*

COMMITTEE ON INTERIOR AND INSULAR AFFAIRS

UNITED STATES SENATE

PURSUANT TO

S. Res. 45

A NATIONAL FUELS AND ENERGY POLICY STUDY

Serial No. 93–15 (92–50)



Printed for the use of the Committee on Interior and Insular Affairs

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SENATE RESOLUTION 45

National Fuels and Energy Policy Study

This publication is a background document for the National Fuels and Energy Policy Study authorized by Senate Resolution 45, introduced by Senators Jennings Randolph and Henry M. Jackson on February 4, 1971, and considered, amended, and agreed to by the Senate on May 3, 1971.

The resolution authorizes the Senate Interior and Insular Affairs Committee, and ex officio members of the Committees on Commerce and Public Works and the Joint Committee on Atomic Energy, to make a full and complete investigation and study of National Fuels and Energy Policies.

This document is published to assist members of the Committee and other interested parties in their understanding of the issues inherent in the formulation of a long-term National Energy Policy which assures the continued welfare of the Nation, including balance growth, safeguarding and enhancing the quality of the environment, and national security.

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AGO 533742

MEMORANDUM OF THE CHAIRMAN

To members and ex officio members of the Senate Committee on Interior and Insular Affairs' National Fuels and Energy Policy Study (S. Res. 45):

On May 31, 1973, I asked the Federal Trade Commission to prepare a report on the role of the petroleum industry in the development of the present fuel shortages. The FTC study, entitled "Preliminary Federal Trade Commission Staff Report on Its Investigation of the Petroleum Industry," was forwarded to me on July 6, 1973.

In his transmittal letter of July 6, 1973, Commission Chairman Lewis A. Engman stated that he would not release this report to the public because of FTC policy not to release studies which relate to matters pending before the FTC. In my letter of July 9 to Chairman Engman, I requested specific reasons why this report should not be made public. His response of July 11, 1973, again restated the Commission's general policy of nondisclosure.

My review of the report and the analysis provided to me by staff does not disclose any specific information about identifiable companies, events, or activities which, in my view, could reasonably be construed to either jeopardize Commission law enforcement activities or to prejudice in any manner the rights or legal defenses of any company or individual against whom legal action might be taken in the future.

Therefore, in the interest of full disclosure of all the facts relevant to current and pending fuel shortages, I have directed that the FTC report be published at this time in the form of a committee print for the use of interested Senators and as background for the committee's consideration of energy policy issues.

HENRY M. JACKSON, *Chairman.*

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U.S. SENATE,
COMMITTEE ON INTERIOR AND INSULAR AFFAIRS,
Washington, D.C., May 31, 1973.

HON. LEWIS A. ENGMAN,
Chairman, Federal Trade Commission,
Washington, D.C.

DEAR MR. CHAIRMAN: Over the past six months every section of the nation has experienced serious shortages of heating oil, gasoline, diesel fuel and propane. These shortages—especially gasoline and diesel shortages—threaten to become critical within the next few months. Shortages of fuel oil next fall and winter are certain. They may be the most serious ever experienced in this country.

You are undoubtedly aware of the growing and increasingly widespread conviction that the fuel shortage is a *deliberate, conscious contrivance* of the major integrated petroleum companies to destroy the independent refiners and marketers, to capture new markets, to increase gasoline prices, and to obtain the repeal of environmental protection legislation. Allegations and some circumstantial evidence of this sort are coming increasingly from oil independents, consumer organizations, students of the industry, Members of Congress, and from the chief legal officers of local and State governments.

As Chairman of the National Fuels and Energy Policy Study authorized by S. Res. 45, I recognize that the origins of the current fuels shortages are complex. They involve, among other things, stringent environmental regulations, a lack of refining capacity, an incentive system that is not producing desired results, the need for deep-water port facilities, and many other factors.

One major cause of the shortage which should not be overlooked or minimized is the present Administration's incomprehensible and foolish reliance last summer on the clearly incorrect and self-serving recommendations of major oil companies that import controls should be maintained; that refined products should not be imported; and the assurance that refinery capacity would be adequate to meet all demands for petroleum products over the next year.

We know, for example, that Texaco's Chairman of the Board wrote General Lincoln, then the Director of the Office of Emergency Preparedness, last July objecting to the granting of more import quotas for finished products and stating that there is "sufficient refining capacity available in the U.S. to meet anticipated demand for clean products over the balance of this year." We know that the President of Humble Oil (now Exxon, U.S.A.) assured General Lincoln in September that "Humble could not speak for the remainder of the industry but felt in a tight situation the industry would do its best including going beyond its contract commitments if it were capable of doing so . . ."

While I am not yet ready to definitely conclude that the current crisis can be fully explained in terms of "conspiracies" between or "excessive

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market power" exercised by a relatively few oil companies this does pose a major question of public policy which deserves careful review and analysis. The very fact that the so-called "conspiracy theory" is supported by circumstantial evidence and that it does have credibility among knowledgeable observers of the industry makes an in-depth investigation mandatory. If investigation shows that the current shortages have been calculated and engineered for private profit or advantage, legislation will be required to effectuate fundamental changes in the structure and operation of the petroleum industry.

Later in this letter I will be requesting the Federal Trade Commission to undertake an investigation of this matter.

Whatever the ultimate cause or causes of the shortages it is indisputable that they threaten to extinguish the independent refining and marketing sectors as a viable competitive force in the petroleum industry. It is furthermore a fact that retail gasoline and fuel prices—the price consumers pay—have risen drastically and will continue to rise. At the same time, the earnings of the five biggest oil companies jumped by 26 percent between the first quarters of 1972 and 1973.

The earnings of Exxon, the largest oil company in the United States, jumped by an amazing 43 percent. The earnings for 27 smaller oil companies jumped by 32.1 percent during the same period.

The fact that oil company earnings show startling increases during a period of time when the companies are under price controls, when independents are being put out of business, and when the American consumer cannot get gasoline also raises fundamental questions of public policy. This is particularly true in view of the disturbing signs that the present shortages are being accompanied and perhaps caused by major structural changes in petroleum marketing which could seriously limit competition.

The strength, efficiency, and economy of America's oil industry has been based on the high degree of competition at the retail level afforded by numerous companies supplying the same market. It is a classical first step of any small group of companies who wish to restrain trade and raise prices to first centralize their marketing areas so as to reduce competition. Indeed it is the purpose of the Federal Antitrust Laws to assure that there is adequate competition. Some of the disquieting market limiting instances—all within the past few months—are as follows:

Gulf is withdrawing in Michigan, Maryland, Iowa, Wisconsin, Delaware, Minnesota, North Dakota, South Dakota, Kansas, Nebraska, Montana, Wyoming, Washington, Oregon, Idaho, Utah, Nevada and Northern California. They are just getting out of those areas and have a $250,000,000 withdrawal program under way.

Exxon is selling 150 retail service stations in Indiana, Illinois, Wisconsin and Michigan and possibly an additional 250 stations.

Phillips by October 1, 1973, is withdrawing from New England all the way as far south as Maryland and Northern Virginia.

British Petroleum has sold its New York State marketing network to United Refinery. West of Hudson, New York, it is giving no new supplies to its jobbers. BP has notified its jobbers in New Jersey, Rhode Island and part of Massachusetts that their contracts will soon be cancelled.

Atlantic Richfield Company is selling its terminal and bulk plant in Mississippi. ARCO is also divesting itself of a 32,000 barrel a day

refinery in Sinclair, Wyoming. It is dropping 2,400 retail outlets in Colorado, Idaho, Wyoming, North Dakota, South Dakota, Nebraska, Kansas, Minnesota, Iowa, Missouri and parts of Louisiana, Alabama and Oklahoma.

Amoco, according to trade reports, plans to pull out of the Western United States with the exception of Washington and Oregon.

Sunoco is withdrawing from North Dakota, South Dakota, Nebraska, Wisconsin, Minnesota, Kansas, Tennessee and the Metropolitan Chicago area. However, it is excluding certain other metropolitan areas such as Omaha, Eastern Kansas, Memphis and its Interstate Highway outlets.

Fina will purchase the BP marketing properties in Georgia and Florida and part of those in North Carolina and South Carolina.

There are instances of other oil companies which are abandoning certain "uneconomical" areas. Moreover, many of these and other major oil companies are apparently terminating existing dealer franchises and, *at the same time*, establishing new chains of dealerships under new second and third name "fighting brands."

It is highly suggestive to those who have studied the dynamics and structure of the national and international oil corporations which dominate the industry and the patterns of marketing that all of these factors and results are not happenstance. In major respects they may represent conscious, knowing decisions to shift traditional profit centers from "production" in historically, low cost, profitable Mid-east sources to the downstream sources of "refining" and "marketing" both in the United States and Europe. This shift in profit taking sources was compelled by the nationalistic attitude of Mid-East nations to control their own resources and to maximize host government revenues. On the basis of available evidence I do not charge or allege conspiracy; I do, however, charge that corporate self-interest, acting in response to friendly, timid and often incompetent Administration policy, has led to a situation in which oil industry corporate managers—without meeting, without collusion, without conspiracy—are led, invited, and encouraged: (1) to squeeze out the independents; and (2) to force the price of gasoline and other petroleum products up and up.

It is not clear to me or to other Members of Congress what all of these fast moving events and changes mean, nor what relationship they bear to the shortages of crude oil and petroleum products. The sole purpose of this letter is to get a detailed, objective, and judicial judgment on the issues which have been raised in connection with the current fuels crisis. It is in the national interest to have a strong, viable and competitive industry that is privately owned and has the confidence of the public.

I am hereby requesting the Federal Trade Commission to prepare a report within thirty days regarding the relationship between the structure of the petroleum industry and related industries and the current and prospective shortages of petroleum products. This report should be accompanied by such staff reports, investigations and documentary materials as the Commission may have made or obtained which are relevant to comprehension of this issue by the Congress.

Later today, Senator Humphrey and I will be introducing an amendment to S. 1570, the "Emergency Petroleum Allocation Act of 1973,"

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which will authorize and direct a more detailed six-month study by the Federal Trade Commission of this and other important questions concerning the petroleum industry, its changing structure and operation, and the causes of the current shortages. I am enclosing a copy of the amendment and a table from the May 14, 1973 *Oil and Gas Journal*, showing earnings and profit performance of 32 oil companies in the first quarter of 1973.

Sincerely yours,

HENRY M. JACKSON,
Chairman, Senate Study of a National Fuels and Energy Policy.

How 32 companies performed in the 1st quarter

Company	Net profit [1] ($1,000) 1st quarter 1973	Percent change from 1972
Exxon	508, 000	+43. 1
Texaco	264, 016	+14. 8
Gulf	165, 000	+18. 7
Mobil	155, 800	+10. 1
California Standard	152, 800	+24. 2
Subtotal	1, 245, 616	+26. 0
Indiana Standard	121, 100	+21. 5
Shell	80, 233	+49. 2
Tenneco	53, 413	+14. 4
ARCO	50, 303	+52. 2
Sun	49, 146	+42. 3
Conoco	47, 500	+11. 5
Phillips	43, 448	+22. 1
Union	38, 300	+28. 1
Amerada Hess	36, 706	+25. 1
Cities Service	34, 400	+17. 4
Getty [2]	27, 006	+20. 6
Marathon	24 165	+49. 6
Pennzoil	19, 624	+
Sohio	17, 500	+
Signal	16, 202	+
Ashland	15, 900	+46. 7
Kerr McGee	11, 876	+20.
Skelly	9 961	+
Occidental	8, 934	+57. 8
Murphy	6, 452	+57. 7
Clark	4, 846	+
American Petrofina	4, 735	+105
Tesoro	4, 271	+86. 8
Quaker State	3, 604	+
Kewanee	3, 017	+
Coreo	2, 806	+
Apco	889	34. 0
Subtotal	736, 337	+32. 1
Total	1, 981, 953	+28. 2

[1] Excludes extraordinary items.
[2] Incl. les Getty's share of Mission Corp., and Skelly Oil Co.

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FEDERAL TRADE COMMISSION,
Washington, D.C., June 5, 1973.

Hon. HENRY M. JACKSON,
Chairman, Committee on Interior and Insular Affairs, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Thank you for your letter of May 31, 1973, concerning the present shortage of petroleum products.

As I am sure you are aware, for more than a year the Commission staff has been conducting an intensive investigation into the structure, conduct and performance of the petroleum industry. This investigation is close to completion. There are a number of important hearings scheduled throughout the month of June, and the staff will continue to utilize every available resource to expedite the completion of the hearings and the assimilation and analysis of the latest evidence.

I have asked the staff to report its findings to me no later than July 1, and the Commission will certainly endeavor to provide you with the information which you seek as soon as possible.

Sincerely yours,

LEWIS A. ENGMAN.

FEDERAL TRADE COMMISSION,
Washington, D.C., July 6, 1973.

Hon. HENRY M. JACKSON,
Chairman, Interior and Insular Affairs Committee, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: As Chairman of the Senate Interior and Insular Affairs Committee and the Senate Permanent Subcommittee on Investigations of the Committee on Government Operations, you have requested a report on the relationship between the structure of the petroleum and related industries and the current shortage of petroleum products.

In response to that request, I am enclosing a copy of a preliminary staff report to the Commission prepared at my direction. This report is based upon the comprehensive investigation of the petroleum industry which the staff began in late 1971. This report has not been evaluated or approved by the Commission, and the findings and conclusions contained in the report do not necessarily reflect the views of the Commission.

While the Commission recognizes its obligation to honor your Committee's request for information, I must emphasize that the Commission would not make this report public and therefore we ask that care be taken to avoid unnecessary publicity which could jeopardize any future law enforcement action by the Commission in this area.

Sincerely yours,

LEWIS A. ENGMAN, *Chairman.*

U.S. SENATE,
COMMITTEE ON GOVERNMENT OPERATIONS,
SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
Washington, D.C., July 9, 1973.

Hon. LEWIS A. ENGMAN,
Chairman, Federal Trade Commission,
Washington, D.C.

MY DEAR MR. ENGMAN: I have received and reviewed your staff report on the relationship between the structure of the petroleum and related industries and the current shortage of petroleum products.

Your cover letter of July 6, 1973, accompanying this report, emphasizes "that the Commission would not make this report public and therefore we ask that care be taken to avoid unnecessary publicity which could jeopardize any future law enforcement action by the Commission in this area."

A detailed examination of the report was made not only by me but also by staff attorneys and economists with this caveat in mind. Unfortunately, press accounts on July 7 and 8, 1973, indicate that the report has already been made available by unidentified sources to one of the news services. Consistent with our understanding on this important matter, no release was made of this report by my office or my staff.

However, I must candidly acknowledge that my review of the report and the analysis provided to me by lawyers and economists of the Interior Committee and the Permanent Investigations Subcommittee staffs does not disclose any specific information about identifiable companies, events, or activities which, in my view, could reasonably be construed to either jeopardize Commission law enforcement activities or to prejudice in any manner the rights or legal defenses of any company or individual against whom legal action might be taken in the future. This is especially true when the report is read in the light of recent testimony by staff of the Commission before Congressional Committees on related matters.

Nevertheless, as I have related to you both personally and by letter, we wish to proceed on this matter in a spirit of cooperation which will be most beneficial to the American public. But, we must balance your needs to proceed to a successful conclusion of this long investigation with the needs of the Congress and the public to be fully informed on an issue which affects the well being and the budget of every citizen.

Accordingly, I am requesting that you transmit to me, no later than 10:00 a.m. on Friday, July 13, 1973, specific reasons why the release of this report would jeopardize future legal action by the Commission or prejudice in any manner the rights or legal defenses of any individual or company against whom legal action might be taken in the future. Your reply should identify the specific portions of the report you feel should not be made public. Your response will, of course, remain confidential so as to further protect your future legal actions.

I can assure you that I will carefully consider your suggestions in making my determination as to wether all or only a portion of this report should be released to the public.

I appreciate your continued assistence in this important investigation.

Sincerely,

HENRY M. JACKSON,
Chairman.

FEDERAL TRADE COMMISSION,
Washington, D.C., July 11, 1973.

HON. HENRY M. JACKSON,
Chairman, Senate Permanent Subcommittee on Investigations,
Committee on Government Operations,
U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to your letter of July 9, 1973, concerning a Commission staff report on the relationship between the structure of the petroleum and related industries and the current shortage of petroleum products, a copy of which we provided you at your request on July 6.

In my letter accompanying that report, I emphasized that "the Commission would not make this report public and therefore we ask that care be taken to avoid unnecessary publicity which could jeopardize any future law enforcement action by the Commission in this area." You ask the Commission to justify this statement, and to identify the specific portions of the report which we feel should not be made public.

The answer to your question lies in the basic role of the Commission as a law enforcement agency charged by Congress with the responsibility for insuring compliance with the antitrust laws, and the fact that the staff report in question is an internal staff memorandum prepared in the context of a currently pending investigation. The Commission recognizes its obligation to honor the legitimate requests of congressional committees for information. Disclosure of such a document to Congress, however, must be contrasted with its public release, which the Commission views as inconsistent with its duty to proceed judiciously and responsibly in determining what, if any, action should be taken on the basis of the staff investigation.

The Commission has always taken the position, therefore, that, as a matter of policy, every effort should be made to prevent unnecessary public disclosure of staff conclusions and recommendations pertaining to matters involving potential Commission law enforcement action.

Please let me know if I can be of further assistance.

Sincerely,

LEWIS A. ENGMAN.

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PRELIMINARY FEDERAL TRADE COMMISSION STAFF REPORT ON ITS INVESTIGATION OF THE PETROLEUM INDUSTRY

INTRODUCTION

During the last 22 years, the U.S. energy demand has exploded. Total energy consumption more than doubled from 37 trillion BTUs in 1950 to 76 trillion BTUs in 1972. Petroleum and natural gas, which provided 45 percent of all energy needs in 1950, now account for 70 percent of the energy supply. And the consumption of gasoline, which had risen steadily at about 3 to 5 percent a year since World War II, is now increasing at a 7 percent annual rate.

This recent acceleration in refined product consumption can be attributed to a number of factors. For years, coal was the dominant heating fuel. But with the demand for more convenient operation and regulations requiring cleaner fuel to reduce environmental contamination, factories, electric utilities and homes have turned to oil and natural gas. Because natural gas was in limited supply initially, an even greater overall energy demand has been placed on supplies of oil.

Another important factor accounting for increased gasoline consumption is that Americans are driving heavier and more powerful cars and are adding more power-assisted devices, such as air conditioners, that result in greater fuel consumption per mile. Additionally, the changes that auto manufacturers have made and must continue to make in engines to meet air pollution control standards are further reducing gasoline mileage.

Because of these factors, in early 1973 a number of energy experts and oil companies began predicting shortages of gasoline and other petroleum products by midyear. In April of 1973, many major oil companies stopped soliciting business from new customers and began allocating product to existing customers. As of May 30, 1973, 1,200 gas stations had closed due to lack of product, and all but a handful of these were *independents*. Many of the majors' branded stations have been forced to curtail their hours of operation or limit the gallonage to each customer.

Despite an increase in gasoline consumption of approximately 60 percent over the past 15 years, there has not been one new entrant into refining of any significant size since 1950. "There is just not sufficient refining capacity in the U.S. to meet the total needs of the American public for petroleum products," Frank N. Ikard, the president of the American Petroleum Institute, which is the leading association of major oil companies, told a Senate Committee last May. The oil companies claim that they have not been able to construct new refineries because of environmental constraints, preventing them from using certain supplies of crude oil and from locating refineries at the most

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efficient sites. Delay in construction of the Alaska pipeline is also cited as a hindrance to new refinery construction. Evidence gathered by the Commission staff tends to raise questions about the sufficiency of these explanations.

Independent gasoline marketers and other contract buyers, who buy much of their gasoline from all but the largest major companies, claim that the present shortage has been created by the largest major oil companies to drive the independents out of business and to raise the majors' prices. They point to sharp increases in the profits of the major companies this year as an indication that the squeeze has been successful. The major oil companies counter that they were unable to forecast the tremendous increase in the demand for gasoline that has occurred this year and that they plan to expand their refining capacity substantially over the next few years. Since May of this year, Exxon, Mobil, and Standard Oil Company of California have all announced significant new refinery construction. However, it may well be three years before these refineries are in production.

There can be little doubt that the independent sector of the petroleum industry, especially at the marketing level, has suffered most as a result of the present gasoline shortage. In the final analysis, it is gasoline consumers who will eventually pay higher prices and are presently inconvenienced due to evening and weekend closings of gasoline stations.

The petroleum industry is one of the largest and most complex in the world, and there are no simple explanations of industry behavior. The origins and nature of the present gasoline shortage can only be understood with reference to the structure, conduct and performance of the entire industry. Our focus accordingly turns to a discussion of these topics.

In the following sections, we will discuss in turn:

Background and Methodology of the Current Petroleum Investigation.

Structure, Conduct, and Performance of the Petroleum Industry.

Staff Conclusions.

I. HISTORY AND METHODOLOGY OF THE CURRENT PETROLEUM INVESTIGATION

A. Background of Federal Trade Commission Activity in the Petroleum Industry

The current investigation [1] of the structure, conduct, and performance of the petroleum industry is by no means the first time the Federal Trade Commission has investigated the petroleum industry. During the past 50 years, the Commission staff has been involved in a continuing examination of the marketing practices in the gasoline industry, primarily initiated in response to thousands of complaints received from members of Congress, government agencies, state and local officials, independent gasoline refiners, associations of both major and independent gasoline marketers, as well as members of the public. Over 300 formal investigations have been docketed during these years and almost all of the integrated major oil companies have been the subject of one or more of these investigations. Two Trade Practice Conferences have resulted, in addition to 22 formal complaints involving restraint of trade matters and numerous deceptive practices.

In 1939, the Commission presented to the Temporary National Economic Committee a summary [2] of the complaints it had received regarding marketing practices in the retailing of petroleum products, including the following:

Unjustified price difference and discrimination;
Use of tying and exclusive dealing contracts;
Retail price fixing in gasoline;
Contracts with tire and auto accessories manufacturers; and
Exchange or intersale of gasoline by the major marketers.

1. Overview of Prior FTC Antitrust Litigation In Petroleum Industry

Since 1939 the Federal Trade Commission has brought three basic types of cases against companies in the oil industry. First, cases were directed at price discrimination whereby the major oil companies use selective wholesale price cuts to enable certain of their marketers to reduce their retail prices in order to combat an independent retailer

[1] The Commission authorization for the investigation was as follows:
"The Commission approved, adopted and entered of record a resolution as submitted by the Bureau of Competition with memorandum of September 14, 1971, directing the use of compulsory process to investigate the acts and practices of firms engaged in the production of refining of crude oil or the distribution of petroleum products to determine the effect of vertical integration and joint ownership and operating arrangements on the structure, conduct and performance of the petroleum industry and whether such firms are engaged in unfair methods of competition or unfair acts or practices which are in violation of section 5 of the Federal Trade Commission Act."

[2] FTC, "A Survey of Controversial Marketing Practices in the Petroleum Products Retail Industry," presented to the TNEC, Oct. 16, 1939.

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who poses a threat to the major's share of the market.[3] Two parties are injured: the independent retailer and the major's marketers who do not receive a wholesale price cut but, because of geographical proximity, must compete with the marketer who does.

Secondly, cases were prosecuted which were directed at vertical price fixing, which grew out of the same circumstances as the price discrimination cases.[4] To insure that the major marketers would reduce their retail prices when they received a wholesale price cut, the major employed price fixing agreements to enforce the wholesale price reductions in the retail market. Several of these cases,[5] as well as some of those directed at price discrimination were dismissed without final adjudication as a prelude to the Commission's Conference on Marketing of automotive Gasoline.[6]

Thirdly, cases were brought which were directed at commission-overrides on tires, batteries and accessories (TBA) agreements, whereby the major oil companies were forcing their retailers to purchase a certain brand of TBA, and in return the oil companies would receive a commission on all net sales.[7]

The history of the Federal Trade Commission's activity in the petroleum industry has been characterized by a case-by-case attack on specific anti-competitive marketing practices. This approach has, in general, been of limited success in controlling wasteful marketing practices, dealer coercion, and the lack of competition in the petroleum industry. Despite the staff's success in bringing and winning cases before the Commission and in the courts, as well as obtaining compliance orders, the petroleum industry over the last 50 years has managed to circumvent the orders in many cases by subtle changes in policy or practices.

2. The Need for a New Approach to the Petroleum Problem

The reason for the limited success of the early petroleum cases is not to be found in the cases or remedies themselves. The staff did a thorough job in researching, developing and prosecuting the individual cases. The remedies applied in each case were directed at the particular abuse. But the practice-by-practice approach to antitrust attack, which sought to correct specific anti-competitive conduct at the marketing level, did not adequately address the industry's vertically integrated structure or its multi-level behavior. The major oil companies operate on four levels—crude production, refining, transportation, and marketing. To fashion a remedy for one level without considering the performance of a company, or the industry, at the other levels, ignores

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[3] Examples of price discrimination cases: *Standard Oil Co. v. Federal Trade Commission*, (D. 4389), 340 U.S. 231 (1951), again before the Supreme Court at 355 U.S. 397 (1958) *affirming* 233 F.2d 404 (6th Cir. 1956); *Federal Trade Commission v. Sun Oil Co.*, 371 U.S. 505 (1963), *reversing* 294 F.2d 405 (5th Cir. 1961), *reversing* 55 FTC 955 (1959).

[4] Examples of vertical price fixing cases: *Sun Oil v. Federal Trade Commission*, (D. 6934), 350 F.2d 624 (7th Cir. 1965), *cert. denied*, 382 U.S. 982 (1966); *The Atlantic Refining Co. v. Federal Trade Commission*, (D. 7471), 344 F.2d 309 (6th Cir. 1965), *affirming*, 63 FTC 1497 (1963).

[5] See *Pure Oil Co.* (D. 6616); *Texas Co.* (D. 6808); *Standard Oil (Ind.)* (D. 7567); *Shell Oil Co.* (D. 8537). All were dismissed on December 28, 1964.

[6] Record of hearings: "FTC Industry Conference on Marketing of Automotive Gasoline," Hearings Before Subcommittee No. 4 on Distribution Problems of the Select Committee on Small Business, House of Representatives, 88th Cong., May and Jun 1965.

[7] Examples of TBA cases: *The Atlantic Refining Co. v. Federal Trade Commission*, 381 U.S. 358 (1965), *affirming* 331 F.2d 304 (7th Cir. 1964); *The B. F. Goodrich Co. and The Texas Co.* (D. 6485); *The Goodyear Tire and Rubber Co. and The Atlantic Refining Co.* (D. 6480); *The Firestone Tire and Rubber Co. and Shell Oil Co.* (D. 6487).

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the market power associated with vertical integration and limited competition.

B. The Current Investigation of the Petroleum Industry

Pursuant to the Commission's resolution, the staff of the Bureau of Competition issued subpoenas to nine integrated petroleum firms for the purpose of obtaining basic preliminary information about each company. The subpoenas were narrowly drawn, requiring the production of data which should have been readily available to the firms. However, many of the companies indicated that they would resist the subpoenas. From previous experiences, the staff was acquainted with the extended litigation which normally ensued when large firms challenged subpoenas. Rather than delay the investigation at this preliminary stage, the decision was made to withdraw the subpoenas and re-examine alternative investigative strategies. (The staff had already obtained the exchange agreements of the companies by means of a separate set of subpoenas.)

1. Approach to the Investigation

The investigation into possible antitrust activities on the part of the major oil companies was thus conducted using the most expedient approach. To avoid protracted major firm resistance to providing information, an alternative approach was used to gather data relating to industrial practices of the major oil companies.* The approach concentrated on obtaining information from the largest independent crude producers, refiners, and marketers. Extensive investigative work was done by the Commission staff which began with detailed questionnaires to crude producers, refiners, and marketers which were designed to elicit in depth the nature of the independents' relationships with major oil companies for the years 1967–1971, the last years in which complete data were available. In addition, a large number of firms in each category (crude producers, refiners, marketers) were requested to permit searches of their files by Federal Trade Commission economist and attorneys. Because not every company cooperated, data contained in this summary reflects only that which came from the more than 50 cooperating companies. Data were collected on a national basis, but it was later decided that the investigation should focus primarily on Districts 1 and 3 which could be identified as a separate identifiable market. In general, the surveyed firms were larger on the average than other independent entities in the industry.

In addition to these data, the staff obtained substantial information on the petroleum industry from published public and governmental sources. The staff collected further valuable information from the Department of Interior, the Oil Import Appeals Board, the Interstate Commerce Commission, and other federal agencies. Various state taxing authorities and several state agencies such as the Texas Railroad Commission were contacted. These governmental agencies were cooperative in providing the requested information.

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*The use of the term "major" includes those firms which are vertically integrated and employ various methods of non-price competition. We have identified 18 of these firms. They are Exxon, Gulf, Standard (Ind.), Texaco, Shell, ARCO, Mobil, Socal, Sun, Union, Phillips, Continental, Cities Service, Getty, Standard (Ohio), Amerada Hess, Skelly, and Marathon.

To supplement the staff's understanding of the structure and operation of the oil industry, the Federal Trade Commission on April 20, 1973, again issued subpoenas, this time *ad testificandum* subpoenas to corporate officials of the major oil companies. Rather than merely subpoena documents, the strategy was to develop the factual information through testimony of petroleum company executives, identify relevant documents and make on-the-record requests for submission of such documents to the Commission. These investigative hearings began May 21, 1973, and are now almost completed.

2 Survey Data: Tables and Discussion

CRUDE PRODUCERS

Table I–1 provides a summary of the survey results for the independent crude producers for 1967–1971. The data indicate that the eight largest firms purchased an average of 42.5 percent of independently produced crude oil during the survey period (average of Table 1, column 1). In most cases where the eight largest firms purchased crude from independents, they also owned the gathering lines used to transport it (Table 1). Other results of our survey further indicate that once gathering lines are erected, there are few other buyers of crude from that particular field. Control of these gathering lines, in addition to ownership of approximately 52 percent of crude sources, gives the eight largest firms substantial control of domestically produced crude oil.[9]

REFINERS

Table 2 presents a summary of the survey results for independent refiners from 1967–1971. While most of the measures are self-explanatory, a few need some clarification:

(*a*) Self sufficiency ratio—the percentage of crude inputs acquired by a refiner from owned production facilities.

(*b*) Crude oil exchange ratio—the percentage of crude inputs obtained from other firms via exchange agreements.

(*c*) Gasoline exchange ratio—the percentage of gasoline output obtained from other firms via exchange agreements.

Table I–1.—*Independent crude producer summary, 1967–71*

	Crude sales to 8 largest majors as percent of total sales	Crude sales to other majors as percent of total sales	Percent of gathering lines operated by 8 largest majors	Percent of gathering lines operated by other majors
	(1)	(2)	(3)	(4)
1967	40.2	25.3	39.3	5.2
1968	41.5	26.3	40.7	21.7
1969	42.0	24.8	37.6	3.8
1970	44.6	27.1	42.9	24.9
1971	44.4	25.8	36.0	24.8

[9] The section on Industry Structure, *infra*, suggests that the eight largest firms control 64 percent of the crude in Texas.

Table I–2.—Independent refiners summary

	Percent of capacity operations (1)	Percent of crude secured from 8 largest majors (2)	Percent of crude secured from other majors (3)	Percent of gasoline sold to 8 largest majors (4)	Percent of gasoline sold to other majors (5)	Percent of gas sold to independents (6)	Self-sufficiency ratio (7)	Crude oil exchange ratio (8)	Percent of crude exchanged with 8 largest majors (9)	Gasoline exchange ratio (10)	Percent of gas exchanged with 8 largest majors (11)
1967	91. 1	28. 5	26. 3	10. 6	3. 2	86. 2	4. 3	15. 3	8. 2	46. 9	11. 8
1968	93. 2	29. 7	20. 2	14. 2	3. 1	82. 7	2. 0	14. 5	16. 1	53 6	10. 8
1969	93. 3	28. 2	19. 9	13. 4	2. 1	84. 5	2. 5	15. 2	8. 3	52. 2	11. 8
1970	93. 7	29. 2	19. 0	11. 9	2. 7	85. 4	4. 5	15. 5	12. 1	51. 7	13. 7
1971	95. 0	30. 9	17. 0	6. 8	2. 9	90. 3	4. 3	15. 3	13. 3	50. 7	16. 7

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Independent refiners supplied very little of their own crude oil (an average of 3.5 percent) during the years 1967–1971 (average of Table I–2, column 7). However, they appear to have had little difficulty obtaining crude from other sources; 29 percent of their crude was obtained from the eight largest firms; 21 percent was obtained from other major firms (average of Table 2, columns 2 and 3).

Although largely dependent on all major firms for their crude supply, the independents sold only 14 percent of their gasoline output back to the majors (average of columns 4 and 5, Table 2). The bulk of their refined product was sold to independent retailers many of whom relied exclusively upon independent refiners for their gasoline supplies (Table 2, column 6).

When firms have a surplus of crude oil or refined product, exchanges are often conducted with other refiners. The recipient either provides product or oil where the first company has a shortage, or agrees to provide a like amount of the product or oil in the future. Most of the independent refiners in our sample exchanged crude oil and gasoline with both major and independent oil companies; 15 percent of their crude inputs were obtained via exchange and 51 percent of their gasoline output was accounted for by exchange agreements (average of Table I–2, columns 8 and 10). Of these totals, the eight largest companies accounted for 12 percent of the crude and 13 percent of the gasoline exchanges (average of Table I–2, columns 9 and 11).

Although independent refiners usually sell final product to independent marketers, the eight largest firms appear willing to supply independent refiners with crude oil. The eight majors, however, are reluctant to engage in crude exchange agreements with the independents, and have used processing arrangements as a means of controlling independent capacity and the availability of gasoline to independent marketers. It is possible that as crude oil becomes less abundant the major integrated firms may begin to exercise even more control.

MARKETERS

Table I–3 summarizes the relationship between surveyed marketers and major firms for the period 1967–1971. An examination of independent marketers' data reveals that surveyed independent marketers purchased an average of only 1.1 percent of their gasoline (average of Table I–3, column 1) from the eight largest majors during the period 1967 to 1971; purchases of independent marketers from other majors averaged 46 percent (average of Table I–3, column 2). This immense disparity would tend to indicate that the eight largest majors have limited gasoline supplies to independent marketers.

Although the eight largest firms are unwilling to sell gasoline to independent marketers, they do appear willing to sell to other majors. In 1971, in Districts 1 and 3, they sold over 10 percent of their refined gasoline to other majors (net 96 as a percent of 750) but less than one percent (four as a percent of 750) to independent marketers (see Figure I–2–flow chart).

The data clearly indicate that the eight largest firms have dealt only nominally with independent marketers. Several have testified in investigative hearings that they will not sell to independents, regardless of price. This behavior may be contrasted with that of the other major companies who, in 1971, provided 42.9 percent (100 as a

percent of 223) of independent gasoline requirements in Districts 1 and 3 (see Figure 2-flow chart).

3. Implications for the Petroleum Industry

To present a general overview of the data, flow diagrams have been prepared. Figure I–1 below indicates that magnitude of crude flows from producers to refiners in Districts 1 and 3. Figure I–2 represents the flows of gasoline and natural gas liquids from refiners to marketers in these districts.

All total figures (imports, crude production, exports, refinery input and output, refinery capacity, and consumption) are derived from two U.S. Department of Interior, Bureau of Mines, Mineral Industry Surveys:

(*a*) "Petroleum Refineries in the United States and Puerto Rico," January 1, 1971.

(*b*) "Crude Petroleum, Petroleum Products and Natural Gas Liquids, 1971" (Final Summary).

The latter source was also used for calculation of transfers to other districts; the former was used for calculation of shares of refinery capacity.

The National Petroleum News Factbook Mid-May 1972 was used to calculate market shares of retailers for 1971. This introduces an upward bias in the independent market shares, and a downward bias in major shares (particularly the smaller majors) since only market shares of firms with market shares greater than one percent were listed. We assumed that those below one percent were independents, but occasionally a major firm will have such a share.

Shares of crude production were calculated by extrapolating from *Oil Directory and Production Survey*, 1973, R. W. Byrams and Company, Austin, Texas.

Shares of Crude Oil Imports were calculated from the 1973 *Oil Import Digest*, Oil Import Appeals Board

In the following sections, these data are analyzed to present a more comprehensive picture of the structure, conduct, and performance of the petroleum industry. Following these analytic sections are the Commission staff's conclusions with respect to the nature of competition in the petroleum industry.

The following assumptions were made in the construction of the flow diagrams:

1. In the refining sector, shares of crude oil input and gasoline output were assumed identical to shares of crude oil input capacity, and gasoline output capacity.

Table I–3.—*Purchases of independent marketers*

	Gasoline purchases from 8 largest majors as a percent of total purchases	Gasoline purchases from other majors as a percent of total purchases
1967	1.5	51.0
1968	.5	48.2
1969	.7	43.6
1970	1.0	44.9
1971	1.6	42.7

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2. The survey sample was assumed to be representative of all independents. As noted above, our initial objective was to survey the largest firms in each sector, rather than to sample randomly all firms in the industry. Therefore, the results are representative of the class, "large independents" rather than the class, "all independents." However, since, for example, the majors supply more gasoline to large independents than to small independents, the estimates in this study tend to *overstate* the importance of majors as sources of gasoline to the independent sector.

3. Since data on concentration of gasoline imports were not available, these market shares were assumed to be identical to shares of crude imports.

4. Relative transfer shares (the eight largest majors vis-a-vis the other majors) were assumed to be identical to relative production shares.

It appears that the eight largest firms have avoided market forces in their policy of limited dealings with independent marketers. However, Figure I–1 suggests that the market is less restrained in other sectors of the industry. For example, our sampled refiners purchase 30 percent of their crude inputs from the eight largest majors (365 as a percent of 1,233).[10]

Figure I–2 indicates that the eight largest majors have dealt hardly at all with independent marketers. Only 4 million of 233 million barrels of gasoline used by independents were supplied by eight majors. However, the eight largest supplied the other majors with approximately half of their requirements. The other majors appear to act as buffers between the eight largest majors and the independent marketers. In 1971, they were net buyers of 96 million barrels of gasoline from the eight largest majors, and net sellers of 91 million barrels to the independents. Therefore, although the eight largest majors do not sell to independent marketers, they can impose shortages upon independent sellers by reducing sales to smaller majors.

[10] Our sampled refiners accounted for almost half of all independent refining capacity in Districts 1 and 3.

Figure I-1 - District 1 and 3 Crude to Refiners, 1971
(millions of barrels)

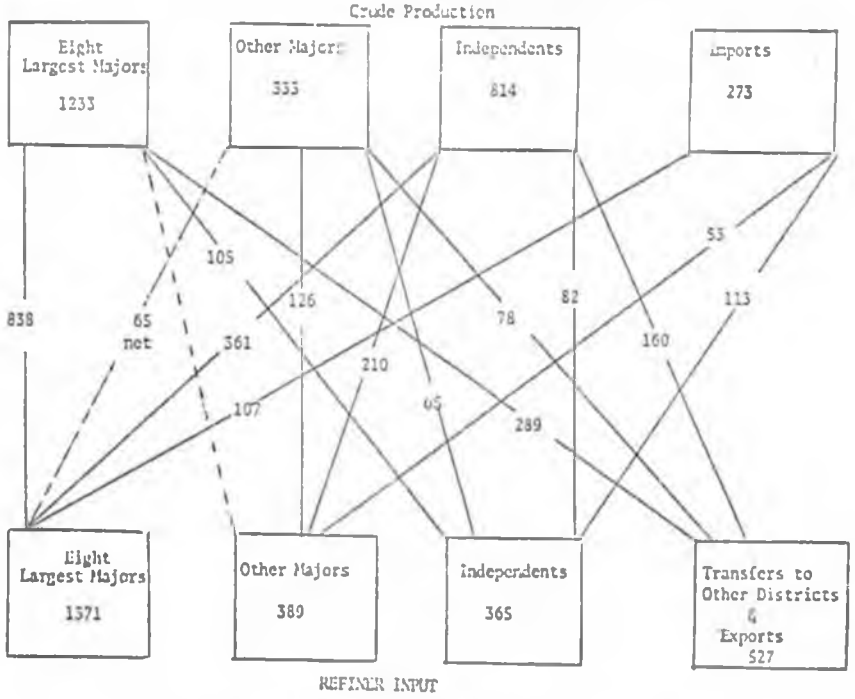
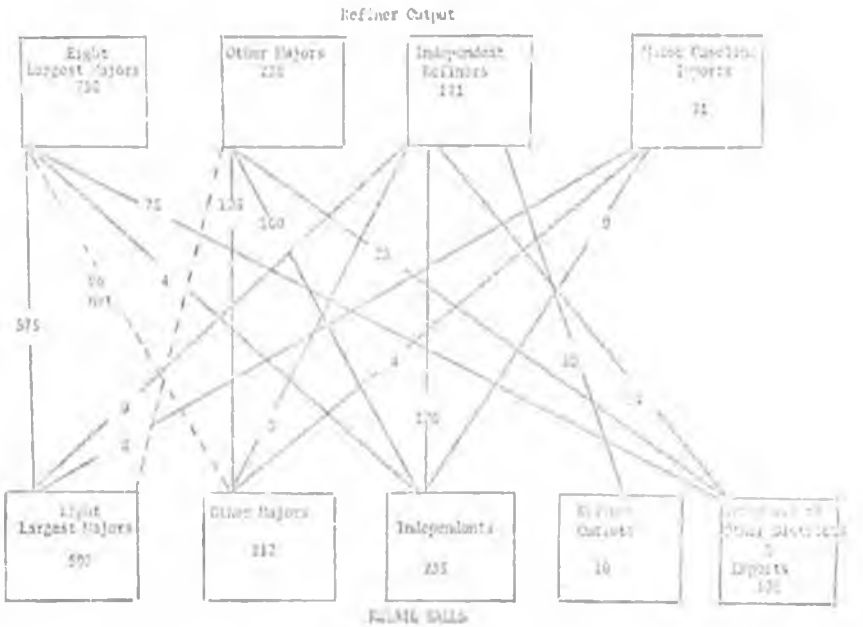


Figure I-1 - District 1 and 3 Crude Flows to Refiners, 1971
(millions of barrels)



NOTE.—Dashed lines indicate net sales of the largest majors to other majors and of other majors to the eight largest. Total sales of the eight largest majors to other majors and sales of other majors to the eight largest were not available.

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II. INDUSTRY STRUCTURE [1]

The petroleum industry is functionally divided into four basic levels: crude oil production, refining, marketing and transportation. While varying numbers of independent companies operate at each level, the industry is dominated by 18 vertically integrated companies that operate at all levels. These firms are large and generally have leading market positions at each level vis-a-vis independents. All 18, according to the *Fortune* 500 sales ranking, are among the 200 largest industrial corporations. Ten are within the top 40, and seven are within the top 20. Industry concentration has resulted both from the dominant positions of these firms and from institutional constraints peculiar to this industry. In order to examine the industry, each level of activity and each relevant institutional factor on a national basis will be discussed.[2]

A. Crude Oil Production

Concentration in crude oil production by the majors has increased markedly since 1960. While it has been estimated that the number of oil producers in the United States is somewhere between 10,000 to 12,000,[3] the Top 4, 8 and 20 oil producing companies in 1969 accounted respectively for 31, 51 and 70 percent of the average daily barrels of crude produced domestically. (See Table II-1, *infra.*) In 1960, the Top 4, 8 and 20 firms accounted for 26, 43 and 62 percent respectively.[4] A clear trend toward even greater concentration is thus borne out by these comparative statistics.

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[1] The discussion of industry structure which follows will provide an overview of the petroleum industry within a national framework. This, however, is not meant to imply that the relevant economic markets for crude oil and refined products are national in scope. Certainly, the market for refined products is less than national in scope, while the market for crude oil may be national or less than national. Defining regional economic markets precisely is not easy; we have, however, provided some structural data at less than the national level, and, of necessity, have assembled these data according to Petroleum Administration for Defense (PAD) districts utilized by the Bureau of Mines. This information is attached as Appendix A to this report.

[2] Company statistics presented throughout this memorandum may tend to be unsystematically biased downward with regard to their real world representation. This is because it is not completely known to what extent joint ventures, exclusive buying-selling contracts and outright ownership are represented in these statistics. For example, Getty Oil owns 72 percent of Skelly Oil, but most of the present statistical sources represent them as separate companies.

[3] *Report on Crude Oil and Gasoline Price Increases of November, 1970: A Background Study*, Nov. 3, 1971, p. 18 (Government monograph).

[4] See the first footnote at the bottom of Table II-1.

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TABLE II–1.—*Company share of domestic net crude production, 1969 and 1960*

Production rank in 1969	Company	Company share 1969 (percent)	Company 1960 [1]
1	Standard (New Jersey)	9. 76	6. 53
2	Texaco	8. 47	8. 93
3	Gulf	6. 78	5. 13
4	Shell	6. 08	4. 78
5	Standard (California)	5. 31	4. 75
6	ARCO [2]	5. 11	5. 92
7	Standard (Indiana)	5. 09	4. 30
8	Mobil	3. 94	3. 42
9	Getty [2]	3. 38	2. 92
10	Union	2. 88	2. 32
11	Sun [2]	2. 47	2. 65
12	Continental	2. 21	2. 54
13	Marathon	1. 64	1. 38
14	Phillips	1. 55	1. 79
15	Cities Service	1. 28	1. 29
16	Amerada Hess	1. 04	1. 22
17	Tenneco	. 99	NA
18	Skelly	. 88	. 94
19	Superior	. 74	1. 39
20	Louisiana Land & Exploration Co.	. 61	. 45
	Top 4	31. 09	26. 51
	Top 8	50. 54	43. 76
	Top 20	70. 21	63. 02

[1] 1960 combined production of Atlantic Refining, Richfield and Sinclair. Individual company data were not available. Because of the 1960 concentration for the Top 4, 8 and 20 firms may be slightly overstated, accordingly, trend toward greater concentration since 1960 may be even greater.
[2] Company production includes some foreign production, mainly Canada.

NOTE.—Individual company production data obtained from the estimates of Rice, Kerr & Co., Engineers. Universe data obtained from Report on Crude Oil and Gasoline Price Increases, cited supra.

While average daily oil production data may yield short-run insight into the structure of the crude producing industry, it is not particularly relevant for long-run considerations. As oil is pumped from a well, its technically efficient rate of production falls. Eventually it becomes a "stripper well" [3] and is operated until the pumping costs make it uneconomic to do so. A more relevant long-run measure of concentration at the crude level is the amount of domestic proven reserves owned by firms in the industry.

While considerable difficulty has been encountered in obtaining proved reserve data, our best estimates, presented in Table II–2, indicate that in 1970, the Top 4, 8 and 20 firms had approximately 37, 64 and 94 percent respectively of domestic crude proven reserves. On the basis of these data, the industry structure viewed in a long-run sense is even more concentrated than short-run statistics have indicated.

The structure of this industry, and hence its conduct and performance, is strongly influenced by certain institutional factors. Basically, these are the import quota, prorationing and special tax regulations.

[3] Although state definitions may vary and may be related to both production and well depth, a stripper well or marginal well may be generally classified as a well that produces less than 10 barrels a day. Domestic production accounted for by stripper wells has steadily declined since 1965. In 1970, they accounted for 13.3 percent of domestic production. See *Ibid.*, p. 50.

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TABLE II-2.—*Company shares of proved domestic crude reserves, 1970*

Rank	Company	Share of domestic proved reserves (percent), 1970
1	Standard (N.J.)	[1 2] 9.92
2	Texaco	[1 3] 9.21
3	Gulf	8.97
4	Standard (Calif.)	[1 3] 8.97
5	Standard (Ind.)	[4 3] 8.46
6	ARCO	[3 2] 7.48
7	Shell	[1 5] 5.90
8	Mobil	[1 3] 4.87
9	Getty	[5] 3.85
10	Phillips	[1 3 6] 3.55
11	Signal	3.28
12	Union	[3] 3.18
13	Continental	[3 6] 2.77
14	Sun	[1 3] 2.67
15	Amerada Hess	[3 7] 2.49
16	Cities Service	[1 3] 2.49
17	Marathon	[3 5] 2.37
18	Skelly	1.09
19	Superior	[1 8] 1.03
20	Tenneco	.90
	Top 4	37.17
	Top 8	63.88
	Top 20	93.55

[1] Includes natural gas liquids.
[2] Includes Alaska.
[3] Includes Canada.
[4] Official, including natural gas liquids.
[5] Official.
[6] Excludes controlled reserves.
[7] Includes equity in Canadian affiliate.
[8] Excludes "probably additional" reserve.

These explanatory notes accompanied the reserve estimates.

Note: Individual company reserves obtained from estimates of Rice, Kerr & Co., Engineers. Universe data obtained from "Report on Crude Oil and Gasoline Price Increases," cited supra. This figure was taken as approximately 39,000,000,000 barrels, including Alaska. Concentration data would be lower the more this figure understates actual proven reserves. Concentration data should be taken to be, at best, only rough estimates. It is not known to what extent both the universe estimate and the individual company reserve data include crude production from secondary recovery techniques.

The single most important federal intervention into the petroleum industry was through mandatory oil import quotas. In order to exercise monopoly power, a firm or firms must be able to control the supply of the industry's product. In the traditional tight oligopoly case, that control is exercised through a combination of few sellers acting in an interdependent fashion and effectively erecting barriers to entry against new suppliers. In the petroleum industry, however, that control of supply is importantly influenced by public policy. Between 1959 when the import quota system became mandatory and May 1, 1973 when the quotas were removed, the entry of foreign produced crude oil was severely limited in the United States. Thus, one of the chief sources of competitive supply was curtailed, and domestic integrated firms were operating in an environment where their domestic prices were protected against large scale alternative sources of supply, namely, imports.

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It is interesting to observe that the mandatory quotas were enacted at a time when events had conspired to cause some of the previous methods of supply control to break down. Until the 1950's control of supply of crude oil was maintained largely by a system of state prorationing. Under that system the states that had enacted prorationing legislation would limit supply with the goal of maintaining crude prices. Such legislation was particularly effective when imports were unimportant and when states with prorationing (Texas, Louisiana, and Oklahoma) accounted for almost all domestic production. But, in the 1950's foreign supplies from the Middle East and domestic supplies from non-prorationed states became increasingly important. In 1957 voluntary import-controls were initiated, and in 1959 the mandatory controls were imposed. Thus, at a time when supply was becoming increasingly loose, new controls to the advantage of the existing petroleum oligopoly were imposed. It is noteworthy that complaints of financial distress from independent refiners and marketers became more prevalent after the imposition of quotas and that many of those firms trace their difficulties to the international arrangement.

The major oil firms have had the advantage of other federal provisions which have served to buttress their control over the supply of crude oil available in domestic markets. The impact of quotas on the price of domestic crude oil was substantial. The domestic price of crude has in recent years averaged $1.25 to $1.50 per barrel above the world price, and most of the difference is attributable to the import quota. The import quota clearly contributed to profits earned in producing crude oil by elevating prices, but the quota increased profits to the major in another way. The right to import went only to existing refineries. Thus, the major companies through import tickets were able to purchase oil at the world price as an input for their refineries, which produced final products at elevated domestic prices. A further benefit accruing to the majors was that they were able frequently to obtain profits by trading at favorable terms domestic crude for the independents' allotted foreign crude because some independents located inland were not in a position to economically utilize imports.

While the import quota was in effect, it was an important source of control of crude oil supply, but there are others that must be considered. The states, with an assist from the federal government, also placed limits on the production of domestic crude oil through prorationing.

Prorationing was originally instituted as a means of conserving the supply of domestic petroleum reserves and avoiding "wasteful" practices such as those that resulted from the rule of capture.* However, it functions as a means of controlling supply and setting price. Essentially, the technologically maximum efficient rate of recovery (MER) is determined for each well. Then, demand forecasts for crude oil are examined, and each well is permitted to pump as much crude (sub-

* Because crude pools transcend land boundaries, two or more different land owners could be tapped into the same pool. Since one man's loss would be another's gain, it is said that each would pump as fast as possible. Today, a form of joint profit maximization, unitization, is generally recognized to be a more efficient means of crude oil recovery. In fact, it is argued it removes the strongest argument for prorationing.

ject to its MER) as will clear the market in the aggregate at the market price.

In the U.S. today, prorationing is used in the states of Texas, Louisiana, Oklahoma, New Mexico and Kansas.[7] (although these states now claim that they are permitting 100 percent well production during the present shortage). Each state has its own prorationing agency to make state supply determinations. Together, these five states accounted for approximately 74 percent of domestic crude production in 1970.[8] Texas alone accounted for approximately 36 percent.[9] Hence, the supply and price of the vast majority of domestic crude are determined by forces outside the marketplace.

The Federal Government gave teeth to prorationing with the passage of the Connally "Hot Oil" Act in 1935. This act prohibits interstate shipments of crude oil produced in violation of state prorationing laws. However, the Federal Government has the power to "suspend its operation—presumably both enforcement activity as well as basic consent legalizing state action—if state action should unduly burden interstate commerce."[10] The Attorney General is responsible for an annual review, under the Interstate Oil Compact, to determine if such legislation is consistent with its intent, and if not, to suspend it. Its intent is set forth in Article V of the Interstate Oil Compact:

> It is not the purpose of this compact to authorize the states joining herein to limit the production of oil and gas for the purpose of stabilizing or fixing the price thereof, or create or perpetuate monopoly, or to promote regimentation, but is limited to the purpose of conserving oil and gas and preventing the avoidable waste thereof within reasonable limitations.[11]

Thus far, Article V has not been invoked.

The set of federal laws remaining to be discussed are those pertaining to the effect of certain tax regulations on industry incentives.

Special tax provisions permit oil companies to expense many of their exploration and drilling costs rather than depreciating them over an extended period. These provisions tend to lead to an understatement of gross income and to a reduction in tax liability. In addition, the oil companies are permitted to treat royalties paid to foreign governments for drilling rights as an income tax. These "taxes" may then be used as a dollar for dollar offset against U.S. corporate income tax liability.[12] These measures act as a subsidy to crude oil production and, therefore, stimulate increased allocation of resources to the dis-

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[7] "The Petroleum Industry," Thomas G. Moore, in *The Structure of American Industry*, Walter Adams, Ed. Fourth Edition 1971, Macmillan Company, p. 130.

[8] *Crude Petroleum, Petroleum Products and Natural Gas Liquids: 1970 (Final Summary)*, Bureau of Mines, December 23, 1971, p. 8. This figure includes lease condensate. It must be pointed out that all of the crude production in each state is not necessarily regulated by prorationing. In Texas stripper wells are not prorationed, and offshore production, as in Louisiana, is under the administration of the Secretary of the Interior. In Texas in 1969, stripper wells accounted for 12 percent of the state's output (*Petroleum Facts and Figures*, American Petroleum Institute, 1971, p. 30 and p. 70). It is not known to what extent Louisiana data reflects offshore production or to what extent Louisiana prorationing is affected by the Secretary of Interior's jurisdiction over offshore production.

[9] It should also be mentioned that special tax treatments in the petroleum industry make it difficult or impossible to assess such variable in any case.

[10] *Petroleum Facts and Figures*, cited *supra*.

[11] *Report of the Attorney General, Pursuant to Section 4 of the Joint Resolution of September 8, 1941, Consenting to an Interstate Compact to Conserve Oil and Gas*, July 1967, p. 31.

[12] *Ibid.*, p. 1.

covery and recovery of crude oil. Hence, it is not surprising that the oil firms seek to integrate backwards to take advantage of the favorable tax provisions. It is, however, the oil depletion allowance that has had the greatest impact upon resource allocation among production stages and relative price structure in the petroleum industry in past years.

Oil depletion allowances were passed originally as a method of encouraging oil exploration.[13] It was argued that since oil was a scarce and valuable natural resource, it would not be advisable to permit national reserves to be depleted. Therefore an incentive was granted to oil producers through a special tax deduction in the hope that more resources would be devoted to the discovery of additional crude oil sources. A crude oil producing firm is permitted to subtract from its gross income before taxes an amount equal to 22 percent of its total revenues from crude production (i.e., actual production times posted price at the wellhead) up to 50 percent of the firms net pretax income. Under this system, the major integrated firms have an incentive to seek high crude prices. The high crude prices are, however, a cost to the major firms' refineries. Thus, an increase in crude prices implies an increase in crude profits but a decrease in refinery profits. The integrated oil companies gain because the depletion allowance reduces the tax on crude profits, while refinery profits are not subject to the same advantageous depletion deduction. A simple model developed by the FTC suggests that for American integrated firms that typically produce between 40 and 80 percent of their crude needs, it pays to raise crude prices up to a point where refinery profits have been reduced to zero.[14] Beyond that point, net income after taxes for the integrated oil firm begins to fall.

Thus, the major integrated oil companies have been able to capitalize upon the existence of import quotas, state prorationing, and oil depletion allowances to limit effectively the supply of crude oil to a point which reduces their refinery profits to zero. Clearly, such a system creates a hazardous existence for independent refiners, who have little or no crude production. In such an environment, only those independent refiners who have: (1) lower costs through locational or other advantages; (2) some monopoly power in a local market; or (3) sufficient access to inexpensive imported oil, can survive.

It is important to note that no technological imperative renders crude production inherently profitable and refinery and marketing operations inherently unprofitable. Rather, the tax laws have made it highly remunerative for integrated firms to artificially shift profits away from downstream activities toward the crude end of integrated business. This goal is accomplished by raising crude prices through various controls on supply.

B. Refining

The petroleum refining industry is the pivotal point in the petroleum industry. It is virtually the sole buyer of crude[15] and it trans-

[13] See Appendix B for a more detailed explanation of how the oil depletion allowance works.

[14] The model assumes a perfectly inelastic demand for crude oil and refined products and relates refiner profits linearly to crude oil prices.

[15] A small amount of crude oil is on occasion used directly as heating fuel when insufficient fuel oil is available.

forms crude into more efficient particular energy products. In 1969, the domestic refinery yield was as follows: [16]

	Percent
Gasoline	45.5
Distillate fuel oil	21.6
Jet fuel	8.2
Residual fuel oil	6.8
Kerosene	2.6
Lubricants	1.7

As of January 1, 1972, there were 282 domestic refineries and approximately 129 refining companies.[17] The 1970 crude oil refining capacity as shown in Table II–3, accounted for by the leading 4, 8 and 20 firms, was 33, 58 and 86 percent respectively. These same firms accounted for 34, 59 and 87 percent of gasoline refining capacity.[18]

TABLE II–3.—*Company share of domestic crude oil and gasoline refining capacity, 1970*

Rank in crude oil capacity	Company	Share of crude oil capacity (percent)	Share of gasoline capacity (percent)
1	Standard (N.J.)	8.59	9.22
2	Standard (Ind.)	8.22	7.94
3	Texaco	8.13	9.19
4	Shell	7.99	7.69
5	Standard (Calif.)	7.66	6.72
6	Mobil	6.28	6.36
7	Gulf	5.78	6.47
8	ARCO	5.42	6.25
9	Sun	3.60	4.54
10	Union	3.51	3.24
11	Standard (Ohio)	3.47	3.09
12	Phillips	3.14	4.24
13	Ashland	2.51	2.11
14	Continental	2.36	2.03
15	Cities Service	2.22	2.26
16	Getty	1.64	1.76
17	Marathon	1.12	1.92
18	Coastal States	1.06	.73
19	Amerada Hess	.98	.79
20	Champlin	.97	.63
	Top 4	32.93	34.04
	Top 8	58.07	58.78
	Top 20	86.15	[1] 87.38

[1] The top 20 firms in gasoline capacity included Clark Oil (1.21 percent), Tenneco (1.35 percent), and American Petrofina (0.85 percent), in lieu of 18–20 above.

Note: Data obtained from Mineral Industry Survey, Bureau of Mines, "Crude Oil Capacity," Jan. 1, 1971.

[16] Standard and Poor's *Industry Surveys*, June 3, 1971, p. 068. The remainder consists of asphalt and petrochemicals.

[17] *Report on Crude Oil and Gasoline Price Increases of November 1970*, p. 46, cited *supra*.

[18] As of January 1, 1961, there were approximately 311 domestic petroleum refineries and approximately 175 refining companies. While crude refining capacity increased by 24.6 percent from January 1961 to January 1971, the share accounted for by the leading four and eight firms increased approximately 4.4 and 12.1 percent respectively. For gasoline capacity, the increase was 7.3 and 10.1 percent. Thus an increasing trend in concentration may be observed. For 1960 data, see "Mineral Industry Survey," January 1, 1961 cited *supra*. Moreover, due to the existence of processing arrangements between major oil companies and independent refiners through which major oil companies supply crude oil in return for refined product, this figure may substantially understate effective refinery concentration.

A comparison of firm rankings in refining and production (Table II–4) yields some interesting results. While there are some minor deviations, three of the top four refiners are among the top four crude producers and the top eight refiners are also the top eight crude producers. Further, 16 of the top 20 refiners are among the top 16 crude producers. Hence, independent monopsonistic purchasing power conducive to downward pressure on crude prices is virtually absent.

TABLE II–4.—*A comparison of company ranking in crude production and crude refining capacity* [1]

Company	Rank in crude production	Rank in crude oil refining capacity
Standard (New Jersey)	1	1
Texaco	2	3
Gulf	3	7
Shell	4	4
Standard (California)	5	5
ARCO	6	8
Standard (Indiana)	7	2
Mobil	8	6
Getty	9	16
Union	10	10
Sun	11	9
Continental	12	14
Marathon	13	17
Phillips	14	12
Cities Service	15	15
Amerada Hess	16	19
Tenneco	17	(2)
Skelly	18	(2)
Superior	19	(2)
Louisiana Land and Exploration	20	(2)
Standard (Ohio)	(2)	11
Ashland	(2)	13

[1] Based on rankings of tables 2 and 3. Production share is for 1969. Crude refining share is for 1970.
[2] Not ranked within the top 20 firms in crude refining capacity.

There could, of course, still be some downward pressure on crude prices, despite the integration of the leading firms, if there were a mismatch between a company's crude production and its refining capacity.[19] The extent of this would depend upon the degree of self-sufficiency and the marginal effect of higher crude prices on total revenue due to the interrelationship of self-sufficiency and the marginal effect of higher crude prices on total revenue due to the interrelationship of self-sufficiency and the oil depletion allowance. De Chazeau and Kahn developed a simple model to examine this relationship.[20] They determined that a company with a self sufficiency greater than 77 percent would benefit from a crude price increase even if this increase were not passed on in the price of products at all. If 50 percent of the price increase were passed on, a company with a degree of self-sufficiency in excess of 38.5 percent would benefit from a price increase.

[19] It must be kept in mind that the aggregate supply and demand of crude are equalized at a given price through prorationing.
[20] For the complete model see De Chazeau and Kahn, *Integration and Competition in the Petroleum Industry*, Yale University Press, 1959, pp. 221–222.

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Their estimates were based on the 27½ percent depletion allowance which was in effect at that time.

Using the identical model and substituting the present 22 percent depletion allowance only alters their conclusions slightly. If the price increase is not passed on, a company with a self-sufficiency in excess of 40.4 percent would benefit from a price increase. The greater the percentage of the price increase passed on, the lower the self-sufficiency required to benefit from a crude price increase.

As can be seen from Table 5, all of the Top 8 and 15 of the Top 17 refining companies have self-sufficiency greater than 40 percent. Three of the Top 8 and 5 of the Top 17 have self-sufficiency greater than 81 percent. Thus, vertical integration combined with the depletion allowance places upward pressure on crude prices.

It is vitally important to keep in mind that while the recent removal of the oil import quota may to some extent exert slight downward pressure on crude prices as the U.S. price reaches an equilibrium with world prices, it will not necessarily substantially alter the structure of the refining level of the petroleum industry. This is true for two reasons. First, the major integrated companies have substantial interests in crude oil production world-wide. Second, and most important, it is questionable that new independent refiners would enter the market, even with available supplies of foreign crude. The reason is quite simple—the uncertainty of the continual availability of foreign crude. Just as the federal government first restricted imports and then removed them, they may be restored at a moment's notice. And since refining is the pivotal point in the petroleum industry, the implications are that removal of the import quotas alone may not be sufficient to cure the present ills of the industry or alter its noncompetitive performance significantly.

TABLE II–5.—*Domestic self-sufficiency of the 17 leading refiners 1969*

Company:	*Self sufficiency (Percent of runs to stills)*
Standard (New Jersey)	97.4
Standard (Indiana)	50.5 d
Texaco	81.0 e
Shell	62.1
Standard (California)	68.8 d
Mobil	42.2 a
Gulf	87.6 d, f
ARCO	64.9
Sun	46.7 b
Union	64.3 d
Standard (Ohio)	6.7 d
Phillips	51.8 d
Ashland [1]	12.6
Continental	64.0
Cities Service	49.9
Getty [2]	137.2 f
Marathon	88.1

(a) Other liquids included in refinery runs.
(b) Crude production excludes Canada.
(d) Other liquids included in crude production.
(e) Estimated.
(f) Excludes crude processed for company's account.
[1] 12 months to September 30, 1969.
[2] Includes subsidiaries.

NOTE.—Obtained from estimates of Kerr, Rice and Co., Engineers.

TABLE II–6.—*Worldwide self-sufficiency of the 17 leading U.S. refiners 1969 and 1959*

U.S. rank in crude refining capacity	Company	Self-sufficiency 1969 (percent)	Self-sufficiency 1959 (percent)
1	Standard (New Jersey)	88.3	77.1
2	Standard (Indiana)	66.4	51.5
3	Texaco	106.7	92.4
4	Shell Group	72.5	74.2
5	Standard (California)	138.1	105.4
6	Mobil	75.5	69.5
7	Gulf	193.0	172.7
8	ARCO	96.7	64.6
9	Sun	87.4	55.7
10	Union	85.6	50.0
11	Standard (Ohio) [1]	28.9	28.1
12	Phillips	65.4	71.3
13	Ashland	13.9	8.8
14	Continental	158.4	104.0
15	Cities Service	89.5	44.6
16	Getty	241.1	71.8
17	Marathon	163.2	109.0
	Top 4	84.8	[2] 76.5
	Top 8	96.2	[2] 84.2
	All 17	97.1	[2] 96.8
	5 largest United States international companies.[3]	108.9	[2] 93.5

[1] Does not include British Petroleum which had a self-sufficiency in 1959 and 1969 of 131.1 percent and 157.4 percent respectively.
[2] Data for the same 4, 8, and 17 leading companies in 1969.
[3] These are Standard Oil (New Jersey), Gulf, Texaco, Standard Oil (California), and Mobil.

Note: Ratios obtained from the "Oil and Gas Journal," Jan. 18, 1971, pp. 22–23. Multicompany measures were computed from production and capacity data contained in the same source.

C. Gasoline Marketing

Gasoline marketing is the most competitive areas of the petroleum industry and has the largest number of independent companies.[21] Marketing consists primarily of jobbers purchasing refined gasoline and supplying retail gasoline stations. These jobbers may be completely independent, may own their own retail stations, or may be vertically tied to refinery operations. They also may carry branded or unbranded products.

The 1970 gasoline market shares of the Top 20 companies are presented in Table 7. The Top 4, 8, and 20 companies accounted for approximately 31, 55 and 79 percent, respectfully, of domestic gasoline sales. The Top 4 and 8 gasoline marketers correspond with the Top 4 and 8 refiners, and the Top 8 crude producers are identical with the Top 8 marketers and refiners (See Table 8).

The distinction between the major branded retail gasoline stations and the independent stations is one of the primary reasons for price competition at this level.[22]

[21] Because gasoline constitutes the primary output of the refinery, we have limited our discussion here to gasoline marketing.

[22] It must be pointed out that while this physical distinction exists, the actual effect on competition is becoming increasingly more difficult to assess because of the trend toward joint ownership. Major oil companies may own both major brand and so called "independent brand" gasoline stations in the same market area. Independent stations also may own other independent stations, under a different brand name, in the same market. Thus, competitive pressures in some markets may be significantly less than the independent major brand rivalry would seem to indicate.

TABLE II-7.—*Company gasoline market shares 1970*

Rank	Company	Market share [1] (percent of)
1	Texaco	8.13
2	Shell	7.87
3	Standard (New Jersey)	7.42
4	Standard (Indiana)	7.30
5	Gulf	7.12
6	Mobil	6.60
7	ARCO	5.55
8	Standard (California)	5.02
9	Sun	4.15
10	Phillips	3.97
11	Union	3.29
12	Continental	2.35
13	Cities Service	1.96
14	Marathon	1.73
15	Standard (Ohio)	1.46
16	BP	1.41
17	Ashland	1.27
18	Tenneco	.93
19	Kerr-McGee	.77
20	Murphy	.75
	Top 4	30.72
	Top 8	55.01
	Top 20	79.05

[1] Based on gallonage sales.

NOTE.—Market shares obtained from *National Petroleum News*, "Factbook Issue," mid-May 1971, p. 127.

TABLE II-8.—*A comparison of company ranking in crude production, crude refining capacity, and gasoline sales* [1]

Company	Rank in crude production	Rank in crude oil refining capacity	Rank in gasoline sales
Standard (New Jersey)	1	1	3
Texaco	2	3	1
Gulf	3	7	5
Shell	4	4	2
Standard (California)	5	5	8
ARCO	6	8	7
Standard (Indiana)	7	2	4
Mobil	8	6	6
Getty	9	16	(2)
Union	10	10	11
Sun	11	9	9
Continental	12	14	12
Marathon	13	17	14
Phillips	14	12	10
Cities Service	15	15	13
Amerada Hess	16	19	(2)
Tenneco	17	(2)	18
Skelly	18	(2)	(2)
Superior	19	(2)	(2)
Louisiana Land & Exploration	20	(2)	(2)
Standard (Ohio)	(2)	11	15
Ashland	(2)	13	17
BP	(2)	(2)	16
Kerr-McGee	(2)	(2)	19
Murphy	(2)	(2)	20

[1] Based on the rankings of tables 4 and 7. Rank in production is for 1969. Rank for capacity and gasoline sales is for 1970.

[2] Not ranked within the top 20 firms.

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The major branded stations differentiate their products and convey a national image. These retail stations generally offer a full line of services, including credit cards, automobile repair, etc. The independents, on the other hand, differentiate their products primarily on a price basis and offer few services other than pumping gasoline. This, of course, gives the consumer a choice between purchasing gasoline and services at a higher price, and purchasing only gasoline at a lower price. If, in a given area consumers show a strong preference for the latter, and/or if independents move into a market, vigorous price competition between the majors and independents may result.

Of course some price competition may result directly from the major companies themselves. This may occur when a major company decides to move into a market area dominated by other majors or possibly independents. As a new entrant, this major company may begin as a vigorous price cutter; but, as his price cuts are matched by other companies, the retail gasoline price will eventually stabilize somewhere near the old level. If he is strong enough, he may achieve his desired market share. But, in doing so, he will have obtained it at the expense of the weakest segment of the market, the independent portion. If independents are diversified geographically, however, they may withstand price competition. If not, they will be the first to be eliminated.[23]

However, today a price war is unnecessary for the elimination of the independent marketer. Because the major oil companies control the lion's share of domestic crude oil and refinery capacity under conditions of excess demand, they have been able to direct the flow of gasoline to their own service stations first, thus denying to the independent marketer access to a substantial portion of the gasoline supply. In fact, independent gasoline marketers receive only about 2 percent of their supply of product from the eight largest oil companies.

D. Transportation

Because crude oil is low in value relative to its weight and the refinery process requires a relatively constant flow of crude and product, pipelines are generally the most economical form of bulk land transportation in this industry. Approximately 75 percent of crude and 27 percent of refinery product are carried by pipeline.[24]

Gathering pipelines collect crude from the well, and transport it to a main trunkline station. From the trunkline station, it flows through a larger diameter pipeline to the refinery. Product pipelines carry gasoline and other products from the refinery to local or regional storage facilities from which jobbers and ultimately retailers purchase their product.

These pipelines form a vast, complex intrastate and interstate transportation network. Because of the high construction costs, most of the pipelines are owned directly by individual major petroleum companies or by several of these companies through joint venture. However,

[23] A reservation should be made at this point. No claim is being made that all price wars are the result of the reasoning provided above or that majors always start price wars. Indeed, economists generally agree that consumers benefit from lower prices associated with price wars. In fact, price wars are often the result of disagreement about the proper price differential between independent and major station prices. They are started by majors, major "mavericks" (i.e., those who reject stated company price policy), and independents. The point is, however, *that sometimes price wars represent a policy adopted by majors to avoid the alternative of selling gasoline to independents.* That result is clearly exclusionary.

[24] According to Moore, p. 124-125, cited *supra*, approximately 75 percent of crude flows to the refinery by pipeline, 17 percent by tanker and 8 percent by truck. For refined petroleum approximately 27 percent is carried by pipeline, 30 percent by water carrier and 43 percent by truck.

the nature of the interstate lines causes them to come under the "common carrier" regulatory jurisdiction of the Interstate Commerce Commission.

Our investigation disclosed charges leveled against these pipeline owners by non-owners who claim that they have been excluded from using the common-carrier lines. The inherent technological nature of the pipeline system and the petroleum industry provides the basis for such exclusionary practices.

Through the pipeline system, crude oil is transported more or less on a constant flow-pressure basis. Trunkline stations can pump-in a batch of crude only when there is a slot in the flow for it and then line pressure must be increased or decreased to adjust for the desired flow speed. The scheduling of pipeline input is very complex and must be worked out in advance of the shipment Because of this process, an independent crude producer may have great difficulty in securing a place in the flow, especially if he does not have storage tanks at the trunkline station and/or ships a relatively small amount of crude. The result of this pipeline system is to place the major firms who own the pipelines in an excellent position to discriminate against the independent producers. The opportunity to require the independent to enter into an agreement to sell his product at the well head in order to obtain regular sale and transportation of crude clearly exists for the majors.

III. BARRIERS TO ENTRY

In addition to being a highly integrated industry, the petroleum industry, and refining in particular, is also characterized by high barriers to entry. Without such barriers, excess profits would attract new firms into the market, increasing the supply, and eliminating the excess profits.

Because of the lack of substantial entry by new independent refiners over the last 20 years, we turn our attention to factors in the petroleum industry which tend to act as barriers to entry. In most instances, the factors leading to further concentration, e.g. import quotas, prorationing, depletion allowances, also serve to inhibit new entrants into the industry or component segments of the industry.

The most obvious barrier is the high capital cost of entering the refining industry. A refinery large enough to achieve maximum scale economies in the production of gasoline costs approximately $250 million.[1] The operation of the capital market is such that the number of firms which can borrow that amount of money is relatively small. Even for those firms which have access to the required capital, the risks which they face vis-a-vis the major petroleum companies are such as to discourage entry.

Several of those risks are associated with the ability of the refiner to obtain a dependable source of supply of its major input, crude oil. In the past, refiners have had to depend on their major oil company competitors for access to this crucial input. This has occurred because the major oil companies directly own substantial amounts of the crude oil, and because they control the vast majority of the remainder of the crude (primarily through control of pipeline transportation). Thus, in any short supply situation, the independent refiner would be the first firm to lose access to crude oil and the last to regain access. Having refinery output subject to great variation because of variation in crude inputs imposes substantial costs upon non integrated refiners. The alternative of entering the petroleum industry as a vertically integrated firm raises capital costs to even greater proportions.

The plight of the would be entrant at the refining stage has to some extent been alleviated through the recent Presidential removal of the oil import quotas. However, this does not eliminate the problems faced by the independent refiners in this context. All students of the petroleum industry (surely anyone planning to expend $250 million as a capital investment would become a serious student of the industry) are well aware that the major firms have always turned to governmental entities to help them rationalize excess supply situations. They would have to assume that if the inflow of foreign crude became sufficient to cause a reduction in the current price of domestic crude,

[1] *Wall Street Journal*, April 17, 1973, p. 15. These data are supported by E. K. Grigsby, et. al., "What Will Future Refineries Cost?" *Hydrocarbon Processing*, May, 1973, pp. 133-135.

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the major companies would again turn to the government to request limitations on imports. Their past success in obtaining such actions is such that one might infer a high probability of future success. Thus, a firm which had built a $250 million refinery might suddenly find that its access to crude oil was greatly reduced. The nature of refinery cost functions, i.e. sharply declining average costs as a refinery nears capacity operation, would make any reduction in the availability of crude oil a traumatic and possibly bankrupting experience for the new entrant.

Since pipelines transporting crude oil across state lines are common carriers subject to Interstate Commerce Commission regulation, it might seem strange to classify pipeline control as a barrier to entry to new refinery capacity. However, there are two reasons to suppose that pipeline control does, in fact, constitute a legitimate barrier. First, the owners of pipelines seek approval from the ICC of rates that provide sufficient returns from their pipeline investment. However, the rate approved may be well above the competitive cost of transporting crude oil. For the vertically integrated owners the excessive rate is no burden. Those firms simply transfer funds from the Refinery Department to the Pipeline Department; a bookkeeping transaction of no moment is made. Non-integrated independent refiners, though, must pay the excessive pipeline charge. For these firms a real cost is incurred. To the extent that major-firm owners of pipelines earn greater than competitive returns on investments, the independent refiners are put at a cost disadvantage relative to their major competitors, and a barrier to entry is imposed. To a lesser extent control of product pipelines can be used to erect a barrier to entry.

Second, pipelines can be employed as a barrier to entry if the owners can exclude or limit flows of crude oil to independents. In fact, this can be done by (1) requiring shipments of minimum size, (2) granting independents irregular shipping dates, (3) limiting available storage at the pipeline terminal, (4) imposing unreasonable product standards upon independent customers of pipelines, and (5) employing other harassing or delaying tactics.

A barrier of substantial importance in the past existed because of the vertical integration in the industry and the federal tax laws. The depletion allowance worked to encourage vertically integrated firms to report all profits at the crude oil stage rather than at later stages such as refining or marketing. The effect was to raise the price of crude oil for refining operations, whether vertically integrated or not. For the vertically integrated concern the price was simply a bookkeeping one and raising it resulted in decreasing refining profits, increasing profits on crude, reducing tax payments, and increasing total profit. For the independent refiner the result was to decrease refining profits which were total profits.

The system contained all the elements essential to a squeeze on refining profits and could be overcome only if the potential refining entrant could enter on a vertically integrated basis. However, entry on this basis substantially increases the already high capital cost of entry. Even with the freeing of imports the system will still work to the disadvantage of independent refiners unless the world price of petroleum settles to a competitive level.

A final barrier to entry results from the recent emphasis on environmental impact. Even firms who can overcome the high barriers may find either that they cannot obtain government permission to build at the optimal location or that additional capital is required to eliminate possible adverse environmental impacts. In any case they may be at a disadvantage relative to existing plants which were located without respect to such contraints.

Summary

Recapitulation, the major oil firms ha[illegible] considerable market power. The industry operates much like a cartel with 15 to 20 integrated firms being the beneficiaries of much federal and state policy. Thus, the federal and state governments with the force of law do for the major companies that which would be illegal for the companies to do themselves. Further, the tax laws induce the major companies to seek high crude prices, which tend to increase crude profits and squeeze refinery profits to the detriment of and exclusion of independent refiners. While the recent removal of the oil import quota may lessen the ability to obtain higher crude oil prices, it will do so only to the extent that the leading U.S. oil companies are not able to exert significant influence over the world oil market. At any rate, the uncertainty of prorationing reducing domestic crude output in response to imports, together with the uncertainty of the oil import quota being reinstituted at some point in time, both of which occurred in the 1950's, are quite likely to retard the entry and expansion of significant independent refining capacity, and hence may have a similar effect on independent gasoline marketing.

The major firms seek to consolidate market power by various exclusionary tactics. These firms basically attempt to sharply limit the supply of crude available to independent refiners and refined product available to independent wholesalers and retailers. This is accomplished by minimizing use of formal market sales and thus avoiding flows of product from within the majors' vertically integrated structure to the market. It is also accomplished through control of pipe lines, exchange agreements, processing agreements, and price protection coupled with price wars. An elaborate network of devices to deny independents access to product has been erected. The resulting system endangers existing independents, makes new entry difficult or impossible, and yields serious economic losses to American consumers.

IV. CONDUCT: COOPERATIVE RATHER THAN COMPETITIVE

Conduct in the large, complex, multifaceted petroleum industry is difficult to evaluate. Basically, we must frame hypotheses about the structure and performance of the industry under the assumption of reasonably competitive conduct. Since a competitive model of structure and performance differs significantly from actual structure and performance in the industry, we shall attempt to isolate those aspects of conduct which have contributed to this disparity. Some types of conduct which may not be anticompetitive in competitive industries, or when practiced by small firms, become anticompetitive in concentrated industries or when practiced by firms that possess market power.

We find anticompetitive conduct on all levels in which the large integrated firms interrelate. In fact, their behavior should properly be characterized as cooperative, rather than competitive, with respect to:

Influencing legislation
Bidding for crude leases
Establishing the purchase price of crude oil
Transporting crude oil
Refining crude oil
Marketing gasoline

There is no way to determine the degree of influence exercised by industry lobbies in affecting petroleum legislation. However, we do know that major firms have been strong advocates of the Oil Import Control program, and also state prorationing legislation. The Import Control program, according to industry sources, has been largely responsible for the present shortage of refinery capacity. In addition, it has effectively created barriers to entry in the industry. The program has been exploited by the major integrated firms to protect the industry's oligopoly position with respect to refined products. Prorationing has been exploited by the majors to raise crude prices above their competitive level and results in a major misallocation of the economy's resources. Morris Adelman, one of the world's leading authorities on the industry, claims that "the great bulk of oil wells are superfluous—a political curiosity, not an economic asset."[1] They are strictly a result of prorationing legislation and import controls, which artificially raise the price of domestic crude, and encourage the development of otherwise uneconomic wells.[2]

Among the choicest of domestic oil fields are those contained in offshore government owned land. The oil leases for these fields are sold through "competitive" bidding. It has been common practice, however, for oil firms to submit joint bids on these leases. The result is a

[1] M. A. Adelman, *The World Petroleum Market*, John Hopkins Press, Baltimore, 1971, p. 46.
[2] M. A. Adelman, "Efficiency of Resource Use in Crude Petroleum," *Southern Economic Journal*, Vol. 31, pp. 101-120.

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small number of bidders for each lease. Joint bidding, and joint ventures in general, may promote competition in certain kinds of situations,[3] but such conduct by large petroleum firms, given the concentration already existing in the industry, is decidedly anticompetitive. Walter Mead has shown that, with respect to Alaskan Oil and gas leases, firms who were partners in joint bidding for one tract tended not to compete with their former partners in bidding for other tracts.[4]

The lack of competition among major oil firms is particularly apparent in the prices paid for crude oil. In a competitive market, prices are set by the interaction of supply and demand. However, in crude transactions the price is established entirely by the buyers. A price is "posted" in a particular field for a particular gravity of crude by the buyer. Within a few days this price is followed and similarly "posted" by other buyers in similar fields.[5] The seller of crude does not dispute or offer alternative prices to the buyer.[6]

Since the posted price is the prevailing price for crude in a particular area, it is in the interest of the integrated firms to post a price higher than marginal costs consistent with each firm's self sufficiency ratio (the ratio of crude production to refining capacity), and the elasticity of demand for gasoline.[7] This is so for two reasons. Remembering, that for the integrated firm, the posted price is the price it both pays itself and uses for tax purposes, the existence of the depletion allowance for crude production means that profits based on high prices at the crude level are "worth" more to the integrated firm than profits at other levels. Second, the integrated firms can "squeeze" those firms which do not have their own crude. An integrated firm, when using its own crude, in effect, pays not the posted price to itself, but rather the real cost of producing the crude. When the non-integrated refiner purchases crude, however, the posted price is, in fact, the "real" price—he is always put at a cost disadvantage if the posted price deviates from marginal cost.[8]

Lack of competition among the major firms is also evidenced by the absence of bidding for crude produced by independents. Once a major integrated firm erects gathering lines leading from the crude field, it purchases most of the crude from that field and becomes the field's price leader. Furthermore, our survey of independents has shown that

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[3] Walter J. Mead, "The Competitive Significance of Joint Ventures," *Antitrust Bulletin*, Vol. XII, Fall 1967, pp. 823–825

[4] *Ibid.*, pp. 841–846.

[5] See, for instance, "8 Texas Crude Given Higher Postings," *Oil and Gas Journal*, June 4, 1973, p. 22.

[6] Adelman suggests that "there is very little room for independent bargaining over crude oil prices with independent refiners desirous, and capable, of carefully examining the range of offers, choosing the best, and trying to play one seller against another. In a market where price is so far above cost, the absence of independent bargaining centers at the various levels of production slows down the attraction of price toward cost. Perhaps even more important, the companies, who to some extent coordinate their production plans, meet again as rivals in refining and marketing." Adelman specifically refers to the world market for oil, but his remarks clearly apply to the domestic market. See Adelman, *op. cit.*, p. 145.

[7] See M. G. DeChazeau and A. E. Kahn, *Integration and Competition in the Petroleum Industry* (New Haven: Yale University Press, 1959, pp. 221–2)

[8] There is evidence to suggest that the posted price deviates substantially from long run marginal cost, even when incremental development cost is included in marginal costs. Adelman estimates that total development and operating costs for U.S. crude was $1.22 per barrel while the average price per barrel was $2.80 in 1960–63. In addition, many of our survey crude companies appeared to be earning supernormal profits. See Adelman, *op. cit.*, p. 76 for data on marginal costs, and U.S. Dept. of Interior, Bureau of Mines, *Mineral Industry Surveys, Crude Petroleum, Petroleum Products, and Natural Gas Liquids* 1960–63, Table 3 data on the total value per barrel of crude.

there appears to be no competition for the right to erect gathering lines: although a crude field may be geographically convenient to several refiners, only one refiner asks to install gathering lines. Only in the smaller fields is there some semblance of competition—there, major firms appear to compete with smaller trucking firms in order to secure the crude.

From the gathering lines, crude proceeds to large pipelines. These pipelines are generally owned jointly by a number of major integrated petroleum companies. Although the pipelines are, by law, common carriers and are regulated by the Interstate Commerce Commission, the major firms who own them nevertheless engage in many discriminatory and exclusionary practices with respect to smaller firms who wish to use the pipelines.[9] In addition, cooperative ownership of pipelines provides one more plane on which major integrated firms avoid the rigors of competition.

It is normally the case that in the neighborhood of their refineries, petroleum firms produce less than enough crude oil to meet throughput requirements, but more than enough gasoline to meet the demands of their branded marketers. Therefore, they engage in two kinds of practices designed to keep refineries running at near capacity, while at the same time avoiding excess costs for transporting crude oil and refined products:

(1) *Exchange agreements.*—Company A with refinery in area X will supply crude oil to company B with refinery in area Y. Meanwhile, company B will supply his crude oil in area X to company A. Similarly, A will supply gasoline to B's marketers in area X, while B supplies gasoline to A's marketers in area Y.

(2) *Processing agreements.*—A will refine B's crude oil in area X under contract. In other words, B owns both the crude oil and the final product. He simply pays A for refining it.

Not all exchange and processing agreements are anticompetitive. However, the eight largest firms prefer to keep exchange agreements in the family. This reliance on barter, rather than direct market sales, limits the availability of crude oil to independent refiners and gasoline to independent marketers. As a result, in 1971 less than two percent of the eight largest firms' output was sold to independent marketers. We shall see that these exclusionary practices, in addition to increasing refinery margins, have enabled the major integrated firms to exploit the present shortage of domestic crude oil and refinery capacity, thus threatening the continued viability of the independent marketing sector.

Even prior to the current shortage, anticompetitive conduct, as practiced by the largest firms, effectively limited the independent share of the market. For example, in 1971 independents controlled 34 percent of the market in District V. However, in Maine, where there are no nearby independent refiners, independent marketers accounted for only 4.7 percent of sales.[10]

Independent marketers have been exceptionally innovative in their marketing styles. Therefore, in restricting their access to gasoline the majors have created major misallocations of resources. This is par-

[9] For a detailed discussion of these practices, see section on Barriers to Entry.
[10] 1972, *National Petroleum News Factbook*.

ticularly true in view of the majors' failure to innovate and meaningfully compete among themselves at the retail level. In fact, it appears that the majors have tacitly agreed not to compete with respect to retail prices. They appear willing to compete in secondary respects (appearance of stations, location of stations, giveaways, etc.) but the result is a remarkable homogeneity in the final product and prices offered to consumers.

In the many levels in which they interrelate, the majors demonstrate a clear preference for avoiding competition through mutual cooperation and the use of exclusionary practices. Together they dictate a common price for raw material and seek to stabilize price for refined product. Their common conduct with respect to pipelines and their tendency to bypass the market mechanism through the use of exchange and processing arrangements, has been clearly exclusionary. These exclusionary practices are directed at a common target—the independent sector of the industry. In sum, the majors continually engage in common courses of action for their common benefit.

V. INDUSTRY PERFORMANCE

A thorough analysis of industry performance for specific levels of operation is not possible at this time as the industry is dominated by integrated international companies who do not report profits in any consistent form for less than the company operations as a whole. However, some indications of industry performance may be derived from the data presently available.

As shown in Table 1, the weighted average rate of return on stockholder's equity for these firms for the period 1951–1971 was above the average rate of return for all manufacturers for all years but five. It declined from a high of 15.3 percent in 1951 to 9.6 percent in 1958, and rose to 12.4 percent in 1967. In the period 1969–1971, it remained relatively stable, with a 1971 average rate of 11.1 percent.

For this 21 year period, the median difference between the weighted average rate of return for these companies and for all manufacturing was a positive 1.1 percentage points. That is, for approximately one-half of this period, the weighted average rate of return for these companies was more than 1.1 percentage points above that of all manufacturing.

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TABLE V–1.—*Net income after taxes as a percent of stockholders equity for the eight largest integrated petroleum firms 1951–71* [1]

	1971	1970	1969	1968	1967	1966	1965	1964	1963	1962
Exxon	12.6	12.0	10.4	13.0	13.0	12.1	11.9	12.6	12.8	11.1
Mobil	11.2	10.6	10.1	10.5	10.0	9.7	9.2	8.8	8.6	8.2
Texaco	13.4	13.1	13.1	15.4	15.3	15.9	15.5	15.2	15.5	14.8
Gulf	10.2	10.4	12.1	13.2	13.1	12.3	11.2	11.0	10.9	10.6
Shell	8.7	8.7	10.9	12.3	13.8	13.4	13.4	12.3	12.0	11.2
Standard (Indiana)	9.6	9.3	10.0	10.1	9.5	9.1	8.1	7.5	7.3	6.6
ARCO	6.9	7.4	8.4	11.0	10.2	9.4	8.1	7.3	7.0	7.7
SOCAL	10.4	9.8	10.2	10.7	10.8	12.1	11.9	11.3	11.2	11.6
Weighted average	11.1	10.8	10.8	12.4	12.4	12.1	11.6	11.5	11.5	10.7
Return on equity in all manufacturing [2]	9.7	9.3	11.5	12.1	11.7	13.4	13.0	11.6	10.3	9.8
Net difference [3]	1.4	1.5	−.7	.3	.7	−1.3	−1.4	−.1	1.2	.9

	1961	1960	1959	1958	1957	1956	1955	1954	1953	1952	1951
Exxon	10.4	10.1	9.4	8.7	14.0	15.8	15.2	13.6	16.2	16.6	18.4
Mobil	7.8	7.0	6.5	6.4	9.3	12.0	11.2	10.7	11.6	11.3	12.4
Texaco	14.4	14.3	14.1	13.6	16.2	16.3	15.7	14.8	13.7	13.6	14.6
Gulf	10.9	11.6	11.0	13.5	16.2	14.8	14.3	13.4	14.4	13.0	14.1
Shell	9.5	10.3	11.1	8.8	13.8	15.0	15.4	16.3	17.2	15.2	17.8
Standard (Indiana)	6.5	6.4	6.5	5.7	7.5	7.9	9.2	7.4	8.7	8.8	11.7
ARCO	8.1	8.6	5.8	6.8	7.4	10.1	9.0	9.6	12.2	10.7	12.6
SOCAL	11.7	11.8	12.0	13.0	15.5	15.8	15.1	15.3	15.0	15.0	16.2
Weighted average	10.4	10.2	9.8	9.6	13.1	14.1	13.7	12.8	13.9	13.6	15.3
Return on equity in all manufacturing [2]	8.9	9.2	10.4	8.6	10.9	12.3	12.6	9.9	10.5	10.3	12.1
Net difference [3]	1.5	1.0	−.6	1.0	2.2	1.8	1.1	2.9	3.4	3.3	3.2

[1] Based on "Moody's Industrial Manual."
[2] "Economic Report of the President," January 1973, p. 250. The Federal Trade Commission is cited as the source.
[3] Weighted average return for the 8 companies less that of all manufacturing.

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Ordinarily such a rate of return pattern would not be much cause for concern; however, the petroleum industry has been given a plethora of special tax advantages not equally available to all other manufacturing firms. For example, the oil depletion allowance enables petroleum companies to deduct 22 percent of the value of crude production from gross income. To the extent that this procedure leads to "writing-off" assets more than once, it provides crude producers with substantial "unreported profits." A preliminary attempt to adjust company rates of return for the impact of the depletion allowance showed that it raised rates of return by about .4 percent. In addition, these companies may expense, on a current basis, investments made in drilling operations rather than treating such investments as long-term capital which would be depreciated over time. Further, they receive a foreign investment tax credit and foreign royalty credit which may be used to offset their domestic tax liability. No quantitative adjustment to rates of return to allow for these factors has been possible. However, again these tax provisions tend to cause an important understatement of profitability. Thus, there is considerable reason to believe that the after tax profit shown understates the true profit of the companies.

Evidence accummulated thus far—including materials obtained through surveys of independent crude producers, refiners, and marketers—indicates that (1) crude oil production is highly profitable although profits are undoubtedly overstated because the oil depletion allowance leads companies to try to "report" refinery profits at the crude level since crude profits are effectively taxed at a lower rate; (2) refinery profits have been during the past decade below the competitive level at least for independents so that entry has been deterred; and (3) marketing profits appear to be highly variable with the major firms doing less well than large independents although the present gasoline shortage is imperiling the existence of some independent marketers.

Two additional observations about industry performance need to be made. First, the pattern of refinery margins over the past two decades is analyzed with the relationship between refinery margins and entry especially scrutinized. Second, the cost to consumers in terms of inefficient marketing operations is examined.

Refinery margins were generally lower in the sixties than they had been in the fifties. In the early fifties refinery margins were well over $1 per barrel. While we cannot compute completely accurately the margin required to earn a competitive rate of return in this period, the range must have been on the order of 40 to 70 cents a barrel. Thus, there is little doubt that in a normal industry entry would have been profitable and would have taken place. Toward the late fifties and throughout the sixties rising crude prices were not fully offset by rising product prices and margins were "squeezed." Margins in the sixties were generally below $1, while capital costs had probably doubled. Estimated refinery investment costs per daily barrel were $888 in 1960.[1] By 1970 the figure had risen to $1,500. Annual capital costs rose sharply from 1960 to 1970. It is also likely that operating costs have risen with rising fuel prices and wage rates. Thus, while we cannot say with complete certainty whether refinery margins in the sixties

[1] Adelman, *op. cit.*, p. 377.

were sufficient to yield a competitive rate of return on refinery operations, we can say that entry into refining was *less* attractive in the sixties than the fifties for non-integrated firms.

Thus, during the term of the import quota which gave the majors greater control over crude oil prices, refinery margins diminished even though demand for refined product was growing rapidly and the economy was enjoying rapid, recession-free growth. Average margins for refined products from 1952 through 1972 are given in Table 10. It has been widely reported that independent refiners were not earning competitive profits during the 1960's. Therefore, the absence of independent entry during the 1960's is not at all surprising. In fact, the changes in margins suggest that the majors were capable of exercising a "product squeeze" on independent refiners to create a barrier to entry.

TABLE 10.—*Refinery gross margins, 1952–72* [1]

Year	Average product price per barrel (3)	Average crude petroleum price per barrel (2)	Margin (1–2) (4)
1952	$3.62	$2.526	$1.094
1953	3.76	2.684	1.076
1954	3.73	2.775	.955
1955	3.81	2.765	1.045
1956	3.96	2.788	1.172
1957 [2]	4.24	3.087	1.153
1958	3.89	3.013	.877
1959 [3]	3.87	2.903	.967
1960	3.84	2.882	.958
1961	3.87	2.886	.984
1962	3.84	2.905	.935
1963	3.79	2.894	.896
1964	3.71	2.877	.833
1965	3.83	2.864	.966
1966	3.84	2.882	.958
1967	3.92	2.915	1.005
1968	3.84	2.941	.899
1969	3.89	3.092	.789
1970	4.16	3.177	.983
1971	4.43	3.385	1.045
1972	4.40	3.400	1.000

[1] Source: "U.S. Wholesale Prices of Crude Petroleum and Principal Products," Independent Petroleum Association of America, 1973. Because invested capital grew rapidly over the period, margins as a percent of capital fell much more dramatically.
[2] A voluntary import quota program was initiated in 1957.
[3] A mandatory import quota program was initiated in 1959.

Perhaps the most serious deficiency in performance, however, occurs at the marketing level. The largest major companies (1) tend not to sell gasoline to independent marketers, and (2) seek to gain brand identification by operating or leasing many stations so that motorists will always be within close proximity of the major company's stations. The result is that the number of independent stations is limited by the availability of refined product from sources other than the leading major firms, particularly independent refiners. If no independent refiner exists in a particular area, there will invariably be fewer inde-

pendent retail outlets than in areas where considerable independent refining capacity is present. On the other hand, major integrated companies apparently seek to expand sales through their branded outlets partly by locating stations densely through their natural marketing areas. This strategy means that motorists will on average encounter more of a company's branded stations than a given independents' outlets for any given distance along a street or highway. Presumably the proliferation of branded stations encourages motorists to obtain major company credit cards since the probability of encountering a particular type of branded station of any given type is increased. By inducing consumers to obtain credit cards and by locating stations densely, the majors are able to increase total sales.[2]

This strategy, however, leads to the erection of many branded stations with low volumes. It is clear that some of these stations have such small volumes of gasoline sales that they are neither efficient nor profitable. This supposition is supported by the very high turnover rate among major station dealers (approximately 25 percent per year), by the fact that the majors are closing small stations and building large-volume "fighting brand" outlets now that there are strong incentives to earn profits at the refining and marketing levels rather than at the crude oil level.[3] At the same time that low-volume branded stations proliferated, efficient independent operations were limited by the lack of availability of refined gasoline. In 1970, over 35 percent of major stations had volumes less than 17,000 gallons per month while independents averaged a much higher volume sometimes rising to the 150,000 gallons per month.[4]

At any given time consumers will demand a certain mix of branded and unbranded stations. Some will seek a combination of low-priced gasoline and little service by going to independent outlets. Others will wish a different consumption package including high-priced gasoline and more service and amenities. These consumers will grant their custom to branded stations. In recent years, consumers have increasingly demanded the package provided by independents as evidenced by the rapid growth of these types of outlets. However, that growth has been limited especially in areas where little independent refining capacity exists. Therefore, consumers are provided less of the independent product mix than they want in certain geographic areas (e.g. Maine and other New England states) and more of the branded product than they desire. Thus, real cost is imposed upon consumers by denying them the product mix they seek.

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[2] It is important to point out, however, the profitability of integrated oil companies in gasoline marketing is not necessarily as high as independent marketers. This is so because there are indications that the integrated oil companies are less efficient than the independent gasoline marketers. To some extent, the lack of equal efficiency may be due to an historical lack of effective price competition among the major integrated firms. As independent gasoline marketers became more of a competitive threat to the major oil companies, these major companies, in addition to restrictive devices previously discussed, began to close inefficient stations, retreat in marketing territory, and even market some gasoline through "independent" type high volume, minimum service gasoline stations. However, it is not clear that even under competitive circumstances, the major oil companies could operate as efficiently as independent gasoline marketers because of the large number of retail stations which they operate. That is, it is possible that beyond a certain number of retail outlets, diseconomies of management and rising transactions costs cause the per outlet cost of operation to rise substantially. Thus, the ability of the major oil companies to earn rates of return in gasoline marketing equal to independents exists only to the extent that they can be forced to operate as efficiently.

[3] See discussion of changing incentives in the oil industry, *infra* at VI. 2 *et seq.*

[4] Fred C. Allvine and James M. Patterson, *Competition, Ltd.: The Marketing of Gasoline* (Bloomington, Ind. 1972), pp. 40, 78, and 80.

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Ordinarily when consumers wish more of a particular product, they bid its price up and thereby induce suppliers to produce more of the product. In gasoline marketing, though, independents cannot fully respond to consumer demand unless they can obtain access to additional gasoline. In an open market the independents would get more gasoline by bidding up its price. In the petroleum industry, however, transactions are typically not "arm's length" open market transactions. Rather, gasoline and crude oil are transferred largely by exchange agreements or processing agreements or are simply retained within the confines of vertically integrated firms. Thus, the misallocation of resources associated with having too few independents and too many branded stations is a result of (1) the eight major integrated companies' refusal to deal with independent marketers and (2) the absence of a genuine market.

In the next section, attention will be given to recent developments in the industry which have changed the profit incentives of major integrated firms and have seriously imperiled the existence of independent marketers.

VI. THE CAUSES OF THE PRESENT SHORTAGE

In previous sections we provided a general analysis of the petroleum industry. We now relate the structure, and performance of the oil industry to the causes of the shortage of gasoline.

The current petroleum shortage can be traced to six separate, but interrelated factors:

1. The Oil Import Control Program;
2. Interdependent and cooperative behavior by the largest oil firms;
3. The failure of these firms to construct refinery capacity sufficient to meet current needs;
4. Government induced barriers to entry which have inhibited non-integrated firms from entering into refining;
5. An insufficient supply of domestic crude for independe ' refiners; and
6. The fact that major station gasoline prices have not been allowed to reach their natural level during the period of shortage in certain areas of the country.

The Oil Import Control Program was abolished by the President on May 1, 1973. However, it created, and leaves in its wake, a shortage of domestic refinery capacity which will last for at least three or four years. The program restricted crude oil imports and limited imports of refined gasoline practically to zero. In conjunction with other barriers which prevented entry into refining, it created a near monopoly over refining for the huge integrated firms who control the industry.

These major firms, which consistently appear to cooperate rather than compete in all phases of their operation, have behaved in a similar fashion as would a classical monopolist: they have attempted to increase profits by restricting output. With their advanced econometric models and computer simulations, the major oil companies should have been able to predict the current increase in demand for petroleum products. Whatever their forecasts showed, however, they failed to expand refinery capacity sufficiently to meet this demand. Spokesmen for several majors argue that the lack of expansion can be attributed directly to environmental problems. However, now that import controls have been removed, and governmental intervention into the industry has become a strong threat these companies have suddenly overcome their environmental problems. Exxon has announced plans to build additional refining capacity of 600,000 barrels per day. Other large firms also plan new refineries in the near future.

Normally, we would expect this situation of limited refinery capacity to encourage new entry into refining. However, this has not happened. In fact, there has been no new entry of a non-integrated gasoline producing refinery in the Eastern and Gulf Coast states since 1950. This is due to the exceptionally high barriers discussed earlier.

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On the one hand, import controls and major firm ownership of pipelines has made sources of crude supply for potential new entrants uncertain. On the other hand, state prorationing legislation and the federal oil depletion allowance have created a "refinery squeeze," making refinery operations unprofitable and thereby discouraging entry at that level.[1]

Another element which has contributed to the present shortage, has been the decrease (approximately 2 percent a year) in domestic crude production. Most foreign crude oil is exceptionally rich in sulfur content. Many refineries, particularly those situated inland, are not equipped to process this "sour" crude. The major firms, which control most of the domestic crude supply, appear to be preventing many independent refineries, particularly those in the Midwest, from obtaining sufficient supplies of "sweet" crude. Therefore these refineries are running far below capacity,[2] and the gasoline shortage thus has become further aggravated.

A final cause of the shortage is the fact that efforts by the majors to squeeze the independents' market share have kept retail gasoline prices from responding to excessive demand. In a normal competitive market the "cure" for a shortage would be for prices to increase. The higher prices would cause producers to increase supply and at the same time it would discourage some amount of consumption. Thus supply and demand would be brought into equilibrium. But what has happened here is that the majors have used the shortage as an occasion to attempt to debilitate, if not eradicate, the independent marketing sector. They are doing this not by lowering prices in those areas where they compete with independents but simply by not permitting their prices to rise. The independents, of course, simply do not have available supplies of gasoline to deal with such a tactic. As the shortage forces them to curtail sales they must raise prices. The sole basis on which they can compete with the majors is destroyed. The effect is the same as if the majors had all dropped their prices in those markets where they compete with independents. The consumer may be realizing some temporary advantage (in the midst of great inconvenience) in the form of somewhat lower prices from the majors' stations. However, if this pricing tactic is at all successful in diminishing the market shares of independents the consumer will pay dearly for this advantage. The results of the major companies discouraging their dealer from raising prices have had some serious consequences:

(*a*) Independent marketers have borne the brunt of the shortage because the largest majors will not supply them, and because many of their normal suppliers (independent refiners) are operating under capacity. As a result, over 1,200 independent stations had been forced to close by May 30.

(*b*) Because what gasoline that is available to independent marketers has become very expensive, the traditional 2 to 6 cent price differential between the majors and the independents has been eroding and in some areas of the country the majors are actually

[1] For a detailed discussion about how this squeeze operates, see Appendix B.

[2] Crown Central Petroleum Corp. indicates in its "Interim Report" to stockholders, dated March 31, 1973, that its refinery "operated at approximately 65 percent of desired levels" in the first quarter of 1973, due to an inability to obtain crude oil.

pricing below the independents.[3] In Northern Virginia, Alert regular gasoline (Exxon's "fighting brand") is 1 to 2 cents below Scot and some Mobil and ordinary Exxon stations are priced at the same level as Scot.

Due to all these developments, the prospects for the next three or four years (the period needed for construction of new refineries) appears bleak. As demand increases more rapidly than refinery capacity, shortages of petroleum products will become more acute. The degree of severity will depend upon prices: the lower the retail prices, the more critical will be the shortage of products.

Assuming that crude import quotas are not reinstituted, we are likely to see some new entry into refining during the next few years. Pittston and Pennzoil have already announced plans to build large coastal refineries. We can also expect to see a continued disappearance of independent marketers. On the other hand, it is likely that the major firms will increasingly emulate the independents' style of marketing. In order to capitalize on excess demand for gasoline, and assuming that prices are frozen or otherwise maintained below market clearing levels, they will turn to more efficient (less costly) styles of marketing.

This change in the majors' style of marketing has already begun. Many majors are withdrawing from their least lucrative markets [a partial list is provided in Table 11]. These developments at the marketing level have been caused in part by significant changes in other sectors of the industry.

Table 11.—Marketing changes

Gulf Oil	On October 1972, announced a $250 million write-off of "marginal and unprofitable" operations. Included in the announcement was its plans to sell or close 3,500 service stations in the upper Mid-west and Northwest.
Phillips Petroleum Co	In June 1972 announced plans to withdraw its service station and home heating oil operations in the Northeast. 1,400 service stations are involved.
Arco	Announced plans to withdraw from retail marketing operations in the South, Southwest, Rocky Mountain and Plains states.
Sohio/BP	Sold some 1,150 service stations to American Petrofina, which included all of its marketing operations in Florida and Georgia as well as selected marketing operations in North and South Carolina and parts of Louisiana, Alabama, and Oklahoma.
Sun Oil Co	In February 1973 announced that it was withdrawing from marketing operations in eight Midwestern States. Over 300 service stations were involved. The States are Illinois, Nebraska, Kansas, the Dakotas, Wisconsin, Minnesota and Tennessee.
Mobil Oil Co	Intends to close 575 service stations in 1973.
Exxon	Pulled out of Indiana, Illinois, Wisconsin, and Michigan.
Standard (Ind.)	Pulled out of Western states with the exception of Washington and Oregon.

[3] According to Ernest McClelland, Associate Editor of Platt's Oilgram Price Service, "a 1 to 2 cent difference" between majors and independents is common now "compared with 3 to 6 cents nine months ago."

At the crude level, oil companies are making record high bids on off-shore Louisiana and North Slope Alaskan tracts. On the international front, the press frequently reports accounts of successful demands on the part of the OPEC nations for increased royalty takes and ownership interests in crude production. The Shah of Iran demanded that crude production be increased by 60 percent or the Western oil companies would have to leave when their current contracts expire. The Iraqi government demanded (successfully) a "sharp" (but undisclosed) increase in crude production. Saudi Arabia and Algeria also plan substantial increases in crude production.

The gist of all these press reports is that (1) there appears to be a fundamental change in marketing strategy on the part of the majors; (2) the majors are being forced to accept much lower profits on OPEC crude oil and on domestic off-shore and Alaskan crude oil and (3) they are losing control over the production rates of OPEC oil. These events are not unrelated. The trends in crude oil production are at least part of the reason for the change in marketing strategy. There is now no doubt that a large and increasing fraction of U.S. crude oil consumption will come from crude oil produced abroad.

The removal of the mandatory import quota on May 1 of this year not only allows for a large absolute and percentage increase in imports, it also means the end of state prorationing as a device to successfully restrict domestic crude oil production. Restriction of domestic production will not be an effective way of maintaining crude oil prices, so long as imports are available. Thus, the major U.S. oil companies face the prospect of filling their crude oil needs with an increasing fraction of decreasingly profitable foreign oil. Profits on U.S. crude production will (for the first time) depend heavily on world crude prices. If world crude prices decline, as at least one expert predicts,[4] then profits on domestic on-shore crude production will erode as well. Thus, the majors' profits on foreign crude will continue to fall and profits on domestic crude will be subject to new uncertainty. Heretofore, target (and realized) rates of return have been higher on crude production than on refining and marketing. The depletion allowance gives integrated oil companies an incentive to concentrate their profits at the crude level since (within limits) their Federal income tax liability falls with increasing crude prices. The wish is not necessarily the fact. To succeed, the companies must be able to keep crude prices artificially high. In the past, crude prices have been maintained at high levels by a combination of the devices discussed earlier. In the future, the size of the tax subsidy from the depletion allowance will be more uncertain since domestic crude prices will no longer be insulated from the world market.

Thus, the successful demands for a larger and larger share of the profits from foreign crude oil production by the OPEC nations, the increasing share of domestic crude oil consumption that will be met from foreign production, and the new uncertainty regarding domestic crude prices lead to the conclusion that rates of return at the crude level will be lower in the future than in the past and that these lower profits will be subject to greater uncertainty.

[4] See Morris Adelman, *The World Petroleum Market* (John Hopkins Press, Baltimore, 1972), especially pp. 262–63.

The oil industry, in order to maintain or moderate the fall in rates of return at the crude level, must increase rates of return at the transportation, refining and marketing levels. To do so, refined product prices must rise relative to crude prices. Since gasoline comprises about 40 to 50 percent of the volume of refined product and 65 to 70 percent of the revenue, increased gasoline prices at the retail level are likely and are an important factor in the situation. But the majors cannot raise gasoline price margins in markets where there is increasing entry and expansion by price competing independents and in this sense the independents serve to prevent out of control price increases.

The recent regional marketing withdrawals announced by the majors will increase regional gasoline market concentration if the existing major can transfer its market share to another major. ARCO has sold most of its Florida marketing operations to Mobil Oil Co., for example. All the majors can increase their regional market concentration simultaneously by pulling out of markets where their share is lower than their national average and selling their operations to those majors who remain. This strategy will only work, however, if the majors can retain or expand their regional market shares. To do so, they must prevent the further entry and expansion of independent marketers. Ultimately, the only way to contain or reduce the independents' market shares is through monopoly power at the refining or crude pipeline stages. Eliminating the price differential between majors and independents, while at the same time raising the tank wagon price, can force the independents out, in the short run. Similarly, whatever the root causes of the current product "shortage" (mismanagement, poor forecasts, price controls, import quota or contrivance), the independents will be hurt more than the majors. The eight largest firms can keep their own stations supplied, while at the same time, indirectly reducing the independents' supplies by reducing their sales to the next largest 10 integrated companies. They also effectively reduce the independents' supply by buying gasoline for their secondary branding operations from independent refiners who have traditionally sold to independents.

In the longer run, however, strategies such as those explored above cannot work for more than four or five years unless independents are prevented from entering at the refining level. In addition to capital barriers, transportation barriers, etc. (see above), there is the major question of crude availability. It has been estimated that eight firms produced over 80 percent of world crude oil (excluding U.S. and Canadian production) in the first half of 1969. Seven of the eight (Exxon, BP, Shell, Gulf, Texaco, Standard [California] and Mobil) were either U.S. companies or affiliated with U.S. companies. Even if in the future, these companies make little profit on crude production, they still have a strong interest in preventing their crude from flowing into independent refineries. An important part of the majors' strategy will be to attempt to exclude independent refiners and new entrants from an adequate crude supply even though crude profits are no more than competitive.

It is therefore difficult to accurately forecast the complexion of the industry five years from now. Much will depend upon the demand for and supply of petroleum substitutes, technological advances, and the

progress of the Alaskan pipeline. The most important factor, however, will be the shape of governmental policy towards the oil industry.

Much has been said in this report about the role played by the giant integrated petroleum firms in creating the current shortage. There also has been a significant contribution made by the United States government. The government has established a climate which encourages cooperative and exclusionary behavior by these firms. The Oil Import Program, the Depletion Allowance, the foreign tax credit, price controls, and prorationing legislation are all creations of the government. Some forms of joint ventures ar sanctioned by government agencies. These policies have all contributed to the current gasoline shortage. The major integrated oil companies are, however, taking advantage of the present shortage to drive the only viable long-term source of price competition, the independent marketer, out of market after market.

Conclusions

The survey data lead to certain tentative conclusions about the operation of the various markets of the petroleum industry:

1. The eight largest majors have effectively controlled the output of many of the independent crude producers.

2. A high degree of control over crude is matched by relatively few crude exchanges with independents, an exclusionary practice which denies a high degree of flexibility to the independent sector while reserving it to the majors.

3. Independent refiners are largely dependent on the majors for their crude supply, but independents sell very little of their gasoline output back to major oil companies. Independent refiners sell the largest amount of their output to independent gasoline marketers and to their own stations. Thus, the welfare of the independent marketing sector is largely dependent on the well being of independent refiners.

4. The continued existence and viability of the independent refiner is necessary for the survival of the independent marketer. This is especially true since the eight largest majors rarely sell gasoline to the independent marketers.

5. The major oil companies in general and the eight largest majors in particular have engaged in conduct which exemplifies their market power and has served to squeeze independents at both the refining and marketing levels. Such conduct and associated market power has its origin in the structural peculiarities of the petroleum industry and has limited the independents' share of the market to approximately one quarter of the total, especially in Districts 1 and 3, resulting in a threat to the continued viability of the independent sector in this market.

APPENDIX A

STRUCTURAL CHARACTERISTICS OF REGIONAL PAD DISTRICTS

The petroleum industry on a national basis has been discussed in the body of this report. The purpose of this appendix is to provide additional structural data presently available in a regional framework. Because much of the data in this industry are published according to PAD (Petroleum Administration for Defense) districts by the Department of Interior, Bureau of Mines, it is according to this geographical definition that these statistics are presented. However, as will become evident upon examining the following data, to a large extent, these geographical designations may be reasonable approximations for regional economic markets.

The Department of Interior, Bureau of Mines, identifies five Petroleum Administration for Defense (PAD) Districts in the United States. District 1 includes the East Coast and the Appalachian area; District 2 includes the midwestern states as well as Oklahoma, Kentucky, Tennessee, and Missouri; District 3 had the largest crude oil production of any of the Districts. Similiarly, the Rocky Mountain states; and District 5 includes the West Coast states including Alaska and Hawaii.[1]

Relative Importance of Five Districts

The five Districts will be compared in the following three relevant areas of production and consumption: (1) production of domestic crude oil; (2) number and capacity of refineries; and (3) motor gasoline consumption.

Production of crude oil

Total U.S. production of crude oil was 9.6 million barrels per day in 1970. Because of the large amount of crude oil produced in Texas and Louisiana, District 3 had the largest crude oil production of any of the Districts. Similarly, the large production of California raised District 5 to second place among the Districts. The total for all Districts is shown below in Table 1. In Table 2, the interdistrict and imported shipments of crude oil are set forth.

TABLE 1.—*Production of crude oil by district, 1970*

[In thousands of barrels daily]

District	Production	Percent share of total	Rank of district
1	31	.32	5
2	1,169	12.13	3
3	6,508	67.53	1
Total 1, 2, and 3	7,708	79.98	
4	675	7.00	4
5	1,254	13.01	2
Total	9,637		

NOTE.—Percentages may not add to 100 because of rounding.

SOURCE: U.S. Department of the Interior, Bureau of Mines, *Mineral Industry Surveys*, "Crude Petroleum, Petroleum Products, and Natural Gas Liquids 1970," table 20, p. 36.

[1] See *Mineral Industry Surveys*, "Petroleum Refineries in the United States and Puerto Rico," January 1, 1971, and similar report, Bureau of Mines, U.S. Department of the Interior.

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TABLE 2.—*Supply of crude oil by district, 1970*

[In thousands of barrels daily]

District	Production	Imports	Supply—Domestic receipts from district—				
			1	2	3	4	5
1	31	579	.....	19	651	10	1
2	1,169	317	.....	.....	1,454	274	.....
3	6,508	.....	.....	3	.....	3	.....
4	675	48	.....	.....	.....	.....	.....
5	1,254	380	.....	.....	8	30	.....
Total	9,637	1,324	.....	.....	.....	.....	.....

Source: U.S. Department of the Interior, Bureau of Mines, Mineral Industry Surveys, "Crude Petroleum . . ." table 30, p. 36.

NUMBER OF CAPACITY OF REFINERIES

Total crude oil throughout capacity for operating refineries in the United States was 12.7 million barrels per day in 1970. Alternatively, gasoline output capacity for operating refineries was six million barrels per day in 1970.[1] The total number of operating refineries in the United States was 253. District 3 has the greatest number of refineries and amount of crude oil and gasoline capacity. District 2 and District 5 follow in order. The total for all Districts is shown in Table 3.

MOTOR GASOLINE CONSUMPTION

Total U.S. consumption of gasoline was 5.8 million barrels per day in 1970. The large population centers of District 1 and District 2 had the largest consumption. District 5 was in third place with 860,000 barrels a day consumed. The total for all Districts is shown below in Table 4. Interdistrict gasoline shipments and shipments of imported gasoline are provided in Table 5.

TABLE 3.—*Number and capacity of petroleum refineries by district, 1970*

[In thousands of barrels daily]

District	Number of petroleum refineries	Crude oil capacity	Percent share of total	Gasoline capacity	Percent share of total	Rank of district
1	30	1,501	11.9	635	10.5	4
2	70	3,493	27.6	1,686	28.0	2
3	82	5,227	41.3	2,453	40.7	1
Total 1 and 3	112	6,728	53.2	3,088	51.2	.....
4	26	425	3.4	193	3.2	5
5	45	2,012	15.9	1,062	17.6	3
Total	253	12,658	.....	6,029	.....	.....

NOTE.—Figures may not add to totals because of rounding.

Source: U.S. Department of the Interior, Bureau of Mines, Mineral Industry Surveys, "Petroleum Refineries in the United States and Puerto Rico," table 1, p. 3.

[1] For 1968, average United States percentage yield of gasoline per barrel of crude oil was approximately 44.7 percent. American Petroleum Institute, *Petroleum Facts and Figures*, 1971 edition, Port City Press, Incorporated, Baltimore, Maryland, p. 204.

TABLE 4.—*Motor gasoline consumption by district, 1970*

[In thousands of barrels daily]

District	Gasoline consumption	Percent share of total	Rank of district
1	2,001	34.6	2
2	2,007	34.7	1
3	741	12.8	4
Total 1, 2, and 3	4,749	82.1	
4	175	3.0	5
5	860	14.9	3
Total	5,784		

Source: U.S. Department of the Interior, Bureau of Mines, Mineral Industry Surveys, "Crude Petroleum . . ." table 30, p. 33.

TABLE 5.—*Supply of gasoline by district, 1970*

[Thousand barrels daily]

District	Refinery output	Imports	Domestic receipts by districts				
			From 1	From 2	From 3	From 4	From 5
1	645	66		38	1,333		1
2	1,614		93		243	11	
3	1,737			53			
4	187				10		12
5	736	1			29	43	
Total, United States	4,919	67					

Source: U.S. Department of Interior, Bureau of Mines, Mineral Industry Surveys, "Crude Petroleum . . ." table 30, p. 33.

OVERVIEW OF DISTRICTS 1 THROUGH 5

It is apparent from Tables 1 through 5 that no District emerges as most important in all three of the categories. District 3 is most important in the production and refining of crude oil; however it is fourth in motor gasoline consumption. In contrast, District 1 is fifth and fourth in production and refining of crude oil but second in gasoline consumption. It is also apparent that District 1 must heavily import crude and gasoline from District 3 or from foreign sources. Further, District 2 must also import crude from District 3 or from foreign sources. Indeed, if the analysis of the industry is to include a complete examination of vertical integration, (i. e., production, refining, transportation, and distribution), a proper definition of the geographic market should include Districts 1, 2, and 3 in the crude market, and Districts 1 and 3 in the gasoline market. Districts 4 and 5 seem to be unique in that gasoline consumption requirements can be approximately met by internally produced crude oil and refined gasoline.[8] In Table 6, the crude oil and product pipeline mileage by district provides further district distinction in that the largest crude oil pipeline mileage occurs in Districts 3, 2, and 4 respectively, while the largest product pipeline mileage occurs in Districts 2, 3, and 1 respectively.

[8] District 5 does import about 30 percent of its crude oil, however. This percentage may drop considerably upon the use of Alaskan oil in District 5.

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TABLE 6.—*Pipeline mileage by district, 1969*

District	Crude oil	Percent of total	Product	Percent of total
1	2, 512	4. 1	10, 176	18. 1
2	23, 060	37. 3	26, 712	47. 7
3	29, 656	47. 9	13, 252	23. 6
4	5, 873	9. 5	2, 775	4. 9
5	786	1. 2	3, 181	5. 7

Note: Total U.S. mileage operated: Crude oil, 61,887; product, 56,096. Percentages may not add to 100.0 because of rounding.

Source: Interstate Commerce Commission, Bureau of Accounts, "Transport Statistics in the United States," Dec. 31, 1969, U.S. Government Printing Office, Washington, D.C. (1970), p. 6.

DISTRICTS 1 AND 3, AND DISTRICT 2

CRUDE OIL

Crude oil production statistics by company are not presently available for District 2; however, such statistics are available for the state of Texas, in District 3, which in 1971 accounted for 51.4 percent of crude oil production in the combined 1 and 3 districts. As can be seen in Table 7, the Top 4 and Top 8 firms accounted for an estimated 35.1 and 51.3 percent of crude oil production in Texas in 1971.

TABLE 7.—*Market shares of leading firms in crude production, State of Texas (in barrels), 1971*

Firm	Crude production	Percent share of total
Exxon	166, 124, 784	13. 6
Standard (Indiana)	110, 538, 780	9. 0
Gulf	82, 397, 148	6. 7
Texaco	77, 226, 948	5. 8
SOCAL	59, 574, 648	4. 9
Mobil	53, 536, 068	4. 4
ARCO	46, 780, 728	3. 8
Shell	37, 451, 586	3. 1

Note: Top 4, 35.1 percent; top 8, 51.3 percent.

Source: Firm data from "Oil Directory and Production Survey, 1973," R. W. Byrams & Co., Austin, Tex. (Actual data given are September 1971 data multiplied by 12.) Total Texas crude production data from "Mineral Industry Surveys, Crude Petroleum, Petroleum Products, and Natural Gas Liquids," December 1972, table 3, p. 7.

REFINING

As shown in Table 8, Top 4 concentration for 1970 in crude refining capacity in Districts 1 and 3 is 30.5 percent while Top 8 concentration is 64.5 percent. In gasoline sales, the top 4 firms control 41.2 percent of the market and the top 8 control 65.4 percent of the market. Independent refineries possess only 8.7 percent of crude oil capacity in District 1 and 18.7 percent of capacity in District 3. Market shares of independent gasoline retailers are also small: 15.5 percent in District 1 and 32.4 percent in District 3. Moreover, the market shares of the major oil companies have increased in both refining and gasoline sales during the past 20 years; and new entry into refining has been virtually non-existent.

In District 2, on the other hand, the Top 4 firms in 1970 accounted for 37.1 and 38.8 percent of crude and gasoline refinery capacity respectively, while the Top 8 firms accounted for 58.9 and 60.6 percent respectively (Table 9). Thus, concentration at the refinery level appears to be significantly lower in District 2

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than in the combined 1 and 3 District. Moreover, in District 2, two companies, Ashland Oil and Marathon, both considered "independent", rank within the Top 8 firms and hence, are significant factors in the market.

TABLE 8.—*Crude and gasoline refining capacity, districts 1 and 3, 1970*

[Barrels per day]

Company	Share of market (percent)	Crude capacity	Share of market (percent)	Gasoline capacity
Standard (N.J.)	14. 37	967, 000	15. 11	466, 500
Texaco	9. 61	646, 500	8. 60	265, 700
Gulf	8. 18	550, 500	9. 47	292, 550
Shell	7. 32	492, 500	7. 97	246, 250
Mobil	7. 06	475, 300	6. 69	206, 550
Standard (Ind.)	6. 51	437, 900	8. 03	248, 000
SOCAL	6. 29	423, 000	4. 30	132, 750
ARCO	5. 16	347, 500	5. 25	162, 000
Total crude capacity		6, 728, 678		
Total gasoline capacity				3, 087, 920
Top 4	39. 48			
Top 8	64. 50			
Top 4			41. 22	
Top 8			65. 43	

NOTE: Percentages may not add to 100.0 because of rounding.

Source: U.S. Department of Interior, Bureau of Mines, Mineral Industry Surveys, "Petroleum Refineries . . .," table 2, pp. 4-12, Jan. 11, 1971.

TABLE 9.—*Crude and gasoline refining capacity, district 2, 1970*

[Barrels per day]

Company	Share of market (percent)	Crude capacity	Share of market (percent)	Gasoline capacity
Standard (Ind.)	15. 19	530, 500	12. 06	203, 300
Leland	7. 52	262, 500	6. 36	107, 250
Standard (Ohio)	7. 27	254, 000	7. 77	130, 900
Sun	7. 07	247, 000	9. 27	156, 300
Shell	7. 01	245, 000	9. 72	163, 900
Texaco	6. 27	219, 000	5. 75	96, 900
Marathon	4. 58	160, 000	5. 68	95, 770
Mobil	4. 03	140, 600	4. 04	68, 030
Total crude capacity		3, 492, 670		
Total gasoline capacity				1, 685, 527
Top 4	37. 05			
Top 8	58. 94			
Top 4			38. 82	
Top 8			60. 65	

Note: Percentages may not add to 100.0 because of rounding.

Source: U.S. Department of Interior, Bureau of Mines, Mineral Industry Surveys, "Petroleum Refineries . . .," table 2, pp. 4-12, Jan. 11, 1971.

GASOLINE RETAILING

As indicated in Table 10, the Top 4 and 8 firms accounted for approximately 36.7 and 58.0 percent of gasoline barrel sales in 1971 and the combined 1 and 3 districts. In District 2, for 1970, the Top 4 and 8 firms accounted for 37.0 and 60.3 percent respectively (Table 11).

TABLE 10.—*Market share of leading firms in retailing: 1971*

Firm: DISTRICTS 1 AND 3	*Market share (percent)*
Exxon	11.7
Texaco	9.6
Gulf	8.5
Mobil	6.9
Shell	6.4
Standard (Ind.)	5.3
ARCO	4.9
Sun	4.7
SOCAL	3.8
Top 4	36.7
Top 8	58.0

Source: *National Petroleum News Factbook Issue*, 1972, pp. 118–131.

TABLE 11.—*Market share of leading firms in gasoline retailing: 1970*

Firm: DISTRICT 2	*Market share (percent)*
American	15.1
Shell	8.4
Gulf	6.8
Mobil	6.7
Texaco	6.6
Sun	6.1
Phillips	5.3
ARCO	5.3
Top 4	37.0
Top 8	60.3

Source: *National Petroleum News Factbook Issue*, 1971, pp. 128–133.

PIPELINES

Estimated concentration in crude oil pipelines for the combined 1 and 3 district for 1969 is provided in Table *12*. The Top 4 and 8 firms accounted for an estimated 57.2 and 59.7 percent of barrel miles respectively. In terms of product pipelines in the combined 1 and 3 district (Table *13*), the Top 4 and 8 firms accounted for an estimated 40.6 and 72.4 percent respectively.

TABLE 12.—*Estimated concentration in crude oil pipelines in the combined 1 and 3 district 1969 (after percent of ownership)*

Company	Crude: Rank	Crude: Number of barrels	Company share
Texaco, Inc	1	245, 915, 716	21.5
Mobile Oil Co	2	166, 188, 600	14.5
Shell Oil Co	3	155, 334, 487	13.6
Gulf Oil Co	4	86, 475, 196	7.6
Total, 4 largest		693, 913, 999	57.2
Exxon	5	14, 770, 888	1.3
SOCAL	6	8, 347, 735	.7
ARCO	7	5, 999, 279	.5
Standard Oil (Indiana)	8		
Total, 8 largest		683, 031, 901	59.7

Source: *Oil and Gas Journal Crude Oil Pipeline Atlas, 1971* and Interstate Commerce Commission, *Transport Statistics in the United States*, pt 6, "Oil Pipe Lines," 1970.

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TABLE 13.— *Estimated concentration in product pipelines in the combined 1 and 3 district, 1969 (after percent of ownership)*

Company	Products		
	Rank	Number of barrels	Company share
Arco	1	60, 806, 388	10. 6
Gulf Oil Co	2	60, 170, 615	10. 5
Mobil Oil Co	3	55, 755, 939	9. 7
Exxon	4	55, 462, 881	9. 7
Total, 4 largest		232, 195, 823	40. 6
Shell Oil Co	5	52, 085, 853	9. 1
Texaco, Inc	6	51, 632, 141	9. 0
Standard Oil Co (Indiana)	7	47, 564, 275	8. 3
SOCAL	8	30, 524, 651	5. 3
Total, 8 largest		414, 002, 743	72. 4

Source: *Oil and Gas Journal Products Pipeline Atlas, 1970* and Interstate Commerce Commission, *Transport Statistics in the United States*, pt. 6, "Oil Pipe Lines," 1970.

DISTRICT 4 AND DISTRICT 5

CRUDE OIL

Crude oil statistics are not currently available on a company basis for District 4. However, such statistics are available for California, which, in 1970 accounted for over 80 percent of crude oil production in District 5. Together with other information available for District 5, it is possible to construct some rough estimates of concentration at the crude level.

As shown in Table 14, the Top 4 and Top 7 crude oil producers in 1970 accounted for 39.3 and 53.7 percent of California crude oil production. By including District 5 imports and receipts from other districts (Table 15), estimated Top 4 and Top 7 concentration increases to 41.9 and 59.1 percent respectively, (Table 16).

TABLE 14.—*California crude oil production, 1970*

Company	Barrels per day	Percent market share
SOCAL	151, 528	14. 9
Getty	104, 615	10. 3
Union	77, 280	7. 6
Shell	66, 312	6. 5
Mobil	60, 493	5. 9
Texaco	44, 825	4. 4
ARCO	42, 032	4. 1
Total for State	1, 018, 986	
Top 4 (percent)		39. 3
Top 7 [1] (percent)		53. 7

[1] No information is available for companies ranked below the seven largest.

Source: "*Annual Review of California Oil and Gas Production*," table 8, p. 8.

TABLE 15.—*District 5 imports and receipts from other districts, 1970*

[In barrels per day]

Company	Canadian imports	Other foreign imports	Receipts from other districts
SOCAL		22, 432	[1] 9, 425
Getty			
Union		10, 544	
Shell	84, 353	13, 021	[1] 9, 425
Mobil	64, 111	7, 311	
Texaco	62, 640	12, 997	
ARCO		12, 009	[1] 3, 770
Total	401, 467		37, 700

[1] Estimated figures from pipeline shipments.

Source: *Annual Review of California Oil and Gas Production* . . . , table 15, p. 7 and table 16, p. 9.

TABLE 16.—*District 5 crude oil production, 1970* [1]

[In barrels per day]

Company	Barrels per day	Percent market share [2]
SOCAL	183, 385	12. 6
Getty	104, 615	7. 2
Union	87, 830	6. 0
Shell	173, 111	11. 9
Mobil	131, 915	9. 1
Texaco	120, 465	8. 3
ARCO	57, 811	4. 0

[1] Estimated by summing data contained in tables 14 and 15.

[2] Approximately 232,000 barrels of crude per day are produced in the other district 5 States. These barrels are not included in the market share figures. Thus, to the extent that these companies have approximated the same share of the other 232,000 barrels per day, these concentration figures would be reasonably accurate for the district as a whole.

REFINING

Gasoline and crude oil capacity data have been available for both District 4 and District 5 for 1960, 1964, 1967, and 1970. Total gasoline output for each District consists of the gasoline capacity of the refineries, foreign inputs, and receipts from other Districts.

Gasoline and crude oil capacity data are shown in Tables 17–21.

As shown in Tables 20–24, District 5 crude and gasoline capacity has consistently been higher than District 4 from 1960 through 1970. Although the capacity of refineries has steadily increased in both Districts, Top 4 and Top 8 concentration ratios have remained relatively stable.

District 5 has been dominated by the same seven majors since 1960. Their stable market share during the rapid expansion of the industry demonstrates their substantial degree of market power. Within this group of seven majors, Standard Oil of California has consistently owned a market share of 20 percent or more of industry output. District 4 has also been dominated by a few companies. Standard Oil (Ind.), Standard Oil (N.J.) and Continental Oil Company have had at least 30 percent of the market.

TABLE 17.—*Crude refinery capacity, District 4 selected years, largest 8 companies*

Company	1960		1964		1967		1970	
	Crude capacity	Share of market (percent)	Crude capacity	Share of market (percent)	Crude capacity	Share of market (percent)	Crude capacity	Share of market (percent)
Standard (Indiana)	52, 000	15. 7	65, 000	16. 9	34, 000	8. 5	72, 000	16. 9
Standard (New Jersey)	34, 000	10. 2	34, 000	8. 8	39, 000	9. 7	40, 000	9. 4
Conoco	27, 000	8. 4	57, 000	14. 8	66, 500	16. 5	67, 500	15. 9
Salt Lake	43, 000	12. 9						
Farmer's Union	22, 000	6. 6	26, 000	6. 8				
Frontier (Husky)	20, 000	6. 2	20, 500	5. 3	20, 500	5. 0	41, 100	9. 7
Tidewater (Phillips)	19, 300	5. 8	20, 000	5. 2	24, 500	6. 1	28, 000	6. 6
Texaco	17, 000	5. 1			20, 000	5. 0	22, 000	5. 2
Sinclair			24, 000	6. 2	26, 000	6. 5		
SOCAL (Chevron)			43, 000	11. 2	43, 000	10. 7	43, 000	10. 1
ARCO							28, 700	6. 8
Shell								
Total district 4 capacity	332, 367		385, 050		402, 580		425, 300	
Top 4		47. 2		51. 6		45. 4		51. 9
Top 8		70. 9		75. 1		68. 0		80. 6

Source: U.S. Department of the Interior, Bureau of Mines, "Petroleum Refineries . . ." January 1961, 1965, 1968, and 1971; table 2.

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TABLE 18.—*Gasoline refinery capacity, district 4 selected years, largest 8 companies*

Company	1960		1964		1967		1970	
	Gasoline capacity	Share of market (percent)	Gasoline capacity	Share of market (percent)	Gasoline capacity	Share of market (percent)	Gasoline capacity	Share of market (percent)
Standard (Indiana)	21,050	18.2	17,000	13.1	9,630	5.8	27,300	14.2
Conoco	13,600	11.8	20,050	15.5	27,570	16.7	29,970	15.5
Texaco	10,400	9.0			9,000	5.5	9,000	4.7
Standard (New Jersey)	9,670	8.4	23,780	18.3	19,450	11.8	20,150	10.5
Farmer's Union	9,400	8.1	6,000	4.6				
Sinclair	8,700	7.5	10,300	8.0	12,900	7.8		
Frontier (Husky)	6,500	5.6	6,000	4.6	6,000	3.6	18,245	9.5
Salt Lake	6,400	5.5						
Phillips			8,050	6.2	9,650	5.9	11,350	5.9
Chevron, SOCAL					15,200	9.2	15,900	8.3
California Oil Co			11,100	8.6				
Shell								
ARCO							16,450	8.5
Total district 4 capacity	115,850		129,650		164,905		192,835	
Top 4		47.4		55.5		45.5		49.7
Top 8		74.1		78.9		66.3		77.1

Source: U.S. Department of the Interior, Bureau of Mines, "Petroleum Refineries . . .", January 1961, 1965, 1968, and 1971; table 2.

TABLE 19.—*Crude refinery capacity, district 5 selected years, largest 8 companies*

Company	1960		1964		1967		1970	
	Crude capacity	Share of market (percent)	Crude capacity	Share of market (percent)	Crude capacity	Share of market (percent)	Crude capacity	Share of market (percent)
SOCAL	418, 000	27. 6	421, 000	26. 5	421, 000	24. 4	503, 000	25. 0
Shell	178, 000	11. 7	197, 600	12. 4	253, 000	14. 7	274, 000	13. 6
Union	177, 200	11. 7	182, 500	11. 5	190, 000	11. 0	199, 000	9. 9
Mobil	165, 000	10. 9	147, 000	9. 2	155, 000	9. 0	179, 000	8. 9
ARCO (Richfield)	165, 000	10. 9	165, 000	10. 4	165, 000	9. 6	165, 000	8. 2
Tidewater (Phillips)	108, 000	7. 1	120, 000	7. 6	120, 000	7. 0	110, 000	5. 5
Texaco	105, 000	6. 9	110, 000	6. 9	120, 000	7. 0	142, 000	7. 1
Wilshire (Gulf)	33, 000	2. 2	45, 000	2. 8				
Conoco					46, 900	2. 7		
Standard of New Jersey							80, 000	4. 0
Total district 5 capacity	1, 515, 800		1, 590, 561		1, 724, 750		2, 011, 600	
Top 4		61. 9		60. 8		59. 7		57. 4
Top 8		89. 0		87. 2		85. 4		82. 2

Source: U. S. Department of the Interior, Bureau of Mines, "Petroleum Refineries . . . " January 1961, 1965, 1968, and 1971; table 2.

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TABLE 20.—*Gasoline refinery capacity, district 5, selected years, largest 8 companies*

Company	1960		1964		1967		1970	
	Gas capacity	Share of market (percent)	Gas capacity	Share of market (percent)	Gas capacity	Share of market (percent)	Gas capacity	Share of market (percent)
SOCAL	147, 000	26. 2	150, 000	25. 1	192, 380	22. 9	256, 580	24. 2
Shell	63 200	11. 3	61, 600	10. 3	134, 500	16. 0	144, 000	13. 6
Union	73. 300	13. 1	81, 000	13. 6	87, 450	10. 4	90. 700	8. 6
Mobil	50. 000	8. 9	49, 080	8. 2	101, 430	12. 1	105, 000	9. 9
ARCO (Richfield)	62. 500	11. 1	65, 500	11. 0	94, 055	11. 2	89, 430	8. 4
Tidewater (Phillips)	57, 000	10. 2	74, 900	12. 5	85, 500	10. 2	85, 000	8. 0
Texaco	49, 300	8. 8	39, 300	6. 6	58, 700	7. 0	95, 700	9. 0
Wilshire (Gulf)	16. 200	2. 9	22, 800	3. 8	25, 900	3. 1	35, 890	3. 4
Total district 5 capacity	561, 295		597, 775		839, 635		1, 062 425	
Top 4		61. 7		62. 2		62. 2		56. 3
Top 8		92. 5		91. 1		92. 8		85. 1

Source: U.S. Department of the Interior, Bureau of Mines, "Petroleum Refineries ... January 1961, 1965, 1968, and 1971; table 2.

TABLE 21.—*Crude and gasoline capacity, 1960–70, districts 4 and 5*

[In percent]

	Top 4	Top 8
District 4:		
Crude capacity (share of market):		
1960	47.2	70.9
1964	51.6	75.1
1967	45.4	68 0
1960	51.9	80.6
Gasoline capacity (share of market):		
1960	47.4	74.1
1964	55.5	78.9
1967	45.5	66.3
1970	49.7	77.1
District 5:		
Crude capacity (share of market):		
1960	61.9	89.0
1964	60.8	87.2
1967	59.7	85.4
1970	57.4	82.2
Gasoline capacity (share of market):		
1960	61.7	92.5
1964	62.2	91.1
1967	62.2	92.8
1970	56.3	85.1

Source: Tables 20–23.

Concentration has been higher in District 5 than in District 4 through the ten-year period. Indeed, the share of the market held by the six largest firms in District 5 has been approximately equal to the share of the market held by the largest eight in District 4.

Inputs of gasoline into District 5 amounted to 1,000 barrels per day in 1970.[4] Receipts from other Districts amounted to 10,000 barrels daily in District 4 in 1970. Receipts from other Districts amounted to 72,000 barrels daily in District 5.[5] Without access to confidential data, it is not possible to ascertain which companies are shipping interstate to Districts 4 and 5 or which companies are importing gasoline.

GASOLINE RETAILING

As shown in Table 22, the top 4 and 8 firms in District 5 accounted for 50.0 and 75.2 percent of that District's gasoline barrel sales in 1970 respectively. In District 4, the top 4 and 8 firms accounted for 40.6 and 64.8 percent respectively of that District's gasoline sales.

[4] U.S. Dept. of Interior, Bureau of Mines, *Mineral Industry Survey*, "Crude Petroleum . . ." Table 30, p. 33.
[5] *Ibid.*

TABLE 22.—*Retail gasoline sales, districts 4 and 5, 1970*

(Thousand barrels per year)

Company	District 5 [1]		District 4 [2]	
	Sales	Share of market (percent)	Sales	Share of market (percent)
SOCAL	2,379,156	17.1	206,249	7.8
Shell	2,025,508	14.6		
Union	1,285,357	9.2		
ARCO	1,268,414	9.1	141,160	5.3
Texaco	1,103,768	7.9	293,637	11.0
Mobil	1,114,925	8.0		
Phillips	674,000	4.8	220,368	8.3
Standard (New Jersey)	627,225	4.5	110,521	4.2
Husky			185,209	6.9
Conoco			292,680	10.9
Standard (Indiana)			276,015	10.4
Total	13,924,923		2,663,700	

[1] Top 4=50.0 percent, top 8=75.2 percent.
[2] Top 4=40.6 percent, top 8=64.8 percent.

Source: "Share of the Market, 1970," National Petroleum News Factbook, mid-May 1971, pp. 128-133.

PIPELINES

Concentration statistics in crude oil and product pipelines for Districts 4 and 5 are not available at this time. However, existing pipelines and pipeline ownership information, to the extent that such ownership could be determined, are set forth in Tables 23 through 26.

TABLE 23.—*Product pipelines in district 4* [1]

Pipeline	Originating refineries in districts 1-3	Type of pipeline
1. Yellowstone	Phillips	Interstate.
2. Continental	Texaco	Do.
3. Shoshone	Continental	Do.
4. Cenex	Unknown	Do.
5. Chevron	Phillips, SOCAL	Do.
6. Pioneer	ARCO, Sinclair	Do.
7. Cheyenne	Unknown	Do.
8. Wyco	do	Do.
9. Medicine Bow	Continental	Do.
10. Phillips	Phillips	Do.
11. Sheridan	Unknown	Do.

[1] Products Pipeline Atlas of United States and Canada, "Oil and Gas Journal," Oct. 12, 1970, unpaged.

TABLE 24.—*Crude oil pipelines in district 4* [1]

Pipeline:	*Type of pipeline*
1. Continental	Interstate.
2. Amoco	Do.
3. Butte	Do.
4. Chevron	Do.
5. Phillips	Do.
6. Shell	Do.
7. Western	Intrastate.
8. Permian	Do.
9. Marathon	Do.
10. Platte	Do.
11. ARCO	Do.
12. Belle Fouche	Do.

[1] "1971 Crude-Oil Pipeline Atlas of U.S. and Canada," *Oil and Gas Journal*, October 11, 1971, unpaged.

TABLE 25.—*Product pipeline in district 5* [1]

Pipeline	Owner	Type of pipeline
1. Southern Pacific	Southern Pacific RR [2]	Interstate.
2. Calnev	Union Pacific RR. and Williams	Do.
3. Yellowstone	40 percent Humble; 40 percent Continental; 14 percent Union; 6 percent Husky.	Do.
4. Chevron	SOCAL	Do.
5. Shell	Shell	Intrastate.
6. SOCAL	SOCAL	Do.
7. San Diego	Southern Pacific RR.; Santa Fe RR.	Do.
8. Olympic	Mobil, Shell, Texaco, ARCO	Do.

[1] "Product Pipeline Atlas . . ."
[2] Originating refineries are SOCAL and Texaco.

TABLE 26.—*Crude oil pipelines in district 5* [1]

Pipeline	Owner	Type of pipeline
1. Four Corners	Shell 25 percent; SOCAL 25 percent; Gulf 20 percent; Continental, ARCO, Superior 10 percent each.	Interstate.
2. Trans Mountain	ARCO, Mobil, Phillips	Do.
3. Shell	Shell	Intrastate
4. Getty	Getty	Do.
5. ARCO	ARCO	Do.
6. Texaco	Texaco	Do.
7. Union	Union	Do.
8. Mobil	Mobil	Do.
9. SOCAL	SOCAL	Do.

[1] "1971 Crude Oil Pipelines . . ."

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APPENDIX B

EFFECT OF THE OIL DEPLETION ALLOWANCE ON THE PROFIT STRUCTURE OF INTEGRATED OIL COMPANIES

The oil depletion allowance may directly encourage the exploration for and exploitation of domestic crude oil sources, but it may also indirectly bring about results which limit the supply of refined petroleum products by restraining entry into the refining segment of the industry by nonintegrated firms. This result may occur because the oil depletion allowance creates an incentive to higher crude oil prices. Higher crude prices, however, mean higher costs and lower profit margins for non-integrated refiners. But, lower profit rates imply less entry into the industry. Further, with fewer refiners, other things equal, the demand for crude oil will be reduced so that any incentive the oil depletion allowance created for the expansion of crude supply will be offset, at least in part.

To demonstrate these conclusions, let us posit a simplified world in which a few integrated firms control all domestic crude production and all refinery capacity. Suppose further that imports are eliminated by a quota or prohibitive tariff. Assume that the price and quantity exchanged of refined products is determined by supply and demand and that the price per barrel of refined product is $1.00 and the total demanded is 100 barrels. Assume the cost of recovering a barrel of crude oil is 30¢ and that the cost of refining a barrel of crude oil into a barrel of refined product is 10¢. Assume that the corporate income tax rate is 50 percent and that the oil depletion allowance is 20 percent of gross crude oil receipts. Finally, let us abstract from any quantitative limitation on the application of the depletion allowance and from the special depreciation provisions which apply to the oil industry. These abstractions do not invalidate the following arguments.

Assume that the oil companies in the first instance do not report income at each level for tax purposes. Suppose that the firms transfer crude oil from the well to the refinery at the true cost (30¢) of recovering that product. The combined profit and loss statement for the oil firms would look like Table B-1

TABLE B-1

Total revenue ($1 × 100 barrels)	$100
Crude recovery costs (30 cents × 100 barrels)	30
Refining costs (40 cents × 100 barrels)	40
Total costs	70
Gross income before taxes	30
Depletion allowance (20 percent of crude receipts)	6
Gross profits before income tax	24
Income tax (50 percent of profits before taxes)	12
Net profits after taxes	12
Real net Profits (Net profits + depletion allowance)	18

Rate of return on revenues: $18 divided by 100 equals 18 percent.

Under this accounting treatment the oil firms earn $18 of real profits, and after tax profit as a percent of total revenue is 18 percent.

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Now, however, assume that the oil firms choose a price of crude oil such that refinery profits taken separately are reduced to zero. In this model, the firms are clearly free to do this since the crude oil price is simply a transfer or accounting price since no crude oil is sold in any market; it is simply transferred from one division to another by an integrated firm. Table B–2 shows the profit and loss statements for the oil firms under these new assumptions.

TABLE B–2

Crude oil division:	
Total revenues	$60
Cost of crude recovery	30
Gross income before taxes	30
Depletion allowance (20 percent of crude receipts)	12
Gross profits before taxes	18
Corporate income tax	9
Net profits after taxes	9
Refinery division:	
Total revenues	100
Crude oil costs	60
Refining costs	40
Total costs	100
Gross income before taxes	0
Net profits after taxes	0
Real net profits (net profits plus depletion allowance)	21

Rate of return on revenues: $21 divided by $100 equals 21 percent.

Under this accounting alternative the oil firms earn $21 of real after-tax profits, and after-tax profits as a percent of total revenue is 21 percent. Thus, it is clear that the oil depletion allowance creates an incentive to higher crude oil prices and smaller refinery margins. In the example provided, an increased crude price leads to a 16⅔ percent increase in net profits.

Let us now in stages make our market more like the real world. First, assume that the integrated firms continue to own all domestic crude oil but only own one-half of the refineries. The remaining refineries can be termed "independents." The independents must buy crude oil from the majors. Surely the majors continue to have a tax incentive to obtain high crude prices. However, the majors must not choose a crude price so high that the independents go out of business as a result of earning zero profits, for if independents shut down, the majors will lose customers for one-half of their crude production. Rather, the majors will select a crude oil price which permits refinery profit margins to be large enough to induce the present independents to stay in the market but will not be large enough to induce new independents to enter the industry, increase the supply of refined product, and cause prices and profits in the oil industry to decline. Thus, the oil depletion allowance induces a refinery margin "squeeze" which retards entry.

Finally, suppose that the majors no longer control the entire supply of crude oil; and that independent crude producers would react to higher crude prices by exploring for new crude and by expanding output of previously discovered crude. The oil depletion allowance still provides an incentive to higher crude prices for the majors (and other crude producers for that matter), but will the majors be able to obtain a higher market price for crude oil? At first glance, the answer appears to be, "no." Higher crude prices will elicit greater supplies, which will, in turn, cause prices to fall to previous levels. However, the majors may be able to control crude supply and thereby bring about the desired higher prices. They may restrict crude supply by (1) restricting access to crude gathering lines and pipelines, (2) convincing state governments to impose prorationing programs, (3) persuading the U.S. Government to adopt strict import quotas, and/or (4) squeezing refinery margins so much that crude producers have only a limited market for their product. All of these strategies have been followed at one time or another by the majors in the real world. Therefore, apparently the majors *can* control crude supply and can realize higher crude prices.

It appears, then, that the depletion allowance has two impacts upon crude supply. First, it tends to encourage greater crude production at any given price since it constitutes a subsidy to crude oil production. Second, however, it creates an incentive to higher crude prices for tax reasons. But, in order to realize higher crude prices, the supply of crude oil must be restrained. Thus, the stimulus to greater crude oil exploration and production provide by the oil depletion allowance may be very small or virtually non-existent.

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SPEC.
SESS.
LIPTON
Testimony

Pipeline Legis. ::
Sp. Session

SENATE RESOURCES COMMITTEE

Special Legislative Session

October 20, 1973

Mr. Lipton

I'll try to get my introductory remarks to the point of the issues which you are considering here with respect to the legislation submitted by the Governor. First of all it is very obvious that there is considerable urgency in getting on with the construction of the pipeline. This is clearly evider Congressional action to authoriz construction. And I think the action by Congress implies not only an appreciation of the hightened concern by the nation as a whole for the potential contribution of North Slope oil to the nation's precarious balance in essential energy supplies, but also a feeling that it is imperative at this stage to avoid further unecessary delays on account of litigation in the courts. And I think that the same spirit, the desire to avoid unecessary delays, is reflected in the negotiations between the Governor and the companies. There is no doubt but that the State and the companies have a very common interest at least in getting on with the job.

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You must independently review the proposed legislation in the light of the many issues involved so in my introductory remarks I would like to address myself to the question - what have been the major concerns which have impelled past legislation, to what extent are these concerns still relevant to the State of Alaska, and to what extent do the proposed changes in the legislation adequately take care of the concerns of the State and to what extent may you want to consider variations, deviations, or at least review what is being proposed.

The first thing that I would like to stress is the public interest that is inevitably and irrevocably involved in the pipeline. This is a circumstance which is unique to Alaska, it is of tremendous importance to Alaska and it just does not obtain elsewhere. This is one of the reasons why in your legislation you must be circumspect to a degree that perhaps other states need not be. The contrast between the pipeline that is proposed to be built along a corridor from the North Slope to Valdez contrasts with any other transportation circumstances in the lower 48 states. There was never a time when it was not possible, quickly and expeditiously, for any crude oil producer having a significant flow of crude oil without access to pipeline capacity to undertake to build a new pipeline. Or for any refinery without access to pipeline that would bring crude oil to

his refinery not to undertake the construction of a pipeline. There is today for example a very serious shortage of pipeline capacity into the Midwest area. CAP line, which until Alyeska was the largest undivided interest crude oil pipeline in the United States is expanding its capacity under different investments by the various companies participating. Its not a proportional expansion of capacity but to reflect their several needs. There are refineries located in the mid-continent area of the United States that have historically drawn their crude supplies from Oklahoma and Kansas where crude production is going down that are prepared to build their own pipeline from the U.S. Gulf area into the mid-continent area. There was a new fairly large capacity pipeline just completed to carry products from the gulf coast area to new consumer markets in the mid-west. So that although individual pipelines have, in a sense, a monopoly over their own rights-of-way and are regulated, the circumstances of investment construction in the lower 48 make it possible for competing or alternative forms of transportation to be provided. This is simply not the case with respect to the crude oil resources of the North Slope and the access to export markets in southern Alaska. That pipeline corridor will convey to whatever company builds that pipeline an

an irrevocable right for the transportation of crude oil. The state has tremendous interest in this pipeline. It has interest in seeing that the facilities are operated in the most economical, efficient fashion. That the facilities, whatever their capacity, may in due course be expanded to meet the needs either of incoming production or facilities provided to expand the delivery of crude oil, for example, to intermediate points within the State, such as Fairbanks. My point simply is that company interests may not always correspond in toto, or at a moment in time to the concerns that are of primary interest to the State.

I had the privelege of listening to Mr. Spahr's testimony before this Committee yesterday afternoon and I was quite impressed with his very careful and precise statement of how a company balances all of its investment decisions against their many alternatives, which means in effect that the economic interests of the State, from time to time and in various respects may not coincide with the inclinations of the individual companies who are participants in the pipeline.

There is no way in which the State, through its regulatory machinery, can impose arbitrary or capricious demands upon the pipeline, either to deny them the right to do things or to compel them to do things, because the pipleline always has recourse to the state courts, under the due process of law, against capricious, arbitrary or confiscatory demands

made by a regulatory authority. There is likely to be a wide range of business transacted by that pipeline which involves intra-state commerce and which involves State interest in the totality of its commerce. And, to the extent that the State has an interest and can exercise jurisdiction, it would seem to us that the legislation enacted by this legislature should claim for the State such jurisdiction, subject both to the prior jurisdiction that the ICC may have, and subject also to court review of how the State exercises such jurisdiction as is available to it. But, I would not think that the claim by the State, in its legislation, to exercise regulatory jurisdiction, should be such a disabling factor that in advance they would say that we will not submit to the legislative exercise of this power and go ahead with the construction of our pipeline unless it has been previously reviewed in the courts. The exercise of the State regulatory authority is always available to them subject to judicial review. I would not think that this one, among the many issues would be the one that would be such a stickler that it would involve prior litigation and unecessary delays on the subject of the construction of the pipeline. This bears upon aspects both in the proposed amendments to the Pipeline Commission Act and certain proposed amendments in the Right-Of-Way Act.

The second overwhelming interest of the State I think is in the tariff which the pipeline will eventually establish.

The estimated costs of the pipeline goes up by leaps and bounds. The figure that is now being used in the range of 4 - 4 1/2 billion dollars which makes it both an incredible industrial undertaking and private investment. But it ought to be seen in context. There has been over the past three years, according to estimates, an increase of 3 billion dollars in the construction costs of the pipeline. On the other hand, the increase in wellhead values in Alaska, as measured only by the increase in postings already put into effect in California, are on the order of 60¢ a barrel, and 60¢ a barrel on 10 billion barrels of recoverable oil, means at least that the capital assets which underlie all of the incentives to construct this pipeline have gone up by about 6 billion dollars in the same period of time. Insofar as the economics of the pipeline are irrevocably tied in with the economics of crude oil production, the increase in the construction costs of the pipeline, occasioned by inflation, environmental considerations, regulation, etc. are not disproportionate to the tremendous increases in the value of Alaskan oil, which have already obtained by virtue of the run up in energy prices and crude oil values in California, and also with respect to foreign oil at the price which it can be

brought into the United States.

These higher wellhead values, reflecting world oil prices, are no reason for the legislature to have less concern than before about the relationship between a pipeline tariff and a wellhead price at which their severance tax and royalties are assessed. The mere fact that the oil is worth more is no reason for you not to insist that the maximum worth accrues to the State, and that it not be unecessarily depressed, even if its depressed from an unexpectedl. high level by virtue of the tariff which is established on the pipeline.

It is not the issue that one questions the good will or the economics of the company. The real question has to do with how the State, given its economic interest, exercises its responsible legislative authority to protect the interests of the State in the event that company interests, for one reason or another, are found in such a way that the State feels its own interests are being bypassed. It is for that reason that we have felt very strongly that the State should be looking at a package of legislative means that not necessarily by themselves but together, would always conduce to the most favorable tariff, in light of the States economic interest.

One of the specific issues involved is one that came to the fore in the Right-Of-Way Leasing Act of 1972 was the percentage lease rental and the many provisions associated with it. If you recall our testimony last year, this was

one area in which we had certain reservations. It certainly was, to our mind, an imaginative approach on the part of the State, since the main intent and purpose of the percentage lease rental formula was not to raise revenue for the State. Quite the contrary, the intent and purpose was to hold out an alternative of pains or rewards to the pipeline participating companies. Pains in the form of a very high lease rental if they set too high a tariff, and rewards in the form of an appreciably lower lease rental if they set the lower tariff. We had however, considerable uncertainty as to what the company response would be to it. It was then very, very difficult and it remains very, very difficult to compute, company by company, the way in which the impact of the percentage lease rental would fall upon the company, not knowing in advance what the ultimate proportions would be between a company's equity in the pipeline and a company's equity in the crude oil, that is whether they were a net buyer or a net seller. And not knowing what the tax exposure was of individual companies with respect to income earned on production, which has the advantage of depletion allowance and the disadvantage of severance tax royalty, or what their income tax exposure might be on pipeline operations given accelerated amortization, investment tax credits, etc. This is a very difficult corporate computation. So there was considerable uncertainty as to whether the incentive that was intended in the percentage lease rental would actually

work.

Then there was the second problem about the pyramiding of lease rentals. Any rental payment that a pipeline company makes, insofar as it is subject to ICC jurisdiction and insofar as it sets its tariffs subject to the Icc rate making rule, if it pays a rental it is in effect able to recover that rental payment through the tariff. So that the higher the rentals are the higher the tariff would have to be.

Third there was the legal issue, and I think that, under the circumstances, where this has been made by the industry, one of the pivotal issues in their litigation I suspect that the legislature would want to consider very. very carefully the extent to which the percentage lease rental formula and all the provisions associated with it are essential to the interests of the State or whether there are other alternatives.

The second innovation that was introduced in the legislature last year and is now subject for your review, is the option of the State to buy up to 20% equity in the pipeline. Last year we were rather negative on the subject of 100% state ownership for reason which we would still enunciate. But we did feel that there was a very cogent reason for the State to have an option to buy a participation in the pipeline. in due course. What we had recommended, and what was enacted into your legislation last year, was an option to acquire up

to a 20% undivided interest in the pipeline. The reasons for that were, if the State exercised its option, it could use its ownership of some percentage, and it does not have to be a very large percentage, it could be less than 20%, to utilize its ownership of transportation facilities to leverage all tariffs downward. The State could set a tariff and say that this is an appropriate yardstick that others can follow. Or the State could set a tariff and if the tariff were lower than the company's tariff presumably all shippers would elect first to move their oil where the transportation charge is least, and on that basis the State would be in a position, with its relatively lower tariffs, to say that this is what determines the value of oil on the North Slope, and use that as the basis for its severance tax and royalty calculations, with the onus being on the company to prove that a higher tariff is necessary. Or if all else fail alternatively for the State to say we too will charge a high tariff and in effect we will recover in the profit on the oil that we move through our share of the pipeline what we may have lost through severance tax and royalty revenues because a high tariff depresses the value of the oil on the North Slope.

The attractiveness of the option provision was that having the option it would not have to be exercised.

That what the State could do by its option, plus what it might do through its taxing authority, that all of these would be conducive to a reasonable agreement between the companies and the State as to what a reasonable tariff would be, which might very well be at an ICC rate, depending on what ICC rate making policy is in 1977 and 1978. Or it might be somewhat lower, but at least it provides the State with a negotiating leverage and it would be one of those tools which hopefully the State would never have to exercise. The negotiations between the Governor and the industry have changes quite substantially the whole concept of the State's right to acquire an interest in the pipeline. Last year the company representatives were absolutely adamant that State ownership or State participation or State option were absolutely unacceptable and this was very largely couched in terms of the financing problems that would be posed.

I would like to call attention to arrangements that have been made elsewhere which involve government participation in a pipeline and a government option to buy. I'm referring now to an arrangement which has been made between a consortium of oil companies called SINCRUDE and the Province of Alberta in Canada having to do with the right to produce and transport a synthetic oil processed from the tar sands of the Athabascan tar belt. Will have to be a pipeline which connects the Athabascan Tar Sands Development

Project with the City of Edmonton where the oil will then move into other pipelines. The Province of Alberta is given, de nova, from start, an 80% equity in the pipeline. The companies which are participants in SINCRUDE commit their shares of the oil to that pipeline, without reservation. Secondly, and this does not have to do with pipeline but it has to do with an option, the Province of Alberta has an option to acquire, after the start of production, an undivided interest in the production itself, of not less than 5% and not more than 20%, with a formula that determines in advance what price will be paid by the Province of Alberta for the acquiring of that option.

I must be very careful to distinguish between the magnitude of what is involved here. The Alyeska Pipeline with an investment of some 4 - 4 1/2 billion dollars is a much larger pipeline facility than either the Athabascan pipeline or even the producing operations. There are differences in the magnitudes and degrees, but surely the principle of a definite participation in the pipeline, or the option to acquire a participation is not without precedent. If there are problems involved in the financing of the pipeline because there is an outstanding option for the State to acquire it, I would believe that those financing problems could be resolved if the terms and conditions of acquisition

under the option were spelled out. That is to say their investment, their costs, plus interest on their investment up to the time of the States taking over the pipeline, will be paid to them, and that the State thereafter undertakes commensurate obligations for whatever the outstanding debt may be.

The principle of an option to buy is not without precedent. This consortium of oil companies, who together constitute the SINCRUDE group, contains within their membership of four, two; the Exxon Corporation, through Imperial Oil in Canada, and Atlantic Richfield, who are major participants in the Alyeska Pipeline. So that insofar as the purpose of an option still commends itself to the Legislature as a significant factor in the protection of the State interest, which probably may never be exercised; which nonetheless represents a prudent approach by the Legislature. I think it may also be considered that the precedents which have been transpired, and if necessary, agreement by the State in advance on what the formula for payment will be, so that it is carefully spelled out, I would think that at that stage of the game it should not be a completely inhibiting factor with respect to the financing of the pipeline.

The third broad area at issues has to do with taxation. Obviously the taxing power of the State is the ultimate power. that the Legislature exercises with respect to any of the

issues which may be involved with respect to Alaskan oil.

There is now tabled before you two major tax measures, an ad valorem property tax and an amendment to the severance tax. No legislature can bind itself through its term of office, let alone bind future legislatures, so whatever is enacted in terms of tax legislation is susceptible to amendment at any time. Certainly an oil company, more than any company in the world, is aware of the taxing power of sovereign states or States. In the context of the package of legislation that is submitted to you, it would appear that any tax legislation that you enact in this Special Session of the Legislature, implies some kind of a commitment. Here there have been negotiations, tax proposals have been made, in a special session of the Legislature you are being asked to amend or pass legislation which seems to be part and parcel of a whole package of legislative items, and certainly the industry, no matter how much it feels is subject to amendment in the future, will not be remiss is recalling to this or subsequent legislatures, that what you enact today was part of a package.

Therefore it seems to me that this particular legislature ought to be especially careful in what it does in terms of their tax decisions, and certainly the legislative record ought to show that a present enactment represents the sense of the Legislature to the extent that it is able to look ahead and see the circumstances under which the tax will be

operative. From the visibility of today, I submit that 1977 and 1978 might not look at all the way you or I think its going to look with respect to the economics of North Slope production or the economics of exploration and development elsewhere in the State. So in a sense, if you are enacting tax legislation today, you must also be alert to the fact that the interests that the State will be looking at 3 - 4 - 5 years hence may appear very differently than the best perspective any of us can hope to have on the future from today. So that the tax legislation will be subject to review, no only as a matter of legislative perogative, but also as a matter of very basic equity as circumstances may be changing.

There are three categories of taxation which are relevant to your Legislature.

(1) The first is a severance tax with amendments set before you. We have always looked on the severance tax as a tax which captures for the State a portion of the economic interest in its natural resource, and which was sufficiently broad guaged so that it really wasn't directed to the production of one specific company or the production of any specific _____. Two to three years ago we felt that what the legislature did ought not to be constrained by the particular circumstances of Cook Inlet at that time, nor ought to be so flamboyant that it was directed entirely to the hectic

expectations of North Slope development, but that in a sense it represented a fair and equitible tax given the circumstances of current, prospective and future production out of Alaska. Out of that came your tax which was the percentage of wellhead value and which contained four different brackets which related to average wellhead activity.

Last year your severance tax underwent substantial change with the introduction of cents per barrel which was designed as a floor below which the State's revenue would not fall whatever transpired with respect to wellhead value of the oil.

There are two different ways of looking at the cents per barrel aspect of the severance tax. One is as a means of offsetting depressed wellhead values. That is to say, if the pipeline tariff is high and the wellhead value is depressed, then if you can't get it as a percentage of wellhead value then you get it as cents per barrel. It is a response to what you might have considered an unjustifiably high tariff which depressed wellhead value and hence your severance tax. Of course you can get that also by changing your schedule in percentage of wellhead values. But as an offset to cents per barrel, or the severance tax however its enacted, as an offset to the lowering of wellhead values through the high tariff, it is a blunt instrument because it affects every producer in the State with higher severance tax obligations irrespective of whether or not that producer is a member of the pipeline or not.

As a revenue measure, every severance tax bears on producing profits. But it bears on it indirectly, that is to say it is a percentage of gross value. And as a revenue measure it comes out of producing profits, but it can be a different proportion of producing profits depending upon the relationship for individual fields and individual companies and individual circumstances, of the relationship between gross value and net value of the oil. Therefore it is not an income tax though it does fall upon it. It is a revenue raising measure that is always available to the State and is susceptible to whatever rates the State may want to impose, which the State can adjust whenever it chooses if it is dissatisfied with wellhead values. But this is an economic judgement.

The royalty offset feature in the last amendment of the severance tax was obviously a legal issue of considerable general concern to the industry. Because what it implied to the industry was that here in Alaska, and potentially elsewhere, royalty payments which they entered upon by virtue of contractual lease arrangements, might in effect be changed by the State enactment of severance tax legislation.

You can of course achieve whatever level of tax income from the State directly for severance tax or even higher severance tax to offset what you consider to be a loss of royalty income, not by a royalty offset but simply by a high

severance tax.

The legal attack upon your last severance tax enactment could be voided by a very simple amendment, that is to simply eliminate the royalty offset and leave all the old schedule, in which case the industry would be paying a very considerably higher severance tax than they paid under their old tax or they are paying under the governments proposed legislation. To avoid the legal issue of the royalty offset is something I think well worth considering, because you can exercise your severance taxing power at any time.

(2) The ad valorem tax is very clearly to raise revenue for the State and particularly as an interim source of revenue and is one among various ones that you might consider. The only thing that I would like to mention about it is the observation that an ad valorem tax imposed upon a pipeline is recoverable by its tariff. It is a cost of doing business by the pipeline and under ICC regulations, and I suspect under your own State of Alaska Public Utility regulations, an ad valorem tax becomes a cost of doing business and therefore can be added onto the tariff.

By way of rough calculation, on a 4 1/2 billion barrel pipeline a 20 mill rate would yield about 90 million dollars per year in tax revenue ad valorem tax on the pipeline itself, which in effect would mean about 20¢ per barrel addition to the tariff. The ad valorem tax would be passed on to someone else in the tariff of the pipeline. Insofar as the pipeline

tariff is higher and the wellhead values are lower, the State itself would bear 20% of the burden of the tax because it would reduce the royalty severance tax income. The tax would become a burden on those producers on the North Slope who are not participants in the pipeline but who have to transport oil because the tariffs to them will be higher. They would bear a portion of the burden in proportion to the amount of oil that they produce and ship relative to the amount of oil that is produced and shipped by companies who are also participants in the pipeline. The rest of it would be borne by the pipeline companies themselves as its passed back to the cost of transportation of their own crude oil.

The same holds true not only for the ad valorem taxes that the pipeline will pay in 1978 when the pipeline is in operation, but I suspect that the same thing holds true for all the cumulative ad valorem taxes that the pipeline will be paying between 1974 and the start up of operations, because those taxes are also recoverable costs of doing business and in due course will have to the companies as pipeline operators in their tariff.

All of which is not a reason in and of itself for you to say no more ad valorem tax. This all depends on when you want your revenues and how you best decide the State can raise its revenues.

(3) Finally, a few words about what I think is the most important aspect of taxation which is available to the State, that is your State income tax.

I think the Legislature, in due course, its certainly not required at this Special Session of the Legislature, must review its legislation to insure that incomes earned in the State are within reach of the State's income taxing power. This does not imply anything about the way you levy income tax, or whether there are any changes, but it does imply that you will scrutinize your income tax legislation very carefully.

In the end the income taxing power of the State is the means by which the State can insure that there is in the future a reasonable partition, or sharing, of what are the ultimate economic benefits of resource production in the State. I'm not only talking about crude oil but I'm talking about what hopefully will be a major exploratory and development program now that lands are beginning to be available for the reopening of leasing operations. Through your income taxing power you have the final means by which the State can decide, but not arbitrarily, never by itself, because its all subject to the essential incentives of investment by private companies in exploration and development. But within these limits the State has a means to participate in a reasonable and equitable way in the benefits that will come from Alaskan resource development.

SENATE RESOURCES COMMITTEE

October 22, 1973 Hearing

TESTIMONY OF MR. MILTON LIPTON

The legislation that's directly before you is the Right of Way Leasing Act but before I address myself to that specifically, I would like to say something about the entire package of legislation. It has been stated by industry, of course, that it is a package and they will review whatever decisions come out of the Legislature as a whole. I think it's true even more so for the state than for industry that the whole complex of oil legislation that's before you determines the extent to which the interests of the state are protected or the extent to which the interests of the state are yielded.

I don't want to take too much time on other aspects of it and get to the Right of Way Leasing Act as quickly as possible. So let me start out by saying that, in our opinion, having looked at all the legislation carefully, having listened to a great deal of the testimony that was made before the various committees, we now feel that the pivotal piece of legislation which determines the extent to which any compromise is satisfactory to the interest of the state, is the Alaska Pipeline Commission Act. This is your regulatory bill, a strong bill that was enacted in the 1972 session of the legislature, a bill for which the government and industry have submitted proposed amendments which largely convert what had been intended by the legislature in the first instance as a regulatory bill into an entirely different instrument for

the state, namely a device whereby a commission of the state simply represents the state in hearings before the Interstate Commerce Commission. The amendment to the bill as proposed and as pointed out by Professor Witherspoon yesterday afternoon, in effect, specifically denies (if the amendment is passed) by act of the Alaska legislature any and all jurisdiction which the state of Alaska might in the normal course of events, exercise over pipeline activities in this state, if only a pipeline such as transAlaska subjects itself to or is subjected to the jurisdiction of the ICC.

Now let me explain the reasons for our thinking that this particular act, as it now stands, the Alaska Pipeline Commission, is one of the most important tools available to the state of Alaska in protecting its interest. First of all, the act that's on the books claims very extensive jurisdiction for the pipeline commission which is being established. The jurisdiction extends to various aspects of regulation extensions of services, connections, expansion of capacity, potential abandonments --- so that with respect to these various aspects of pipeline operations the state of Alaska claims jurisdiction for its pipeline commission. Secondly, it vests in this pipeline commission wide authority to pass upon the validity of tariffs which are set by the pipeline. There is no claim made in the existing act, which is on your books, that the state of Alaska can regulate tariffs for the movement of oil in interstate commerce. This falls within the jurisdiction of the ICC. But there will undoubtedly be movement of oil in intrastate commerce, as for example from the northslope

to Fairbanks. There will probably be movement of oil in intrastate commerce from the north slope to Valdez which will remain within the state, for example, if the state should contract to take royalty oil and sell it for a year or two years or five years to the Tesoro Refinery or any other refinery which may be then or in the future be constructed within the state. So the state need only claim jurisdiction over the operations of the pipeline which affect intrastate commerce and jurisdiction over tariffs which involve the movement of oil in intrastate commerce.

Now what's the value of this? Insofar as there may be in the future an issue over the tariff set by the pipeline and this has been pivotal to your deliberations for two years now, insofar as there should be an issue over the tariff, there has really to be two things -- one, a determination as to what the appropriate tariff is, and secondly, a decision by the state as to what it will do to try to enforce what it believes is an appropriate tariff. How does one go about determining what is an appropriate tariff for the pipeline? I don't believe that the legislature in its deliberation is going to want to tackle the job -- that fantastically difficult and complicated job -- of determining what is fair value on a pipeline -- what goes into the capital base and what is not allowed in the capital base, and of what rate of depreciation is appropriate, and everything else --. Or what is a fair return -- this is an incredibly involved problem which the ICC struggles with or avoids by not doing anything about it,

as the case may be. In any case this is really not a problem of the legislature.

But you have established in the existing legislation a pipeline commission which has jurisdiction to determine the fairness and adequacy of tariffs insofar as it involves intrastate commerce. It would do so by holding hearings. If a rate is filed for the intrastate movement of oil, your pipeline commission may accept that rate as it's filed, or it may protest that rate in which case it has administrative processes by which it holds hearings, by which if it renders a decision it must support and justify why that particular decision was issued. And it provides opportunity for the pipeline companies to protest any tariff decision, or any other decision of the pipeline commission, insofar as the pipeline companies believe that it runs counter to due process of law, which means that the administrative decision of your pipeline commission will be tested in your state courts, or if necessary in a federal court.

But if in fact, your own adminitrative and judicial process has come up with a tariff which is lower than the tariff set by the pipeline companies it can be then enforced upon the intrastate movements, and the legislature and the state of Alaska is in a position to expect that the companies will apply an equivalent tariff to interstate movements also. Now that may not be enforced but I put it to you that on the day that it is determined by the state of Alaska, through its administrative and judicial processes, that a tariff is appropriate

for the intrastate movement of oil from the north slope to Valdez -- if on that day the companies refuse to reduce the tariff, which means to increase the well head value on all the oil that moves in interstate commerce, then the problem of the legislature in recapturing the interest of the state is a simple one, at that point you have the taxing power and know exactly at what level and what rate to exercise it, because you have through the instrumentalities of your own legislation already created the means and device by which an appropriate tariff can be determined; by which your own courts will reject the findings of the pipeline commission if they are arbitrary, confiscatory or capricious, but if administratively and judiciously that tariff is upheld, then the legislature has the guidelines precisely how to go about recapturing the interest in the state through its incontrovertible sovereign powers - that is to say the power of taxation.

It's for this reason that we feel the regulatory bill is absolutely the heart of the entire package. Furthermore, it is our feeling, and here of course it's difficult to speak for companies because, as they said, they would go back and review the whole package, but insofar as the companies feel that there is a claim of jurisdiction by the state which is unconstitutional because it involves interstate commerce or insofar as they feel that there's a decision by your pipeline commission in an area where it has jurisdiction but which decision goes against the law because it violates due process, they always have recourse to the courts. They need not litigate this issue in

advance because the mere fact that this law is on your statute books and I'm referring to the 1972 pipeline commission act, the mere fact that this law is on the statute books does not impose in advance the kind of disabilities upon their intentions to construct the pipeline that will require extensive litigation at this state of the game. Furthermore, as we have pointed out at the previous sessions of the legislature where regulatory bills were before you, there is legislation to this effect on the books of other major producing states and these have never involved extensive constitutional issues so far as we know. Well then, this pipeline commission act we feel is the guts of any compromise which the legislature may wish to substitute in lieu of the compromise package which has been put before you by the executive department.

Now let me pass on then to the Right of Way, but before I do, let me say a few words about the other bills and then come to the guts of the legislation which is before you which is the Right of Way Leasing Act. There are three different tax measures before you and I don't believe that any of them are in any respect crucial to the willingness of the companies to abandoning litigation or to going ahead with the construction of the pipeline. The severance tax, of course is in the course of litigation and it's in course of litigation because the 1972 amendment to your severance tax law contains a royalty credit feature which the companies feel would establish a very unacceptable precedent if it were, first of all applied here, and secondly if it were emulated in other states. I think they're misguided in their concerns; I think the state of Alaska has very little interest, really, in maintaining the

royalty offset provision. It's applied actually by the state of Alaska in a very generous way so that the relatively high cents per barrel tax, which was imposed in your 72 legislation is evaded and reduced by virtue of the royalty credit. You could settle the legal issue in five minutes by repealing the royalty credit and leaving everything else stand, in which case the companies would be subjected to considerably higher taxation than they were previously and that they are in the governor's proposal. So that the removal of the royalty credit feature in your severance tax which the companies are so eager to obtain, we would surely recommend that the legislature give to them. Perhaps the easiest way of doing it is to give it to them by accepting the severance tax amendment which is before you. But I caution one thing: I don't believe that this is the time for the Alaskan legislature to enact a severance tax schedule, whether it's a percent of value at the wellhead or cents per barrel or a combination of both with the idea that what is enacted today is going to be appropriate to whatever the volumes and values of oil may be that are going to be produced in 1977 and 1978. So if you prepare to accept the proposed severance tax amendment as part of a compromise package, I would strongly suggest that it is part of the legislative record in your committee hearings and in your debate that in no sense does this represent a commitment on the part of the legislature that these particular tax rates are the rates which will obtain five and six and seven and eight years from today. We will have time to review that. So that in a sense what you are giving by accepting the proposed amendment to the severance tax is a willingness

on the part of the legislature to avoid extensive litigation on the royalty offset feature which we think is of very little interest to the state of Alaska, in any case.

Now, the severance tax of course is one of your important weapons. I mentioned in previous hearings before this committee and elsewhere, that eventually your income tax is an important thing but that's not up for discussion. It's not an appropriate time for the legislature to review your state income tax legislation although I strongly urge that at one of your sessions you review with your commissioner of revenue your entire concept of corporate income taxation here in the state. The conservation tax bill which is before you, I think is unncessary. We had recommended that the conservation tax which had been on your statute books in the past be eliminated and simply subsumed within your severance tax. It's an added piece of legislation that we don't feel strongly about one way or the other, but it complicates the whole process of paying and collecting monies as between the state and the industry. On the ad valorem tax, as we see it, this is a revenue measure designed largely to yield income to the state over interim years before Prudhoe Bay production begins, before the pipeline is completed. It falls within the province of the legislature to decide how, when and under what conditions it wants to raise that amount of money.

It's the combination then of a strong regulatory bill and the fact that you have continuing flexibility and authority

to tax via your severance tax or eventually through your income tax that we believe yields the greatest control by the state over the operations and the tariff determinations of the pipeline so as to protect the interest of the state.

Now let me get on the Right-of-Way Leasing Bill. We have gone through this bill chapter, book and verse, section, sub-section and paragraph and I think we are prepared to sit down with this committee and other committees of the legislature to discuss it in detail. I don't believe we have time to go through each and every aspect of this here, but I will report on those which we feel are most critical to whatever compromise package comes out. The first issue, as we see it, involving any amendments to the Right-of-Way Leasing Act is how much of the regulatory power that the state wants to exercise shall be done by indirection in the form of stipulations and agreements as conditions of leasing. The industry is challenging the 1972 Right-of-Way Leasing Act in the courts on constitutional grounds, claiming that in effect regulation achieved by indirection which cannot be exercised by the state directly is an illegal exercise of the leasing powers of the state of Alaska. This is one of the major issues under litigation. We obviously are not in a position to pass any judgment whatsoever on the merits of the case in litigation. I think there is a spirit of compromise abroad, I see it very much in the proposals of the Governor's Office, I'm not quite sure I see that much spirit of compromise

in what the companies are proposing in their package, but nevertheless, there is a spirit of compromise abroad and certainly we would feel strongly, and I hope the legislature does also, that it is desirable to avoid unnecessary prolongation of litigation, and the possibility that such continuing litigation may delay the start of construction. So if it is possible to avoid litigation without unduly sapping the legislative enactments that are vital to the state interest, we would feel that there is some merit in the legislature going ahead with the executive departments decision that a compromise is now in order. So on then to the question of the regulatory items which are introduced into the Right-of-Way Leasing Act by virtue of stipulations as a conditions of lease. One, the most important one in our opinion, which is largely eliminated is in section 120 (a) (3) that's the common carrier section. For many reasons it is of importance to this state that it is understood beyond any doubt that the transAlaska pipeline is a common carrier; a common carrier not only for purposes of regulation of interstate oil movements by ICC but a common carrier also for purposes of regulation by your pipeline commission. There is merit, that as a condition of the lease the pipeline stipulates that it is a common carrier period --without reservations, without qualifications, or anything else. Now this is so common, this is so common in state and federal regulation, that it is really surprising to me that any amendment to the existing Right-of-Way Leasing Act should in effect qualify the common carrier status here. It says first of all, that there will be common carrier if the

the commission so determines at the time the lease is issued. I don't think this should require a determination by the commissioner. Under these circumstances the pipeline is a common carrier -- without hearing, without determination, or anything else. Secondly, I don't think it is necessary in the Right-of-Way Leasing Act to stipulate what obligations fall upon a common carrier and certainly not to qualify the obligations incumbent upon a common carrier. 120 (a) (3) says that it will accept, convey, transport without discrimination, crude oil. This is something which will be covered by your pipeline commission in the course of regulation if it is a common carrier. Certainly not in advance to limit the jurisdiction over a common carrier by your own pipeline commission by saying that the imposition of common carrier status does not require the lessee to accept tenders of crude oil, except at points where there exists public, etc. etc. Do not qualify the obligations of a common carrier. This is a function of your regulatory agency and insofar as your regulatory agency in its individual decision from month to month or year to year may either deny rights to a common carrier or impose obligations upon a common carrier which the pipeline owning companies feel are unduly onerous, they have recourse to the courts. So I don't think that one should qualify the obligations of a common carrier. I think that your 120 (a) (3) should simply stipulate that as a condition of obtaining a right-of-way over state lands, the lease for the right-of-way over state lands, the pipeline carrier itself, submits itself as a common carrier. Not only for the ICC

jurisdictional purposes but for the purposes of the exercise of jurisdiction by your pipeline commission.

120 (a) (4) in the recommended legislation removes the common purchaser provision from your 1972 legislation. At that time it was a permissible feature of your law. In place of the removal of the common purchaser status as a condition of leasing, the Governor has sent down a special bill that would make it possible to establish under certain conditions and subject to certain provisos, common purchaser status for companies owning the transAlaska pipeline. We do not feel now and we felt for a long time that there is real doubt as to how important common purchaser provision is in the state of Alaska, under the conditions where your oil is being produced and transported. Common carrier, yes, because it provides access to transportation and an equitable basis for everybody who is able to achieve production in the new state. Common purchaser for many reasons we have reservations about whether to leave it or not. The bill which is proposed to you we think is a weak and rather attenuated version of a common purchaser act, as it is applied in other states in the United States. Our recommendation at this stage of the game would be that you can afford and should yield the common purchaser provision as a condition of right-of-way leasing and probably simply pass over this special piece of legislation which establishes a common purchaser provision and hold that over to future sessions of the legislature as not being important at this time. When and as common purchaser provisions become meaningful in the conditions of the state of Alaska, at that

time to enact not the legislation that's proposed by the Governor, but a strong common purchaser act which is appropriate to the circumstances at such time. You will have ability and time to do that in the future. I don't think it's an essential point of the compromise, either from the companies' standpoint or from the State's standpoint.

I'm bringing before you here only major things or illustrative aspects of it. 030 - 040 -- these are repealed in the proposed amendment. In the proposed amendment to the Right of Way Leasing Act 1972, section 2 repeals 030-040. Now, 030-040 in the act that is now on the books governs the abandonment of or reduction or impairment of service and temporary emergencies services, and so on. It has to do with the authority that the state claims for itself and buttresses that authority by virtue of this being a condition of the lease. I would think that it might be appropriate, again in the spirit of compromise, that 030 and 040 be retained but that the language be rewritten to say that insofar as these are imposed upon the carrier, that they are in accordance with the jurisdiction and orders of the Interstate Commerce Commission or the Alaska Pipeline Commission, as is appropriate to the case. Which means in effect that the companies, although they are governed by these two clauses, nonetheless know that these two clauses are in accordance -- what is obligatory upon them is in accordance with the regulations that may be promulgated, either by the ICC if it involves interstate commerce or by the Alaska Pipeline Commission if it involves intrastate commerce. I put these out only as illustrative of the

aspects of regulation within the Right of Way Leasing Act which is at issue in the courts -- where we think either the state should stand firm, such as in the matter of common carrier, or where we think the state may very well yield. In general I would think that insofar as the state can achieve a right of way leasing act which avoids litigation but does not give up essential rights which the state still retains through, and I repeat, the combination of a strong regulatory bill and the ultimate enforcement of state regulation through its taxing power, that the legislature can yield on certain of these items in the Right of Way Leasing Act.

This by no means exhausts the regulatory aspects, but in the interest of time I want to move on to other things and as I said we're prepared to go through section by section with our specific recommendations to you.

The second major issue in the Right of Way Leasing Act is the percentage lease rental formula. There are two different impressions abroad as to the purpose of the percentage lease rental formula. Prof. Witherspoon yesterday afternoon suggested that he looked upon it as a revenue measure for the state. That if, in fact, the value of state lands were to be appreciated by the construction of the pipeline then the state like any other owner of land should be in a position to bargain for a fair share of the value of the land when it is being put to a superior use. I have no quarrel with this in principle; however, our position always has been that the leasing of state lands for pipeline right of way should not be regarded as a revenue device by the state of Alaska. We have always recommended that the interest of the state of Alaska is in the lowest possible cost transporta-

tion and the state of Alaska should not in and of itself undertake measures which inherently tend to increase costs of transportation, insofar as producing operation in the development of Alaska's resources provide the base for state taxation. It should be other than through the rentals of the right of way leasing of state land. So we have always urged the lowest reasonable rental for the commitment of state land to right of way. I would point out, for example, that even private property insofar as it's condemned by eminent domain for public utility or pipeline purposes does not convey even to a private owner any right or any entitlement to the enhanced value of land if it's put to other use. So we would recommend that however one looks at the rental for right of way lease that this not be regarded by the legislature as an aspect of its taxing power or as a means of gaining state revenues. That comes from other taxing devices in the state.

The other aspect of the percentage lease rental provision in the right of way leasing bill was that it was to be looked upon as an alternative -- either pain of paying or inducement to the companies to bring their tariffs down to a level which is compatible with the interests of the state; that is to say, a tariff that is lower than the maximum it might obtain under the ICC rate-making rule, certainly high enough to be rewarding for their investment and their risks but a level which is appropriate to the circumstances of pipeline operation in the state. And insofar as they increased their tariffs above a certain level, they were in effect subjecting themselves to the pains of progressively higher lease rental.

This was the percentage lease rental formula. This is one of the major items under litigation. For very obvious reasons the companies regard this as not only as something which is onerous to their circumstances in the state of Alaska but a precedent that if it were followed could lead to all kinds of things in their operation elsewhere. We have reservations about the effectiveness with which the percentage lease rental formula would operate for its major purpose, that is to say, in and of itself to induce the companies to bring the tariff down. It might for some companies, it might not for others. The extent to which it does for any of them would be largely contingent upon their respective equities in the pipeline as sellers of transportation services and in production as buyers of pipeline transportation services. There is an element of unpredictability in the operation of it. And while it was from the beginning, in our opinion, an imaginative and constructive approach and we're not saying even today that if properly effective it might not be a useful tool in right of way leasing legislation; but in the context of the violent litigation associated with this aspect of the right of way leasing bill, with the chances that continued litigation over this aspect of the bill may delay construction of the line, and on the presumption that what you have is not an emasculative regulatory bill but a strong regulatory bill, then we would feel that the legislature could give on the percentage lease rental and adopt the alternative to it as is proposed in the amendment to the Right of Way Leasing Act of 1972 by the Governor's amendments. Again, I say

that there are questions about how effectively it would operate in practice. Notwithstanding, there might be reasons for the state to hold to its case, to fight through the issue of litigation, if there weren't such a sense of urgency about getting the pipeline built, if there might not be such a large cost to the state in litigating. And whatever is done by way of amending the Right of Way Leasing Act in order to assuage the fears and concerns of the pipeline companies, either because of what it does or the precedent that it sets, I would say that what the legislature may do in terms of amending the Right of Way Leasing Act, in our opinion should be contingent first upon the retention of a strong and effective regulatory bill, that is to say Alaska Pipeline Commission Act. A strong regulatory bill which is backed then also by the state's taxing power and so that although you yield another tool in the entire package of legislation which was designed in 1972 to effect and enforce the state interest, really yielding to industry concerns, you do so here in the interest of avoiding undue litigation and the danger of delay on the pipeline.

The third aspect of the Right of Way Leasing Act to which I'd like to refer is the option to buy a percentage interest in the pipeline. The option to buy a percentage interest in the pipeline. I will not take time now to review the reasons why we have supported the insertion of the option to buy in the 1972 legislation. I think they're fairly familiar and

they've been reviewed I believe in previous sessions of this committee. We still feel that the option to buy a percentage interest is an important feature of right of way leasing. I think that insofar as the companies have allowed the purchase by the state of an interest in the pipeline to appear as a condition of the lease, even in the proposed amendment by the Governor, suggests that it is not a disabling aspect of the legislation from the standpoint of constitutionality of the legislation -- I don't know. But certainly the alternative which appears in the legislation which is section 120 (a) (7), the alternative which is substituted in the proposed legislation in our opinion represents nothing whatsoever for the state.

I think to amend the Right of Way Leasing Act to include the amended 120 (a) (7) would be to retain nothing for the state in this respect. I certainly would not recommend that part of the amendment. An opportunity to negotiate for an equity in the pipeline under highly qualified conditions, means that the state has an opportunity to negotiate when it serves the interests and purpose of the companies, which is really not what is intended in the option to buy as contained in the existing law. We do feel, however, that the legislature should give very serious consideration to the advice laid before it by Mr. Spahr of Standard of Ohio, that the option as it stands in the

legislation today may pose difficulty to the financing, or at least the financing at attractive terms, of the pipeline. Because of the uncertainty in the minds of prospective lenders as to what the capacity of the state as a possible future owner of a share of the pipeline may be to carry out obligations for the debt that is incurred at the time of construction which carries over and then may have to be shouldered by the state if the state buys the pipeline. I can appreciate that concern. But I would like to point out first of all -- and I have said this in general and I like to be very specific -- that there are precedents for this. The illustrations that I have made before various committees of this legislature the last two days, I would like to refer to very specifically here. There is the agreement between a consortium of oil companies called Syncrude and the province of Alberta in Canada which determines the basis upon which they get the lease to produce oil from the Athabasca tar sands and transport that oil via pipeline from Athabasca to Edmonton where the oil would enter into the major pipeline systems that traverse Canada and enter the United States. First of all, this has to do with ownership of the pipeline. This synthetic crude pipeline shall be constructed and owned as to an undivided 80 percent thereof by Her Majesty and/or an entity or entities hereafter formed by Her Majesty.

So that from the start, the province of Alberta is being given 80 percent participation in the pipeline. Now, an eighty percent participation in the pipeline--where is the oil going to come from? The province of Alberta is going to finance its 80 percent share of the pipeline just as a private company would. But how do you finance construction of a pipeline if you are not sure you are going to have the oil to put through? The lessees, and her Majesty, and the respective assignees of any interests in the Syncrude projects will dedicate their respective shares of the Syncrude oil recovered from the project to the Syncrude pipelines. That is to say, where the oil being produced by that project is committed to the pipeline irrespective of the fact that Her Majesty's government, that is to say in the province of Alberta, has 80 percent interest in the pipeline. So the percent of interest in the pipeline is there, the difference, of course, being that the state of Alaska in its Right-of-Way Leasing Act had wanted an option.

Now the issue of an option comes up. In this same agreement between the Syncrude consortium and the province of Alberta, the lessees, the Syncrude group including Exxon through Imperial Oil Canada, Atlantic Richfield (these are familiar names to you), Cities Service, and Gulf Oil--these lessees hereby grant Her Majesty an irrevocable option to acquire an interest in the Syncrude project. This is in the producing operation including the project sites, the leases and rights granted thereby, and all facilities acquired or constructed as part of the Syncrude project, which interest may equal undivided percentage interest of not less than 5 percent and up to and

including 20 percent. The option may be exercised at any time during the period from the date hereof and up to and including that date which is 6 months after the date of start of production or the 31st day of December 1982, whichever is the earliest.

Now as to how this is paid for, the payment by the government of Alberta to the members, the private companies, that make up Syncrude: Such costs shall be computed (in accordance with the accounting manual) on the basis of all of the costs which they, the companies, have incurred up to the date of the exercise of the option and shall include interest compounded annually at 8 percent. No portion of such costs shall be attributed to the reserves of leased substances. The province of Alberta could thus be buying in at what is the investment costs of the company plus the payment of 8 percent interest for all time that is elapsed. An interest in the producing operation of between 5 and 20 percent.

Why do I introduce this? Simply because I'm trying to suggest that there is precedence where the companies are prepared to undertake both to accept government participation in the pipeline and whereby companies are prepared to accept an option for governments to participate in what is essentially private operation. That the financing of this project does not seem to be inhibited whether by the government's participation in the pipeline or by the government's option to acquire an interest even in producing operations. Now I grant you that there is a very significant difference in the capital costs of the two projects. The TransAlaska pipeline will probably involve an aggregate initial investment on the order of ten times as much as the Syncrude operation. But that doesn't mean that

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individual bond holders are lending ten times as much money. The problem of the bondholder, whatever the number of dollars, always is what security lies behind; what security is there which insures that the viability of the operation will provide for interest and sinking fund contributions. To get back to the crucial point, if the option is retained in the Right-of-Way Leasing Act, the existing legislation may be amended so as to stipulate in advance, first of all, what the basis of compensation will be so that there is clear protection that no member of the Trans Alaska group will in effect suffer deterioration of its capital position by virtue of the exercise of the option by the state. And that in negotiating that option, the commissioner shall be prepared to enter into such stipulations by the state as provides the assurance necessary for the indebtedness that bondholders will be entering into prior to any possible exercise of the state's option. We feel that the right of the option to obtain an equity is a useful aspect of the entire package of legislation which you enacted in 1972. We think there may be a question about the way it is now written, whether or not the companies have as much, what shall I say, protection for their borrowing capacity as they would like to have. This protection can probably be provided both in the legislation where it refers to the terms at which the price will be paid and in the lease negotiation itself where the commissioner is authorized to give certain commitments on the part of the state of Alaska. Existing legislation also requires considerable other steps before an option can ever be exercised, including the positive act by the legislature and a referendum by the people of the

state of Alaska if there is to be debt financing. So I think there can be fair protection all around.

This again, represents in our judgment an approach to the issues which confront the state of Alaska. The issues being, must you continue litigation and risk the fact that prolonged litigation may result in delay in the pipeline? Or must you accept a negotiated package of legislation such as submitted to the legislature by the Governor? Or is there an alternative package of legislation which in your judgment represents the protection of the vital interests of the state of Alaska insofar as resource development and pipeline development is concerned, and probably represents a package which the industry can accept? It may pose uncertainties for industry but insofar as they may be obliged or feel they want to litigate, they need not do it in advance but can start construction of the pipeline and be prepared to litigate specific aspects of it as they become relevant. For example, if your pipeline commission, sometime in the future, issues an order which is deemed to be an unreasonable, in violation of due process, the companies can protest such order in the courts, and upset it if their protest is upheld. I think that what we are suggesting here is in the spirit of the negotiations between the Governor and the companies. It certainly represents a yielding on the part of the legislature, if our recommendations are followed, which go a considerable way to meet the issues posed in litigation by the companies. But I do believe it retains for the state of Alaska in two critical areas--namely the regulatory bill and the ultimate ability to enforce the intentions of regulation by the state's taxing

powers. Plus the retention in the Right-of-Way Leasing Act of certain conditions including the common carrier provision. It means yielding on what had been one of the most provocative and imaginative aspects of the legislation which is percentage lease rental. It means compromise on the option to buy so as to provide certain added protection for the companies. In our judgment, I think that this combination of action by the legislature would secure the interests of the state, and in our judgment (of course we are not in a position to speak for the companies) might not be wholly attractive to the companies, but we would think that they would not litigate to the extent that it would involve delay in the construction of the pipeline.

D R A F T

Judiciary Committee amendment to House Bill 7, "An Act relating to common purchasers of oil and providing an effective date."

Page 1, line 29:

Strike the words "the size and"

Page 2, lines 4 - 5:

Strike the words "a purchaser is purchasing from a field and"

Page 2, line 17:

Strike the word "cannot" and substitute the word "may"

Page 2, lines 21 - 22:

Strike the words "or on the basis of a producer taking its own production"

Page 3, line 8:

Strike the numerals "100" and "1000 and substitute, respectively, the numerals "1,000" and "10,000"

AGO 533506

Jt. HSE
+ SENATE
Resources
73/74
misc.

Joint Hearing of House and Senate Resources Committees

March 6, 1974 1:30 p.m.

testimony of Milton Lipton

W. J. Levy Consultants Corp.

. . .

our basic theme as to how these various bills may affect the interests of the State of Alaska, gentlemen, and then hope that in the discussion that follows I will be able to do more in response to your questions, be more specific and more direct in response to your questions, rather than try to do an exhaustive job and take up the whole afternoon without coming to grips with the things that are on your minds. So let me start then briefly with this introductory material that I've been asked to discuss. Of course I'm sure that the two things that are most impressed upon your minds are, first of all, the shortage of energy that we in the United States are faced with at the moment, which is sometimes referred to as an oil crisis or an energy crisis and sometimes we are told it is nothing of the sort, but certainly the tightness of the present supply of energy which is available to us first, and second, a very, very sharp run up in the prices that we are paying for oil products and for other forms of energy. Partly in response to the shortages, but partly also in response to what looks to be a long run policy with respect to the value of energy in the United States. So, with these two things in mind, first of all the tightness of energy supply and secondly the very, very substantial run up in the prices of energy,

let me back up and turn to the world scene for a moment and suggest how what's happening in the world inter-relates with what's happening in the United States, and then go on to a look into the future because a great deal of your legislation bears one way or another upon the circumstances of the State of Alaska, not so much today, but in the future.

You know, of course, that there has been a tremendous increase in the price of foreign oil, world wide, and this has been brought about through the actions of oil producing countries, most of them organized in a grouping called OPEC, the Organization of Petroleum Exporting Countries, this is old hat, but OPEC was founded in September, 1960, to defend the interests of the producing governments against what was at that time a sharp decline in the price of world oil. For ten years, from September, 1960, to September, 1970, OPEC was a collective bargaining organization. In effect what it was doing was bargaining with the major oil companies over a share of the producing profits on foreign oil. They bargained successively insofar as they were able to maintain their government oil revenues, even increasing them slightly at a time when the profitability of foreign oil production under the pressure of competition, because of surplus producing capacity, when the profit on foreign oil production was going down. So that they bargained successfully in the sense that the government take, the taxation on oil production, is going up marginally while the profit after taxes was going down.

Now, as from September, 1970, beginning in Tripoli, Libya, and then going on to Caracas, Teheran, back to Tripoli, over to Geneva, there were a whole series of confrontations, enforced negotiations, which transformed the relationship between the producing governments and the oil industry completely. There was no longer collective bargaining over the sharing of the profits. There was, in fact, the ability of the country unilaterally, and really without any negotiation to increase the per barrel oil revenue or the per barrel government take successively and progressively, at a time when the profits remaining to the company was marginally low, so that in effect the government take on each barrel of production became a floor under foreign oil prices and as fast as the taxation on the production of foreign oil increased, world oil prices increased.

Between September, 1970, and October, 1973, in the course of two years, a Middle East oil producing government which, at the beginning of the period had been getting a form of royalty and taxes less than a dollar a barrel, had increased their government take by over $2. a barrel so that it became on the order of $3. a barrel. That is to say, before, getting less than $1. a barrel, they boosted the government taxation on each barrel of production by over $2. This was effected as of early October, 1973, but simultaneously we had the outbreak of the war between the Arab countries and Israel,

This was followed by a cutback in Arab oil production, by an embargo against the United States, and even with the high prices that obtained, there was tremendous competition among oil importing countries and among companies, U.S. companies and foreign companies, to get hold of whatever oil was available. So this competitive pressure for a relatively reduced volume of production boosted offering prices very, very high. As I said, in early October, that added tremendously to the government take. As of January 1 of this year, they announced, without any suggestion of negotiation, that the government take, taxes and royalties on a barrel of Middle East oil, would be increased by another $4 a barrel. So that today a barrel of oil produced in the Middle East starts out with a cost to the companies producing it of $7 per barrel payment to the government, plus 10 - 15 cents per barrel physical production costs. And prices, with a continuing shortage of supply range anywhere, until recently they were as high as $17 to $20 a barrel, being bid for the small volume of oil which could still be bid for on the open market. They are now perhaps back around the levels of $8.50 to $9 a barrel. But without regard to these extreme prices what we are talking about is the floor under the price of foreign oil that begins with the government take of some $7 a barrel.

Now, jumping to the United States, we were faced with two circumstances simultaneously. For some years, U.S. production, the production of crude oil in the United States, had not anywhere near kept pace with the demand for oil in the United States. So that to bridge the gap between the amount of oil we were consuming and the amount of oil we were producing, we had to increase very substantially our imports of foreign oil. And just at the time when we had increased our imports of foreign oil, in 1973, we were suddenly faced with an Arab oil embargo which, as of latter October, cut off the importation of almost 3 million barrels a day of oil -- part of it in the form of crude oil which had come from Arab countries and been refined in U.S. refineries, and part of it in the form of products which we had imported from foreign refineries but which had been processed in those refineries from Arab crude oil. So we were faced simultaneously with a short fall of their imports and with a very stringent volume of domestic crude oil. As a result the price of domestic crude oil was bid up progressively from about $3.75 a barrel to $5.25 a barrel, which was the price when price controls were clamped on domestic crude oil. So we have then the base price for domestic crude oil of $5.25 per barrel and insofar as the government has exempted from the price ceiling, new incoming crude and released crude, that is to say old crude which on a barrel for barrel basis is released from price control as an incentive to produce more crude, and stripper crude,

refining companies have been bidding for access to this available crude, and prices for the uncontrolled crude out of the United States have gone to $10 a barrel and more. Probably at the present time affecting close to 30% of total U.S. production. The reason for the bidding up of these domestic prices was that, despite the fact that we have no physical restrictions on the importation of foreign oil, the volume of foreign oil that is available is limited because of the Arab oil embargo. And so any refiner must compare the price that he would have to pay if he went into the open market to buy foreign crude and then move it by tanker to the United States with the price that he may have to pay by bidding competitively for domestic crude. So what happened in the United States was a parallel to what happened abroad. A small volume of crude oil, a relatively small volume of crude oil, available for competitive offers by refiners who were short of crude, which means that you had at the margin, fantastically high prices bid for whatever crude was available. These then were the circumstances that we have faced over the last six months. Where do we go from here?

First of all, the world at large, that is to say, the majority of the countries of the world that depend upon oil imports for any substnatial part of their energy requirements, are faced with very fantastic foreign exchange costs if they must import oil at anything like the current prices.

Just a few numbers to illustrate the point: In 1972 all of the oil importing countries of the world together paid about $22 billion for all of the oil they imported. Since then, of course, their oil import needs have gone up because of the increase in energy consumption and oil consumption. But, if the oil importing countries of the world all together were to import in 1974 just the same amount of oil that they imported in 1973, their oil import costs this year will be well over $100 billion. Five times as high as they were just two years ago. For the United States, our oil import costs this year, if we import no more than we did in 1972, will be up by about $14 billion because of the increase in oil prices. That would be enough -- last year, 1973, we ran for the first time a billion dollars surplus of trade. An increase of $14 billion in our oil import costs could swing a billion dollar trade surplus to a $13 billion trade defecit. An additional $14 billion of oil import costs compares with total gold and foreign exchange holdings of the United States in our central banks of $12 billion. All of western Europe is faced with an increase in oil import costs of about $35 billion, which is half of the gold and foreign exchange holdings of western Europe. And you know that over recent years, because of

the favorable balances of trade of Europe as against the United States they have been building up their gold and foreign exchange balances and they are faced with a rapid run down of it.

Now obviously there are reverse flows from the oil producing countries who benefit from these high oil prices back to the oil importing countries. For example, with all of this oil income they are going to be buying things from the rest of the world. But if you look at the countries who will benefit from this increased oil income and you consider how much they could possibly spend, given their populations and given the most optimistic economic development plans and the most flagrant expenditures on armaments, it's doubtful if they could still spend enough on imports from the rest of the world, except that they will have surpluses in 1974 -- surpluses of $40 - $50 billion over and above what they can spend out of their oil revenues.

Now the second reverse flow, of course, is reinvestment. What will they do with their surpluses? Well their surpluses have to go back to the industrialized world in one form or another -- in loans, in the purchase of industry or whatever. But I put it to you, that if $40 - $50 is reinvested and the countries that receive that capital back from the producing governments have to pay commercial rates of interest -- 8 - 9% -- After all, if the Arab world lends money or invests money they do this in the expectation of a return. At 8 or 9% rate of interest within a few years the carrying charges on

the money invested back in the industrialized world would come to more than the $22billion the industrialized world paid for all of their oil imports in 1972. That is to say, the reverse flow of capital, instead of being something which provides some form of equilibrium in the flow of funds -- you pay for the oil and pay very dearly for it but you get back money which is reinvested -- but if the carrying charges on the reinvestment, because the magnitudes are so large, mount higher and higher and higher, then all we have are still higher oil import costs and pyramided on top of those are the carrying charges on the reinvestments from previous years.

What are the alternatives? We must anticipate that whatever happens there will be, in the United States and in the rest of the world very considerable retardation, a slow down in what had been historical rates of consumption of energy. Instead of going up at 5 1/2% a year it's got to slow down to maybe 4 1/2% or 4% a year. And that, of course, means lower oil imports because everybody else will do whatever they can to develop coal, to develop gas, to develop nuclear power. So if energy slows down, their oil import volumes will slow down and oil import costs will slow down. But this retardation in energy consumption, slow down in the rate of energy consumption, would by itself, by almost any calculation that we have been able to make, still leave the world with a virtually unmanageable payments problem. That is to say that if oil has to be imported

at anything like present prices on a current payments basis it remains an unmanageable problem.

There is a second alternative and that is austerity in oil. That is to say the rest of the world, not so much this year because this year we are still in a kind of a state of horror at what's happened -- we have reserves to draw upon. The importing countries of the world are competing each with the other hoping that if they have a favorable balance of trade they can use some of the foreign exchange earnings to pay for their oil imports. Everybody is trying to go it alone. We're managing, but if this continues for any length of time. This year the problem is fantastic. The same problem next year would be what's more than fantastic -- incredible.

So we reach a point where the world will be forced to austerity in oil consumption. That is to say to sharply lower levels of oil consumption and have to suffer the impact of that upon their total energy supplies which means also in terms of economic growth. There will be a slow down of economic growth too unless something is done about oil prices.

But between these two cases, one which I called the slow down in energy consumption and the other which I refer to as austerity in oil consumption, the difference could be as much as about 11 billion barrels a day in the total demand for oil by the late 1970s which means in the total production

of oil in the late 1970s, which means in the production of oil in the Persian Gulf or the Arabian Gulf. It depends upon which group we are talking to at the moment. But in the Persian/Arabian Gulf by the late 1970s because these are the people with the reserves, these are the people with the productive capacity, and these are the countries which had been anticipating continued increases in the levels of their production at very high prices. But if there's a difference between the one case and the other of 11 million barrels a day and it all comes out of the production in the Persian Gulf and it all falls on the one or two countries that, under normal circumstances would be the balance wheel and would be prepared to tailor their production to the demands so that there is always relatively high prices, it could make a tremendous difference. And under those circumstances we may well face, for a period of time in the late 1970s, a renewal of competitive pressure in world oil where the productive capacity that has been installed begins again to exceed the demand for oil as it had in the past and in contrast to the present when the demand for oil exceeds the immediately available productive capacity at least under the political producing decisions of the major governments of the near east.

So what I'm saying in effect is that as we look ahead there may be some roll back of oil prices fairly soon

in anticipation of the problems that I've tried to very briefly lay before you. That is to say, the producing countries themselves, visualizing these problems, may be prepared to roll back the prices, somewhat, and if they don't and if they don't roll them back enough, there may be a resumption of competitive pressure which forces prices down in the latter 1970s.

Now, what I'm trying to do is to caution against what is, I think, human nature always, to look at the present and to assume that the future will always be an extrapolation of the present. When oil prices were low people tended to anticipate that they would always be low and go a lot lower. Now that oil prices are very high, to anticipate that the oil prices will not only remain this high but will go higher. What I'm saying is that we're facing the period of time when this may not be the case. And this period of time may be a crucial time if it's the late 1970's because it's a time which brings to fruition a great deal of incoming resources that will be competing with Middle East oil. It's not only the time when you'll be bringing in North Slope oil, but it's the time when North Sea oil will be coming in in very, very substantial volume. It's the time when our own stepped up exploration program under the federal government policy of acceleration of leasing of federal lands may be paying dividends, you see. So during this period we may be facing a price, a competitive price situation and an oil

balance in the world which looks a little bit different from what it looks like at the present time. This is not to say that the long term outlook is for anything other than a basic absence of surplus. In due course the world anyway would consume the volume of oil that could be produced. And in the interim the producing governments will make every effort to see that there isn't productive capacity on the market. So we're looking to an absence of surplus over the longer run, to basically higher foreign oil prices, and that means for the United States high domestic energy values because in the end we will have to place ourselves in the posture where we can produce enough domestic energy to be reasonably isolated or protected against undue dependence upon foreign oil. It may not be self-sufficiency in energy -- that's really not necessary. But we've got to develop our domestic resources so that we are not unduely dependent upon foreign oil and that means paying the prices that are necessary to get exploration for oil and gas going, to get the oil shale program going, but in the interim also to develop the most prolific energy resource that we have available to us in the United States at hand which is coal, to be produced, to lend itself to gasification and in due course even to liquification. So we're looking at relatively high energy values which also means that you are looking to a market in which your oil and gas will, over the period of production, not only the oil and gas already discovered, the oil and gas already discovered will be looking at a market where basic energy values will be relatively high and where hopefully

in the U.S. market it will be protected against what may happen to the competitive pressures of foreign oil. Because the biggest mistake that we could make is to be lured by a temporary weakness of foreign oil prices into giving up our own energy development program. So your discovered energy resources look to high value in the markets to which it will move. More importantly, your potential, your undiscovered resources will be looked at with tremendous interest and with tremendous incentive for investment.

So I really want to conclude these remarks with something which I guess I said to almost every session of the legislature that I've ever been invited to address, that when you consider the legislation that's in front of you you will always, of course, look at what is immediately ahead. You have current production of oil and gas in Cook Inlet, you have the prospective production of Prudhoe which now is within reach when the pipeline is completed, but look beyond that because what you must be thinking about is the tremendous opportunity for the development of the State's resources and that your legislation should be pitched, not necessarily constrained by the least profitable nor so exuberant that it is directed to the most profitable -- but is pitched to what is the continuing potential of the State and the incentives that you want to maintain for continuing exploration and development of your oil and gas resources.

So much for background. I'd be delighted to go on to questions on this later on or now, if you prefer.

McGill: Why don't you finish up now and then go back.

Lipton: I want to turn first to the subject of taxation. The first bill to which I direct my attention, and I won't refer to them by number because what I have are bills that have been sent to me over the last week from either Legislative Affairs Agency or your various committee chairmen -- I may have a Senate number on a bill and you may have a House number and so on -- but it has to do with the proposal for the increase in the severance tax on gas production from 4% to 10%. First, a general comment which is appropriate to all severance or production taxation in Alaska, or anywhere else. A production tax or a royalty on production has to be judged in terms of the relationship between the value of that production and the cost of that production. If you have a 2% production tax or a 15% royalty or whatever the case may be, this is not something which is absolutely right or absolutely wrong. The economic consequences or economic implications of a production tax or a severance tax or a royalty, depends upon what the relationship is in the jurisdiction where the tax is levied or on the lease where the royalty is negotiated between the value of the production and the cost of the production. And if costs are very, very high and the values are relatively low so that there is a narrow margin between the two then a particular production tax or severance tax or royalty may be very heavy

or may be very onerous as compared to another area with the value high and where the costs are relatively low. So I think one always has to judge the severance tax or production tax in the context of the circumstances of the lease or the area where the tax is levied and not by abstractions. So that when I discuss a little later for you what alternatives are in other areas of g' ; taxes and royalties and so on, I want you to bear in mind that anywhere a principle of taxation depends upon price cost relationships where the tax is being levied.

On the other hand, here in Alaska, and with particular reference to the circumstances of energy balances and the demand for oil and especially the demand for gas, I would have to suggest to you that, within limits, the severance tax on gas is a tax that will be passed on. Now passed on to whom? In Alaska, of your marketed gas about half is consumed in Alaska, largely in the area around Anchorage, and about half is exported, liquified natural gas to Japan. The proportions are about the same. Which means that any tax on natural gas in today's circumstances will at least fall as heavily upon the Alaska consumer as it falls upon any foreign consumer. I don't know whether you regard people in the lower 48 states as foreign consumers or not, but in any case, in this case, insofar as it's ing to a foreign country, it's a foreign consumer.

I believe that the contract for the sale of domestic gas here in Alaska stipulates that any increase in taxation paid can be passed on to the consumer. Which means in effect, an increase in your gas severance tax, to the extent that the gas is consumed in Alaska, will be carried by your gas consumer. So that if you increase the gas severance tax in the first instance you are asking the Alaskan consumer to pay. Now what are we talking about? The tax today would be, the minimum tax would be in effect, I believe, on Cook Inlet and Kenai Gas, that would be 3¢ per mcf, that would be an increase, I think, of about 2 1/2¢ over what the current rate of taxation on the gas is. If that's passed on to the consumer, that's how much more gas is going to cost. Now proportionally that may not be very much. I think a residential consumer in Anchorage pays about $1.55 per mcf for gas. Would an increase of 2 1/2¢ mean that much? That's for you to decide. My own feeling is that the price of $1.55 per mcf for gas in Anchorage is already a fantastically high price. But you must judge for yourselves. But I point out to you that under the terms of the contract now in effect the price will be passed on.

On your exported gas, I do not know all the terms of the export contract. I don't know since it's very old, since it was the first liquified natural gas contract that was concluded in Japan, and given the circumstances I don't know whether the exporting companies had foresight, and if they

had the foresight would the Japanese then have accepted an escalation clause. But without presuming to talk definitively given the value of gas in Japan and given the prices that they're already paying for liquified natural gas which they are getting from Brunei, which they have contracted to receive from Sarowak from Indonesia and from the near east, I would guess that there ought to be an opportunity for this to be recovered abroad.

Well now, how high is this tax? Louisiana, which in the light on the increase in the value of all of its oil and gas production, has just revised its severance taxs on both oil and gas, has now established a 7¢ per mcf tax on gas. Your tax will be 3¢ per mcf but their well head gas values are considerably higher and they export a very considerably larger proportion of their gas. Export, that is to say to foreigners and other states in the United States as compared to your proportions.

The severance tax in Texas is 7 1/2%. I think your 10% severance tax, as it is proposed would make it the highest severance tax in the United States for what is also relatively low well head values for gas. Now, any increase in taxation is, of course, onerous. I'm sure you've heard this from the industry and it doesn't matter what figure you come up with and what form of taxation, an increase in the taxes is onerous.

I don't believe, in the light of existing values for natural gas, that a 10% severance tax would be an unduely onerous tax -- in the light of the values of the natural gas -- but if, in fact, the value is high enough to encompass the added taxation, I go back to what I said before. Alaskan consumers are going to be paying a very high proportion of it. I would also like to suggest that, on the basis of past experience, a 10% severance tax on gas is no more likely to be the final resting place than your present severance taxation in oil is going to be the present resting place. So the question is, do you today, in the light of who carries the burden of the passed on severance taxation, in the light of the fact that you may want to be reassessing the level of severance taxation on gas in the future when you have a much larger volume of gas to deal with and a much small percentage of the total gas is consumed within Alaska, that you consider whether or not this is the time when you look upon an increase in the tax on gas as an appropriate decision to be taken by this session of the Legislature. I would also suggest that the only figures which we had from Juneau as to the economic effect in terms of revenue was $57 million in the next decade. That of course reflects, I presume, the severance taxation on Prudhoe Bay gas as well as on existing gas production. Our own guess is, our own estimate is, that the10% tax applied at the present time would yield revenues of about

$3 million a year -- but I'm sure you can check that figure with your Finance Department if you don't already have it.

I think what it comes down to is (1) it's an increase in taxation which is onerous but not unreasonably onerous in the light of gas values, but you also have to look at it in terms of what the present well head prices are and who's going to be paying the increase, who's going to be carrying the burder on this increase in taxation. How much revenue would you get out of it and whether you want now to make an adjustment in the severance tax as compared to waiting until such time as you have much larger volumes of gas subject to production or severance taxation and with a different proportion between internal and external consumption.

Let me turn to the resources tax now. The resources tax, I don't know whether it's referred to as a resources tax in your legislation, this is a tax upon the value of oil and gas reserves in place. It would be an ad valorem tax on the value of oil and gas reserves in place. First of all, this is not a tax on current production. In effect that tax is abated because you get higher revenue from severance tax than you would from the tax on the reserves in the ground. So that it would not, presumably, affect current production. It is not likely to be a tax from which you get very substantial revenue from production on leases which have not yet been made. That is to say, if

you are to introduce this kind of a tax, then, to a very considerable extent, any leasing of State land would draw bonus bids or royalties or whatever the negotiable or bidding terms may be that would reflect the expectations of the companies as to the level of resources tax that they may have to pay in the future. Because what is staring them in the face is that at the moment they become successful the definition of success is a proved reserve. At the moment that they become successful, and to the extent that they prove up reserves, they will be subject to this ad valorem tax on the value of the proved reserve for so many years as transpire until they reach levels of production such that the severance tax payments extinguish their resources tax obligations. So that you would not be getting, in effect, enhanced revenues in the future from production that will come from future leases which have not yet been made but which will be bid upon next year or the year thereafter or in future years. So, in effect, what you are talking about is basically a tax on Prudhoe Bay reserves and from this I infer that it is pure and simply a revenue raising measure. Now this resources tax, when I look at the language of the legislation, confronts me with problems. First of all, what are proved reserves? The companies are having a hell of a time deciding among themselves what the proved reserves are at Prudhoe bay for purposes of unitization. Secondly, we know from all historical experience that proved reserves

are subject to annual revision on the basis of subsequent drilling and even on the basis of producing experience and that revision of proved reserves very often is upward but it can just as well be downward. So you have this terrifically difficult problem of defining what proved reserves are and especially in fields in the early stages of exploration where you may have a discovery well and then you begin to delineate one or two offset wells, it will take a while before you can have a really comprehensive knowledge of what the proved reserves are and this may, in the future, affect the timing -- it's not likely now in Prudhoe, but it may in the future, affect the timing of delineation and development drilling by the companies so as not to subject themselves unnecessarily to a period of taxation on proved reserves and then what is the current discounted value if you can define proved reserves you have to have a current discounted value for purposes of assessment and taxation. In the light of what I've said about the opposing pressures on oil balances and on future prices I would say that anyone who has to determine the present discounted value of future income and therefore has to forecast future prices, and a field can be produced over 15 - 20 years, but even the seven years with a discount factor is relative, anybody who predicts future prices is either a hero or a damn fool. It's something which is so illusive that I think that the combination of having to

define proved reserves and having to project values which provide you with the basis for assessment against which the mil rate is levied becomes extremely difficult. Now, I don't mean to appear here as a representative of the oil industry. Obviously they don't need me. So I must enter one other observation. It's not beyond the reach of the State nor is it beyond the rhelm of reasonability in a sense to assess proved reserves or estimated proved reserves on a nominal value basis. That is to say, even though you may not know what all the reserves may be and even though you don't know what the maximum price may be in the future and therefore what the true market value of the resource is, you may establish a nominal value for tax purposes which provides a certain revenue flow -- and in effect, this is the practice which is followed in many of the tax jurisdictions of the lower 48 states where there is ad valorem taxation on oil and gas reserves. There is a nominal value. But, of course, even there they have a tremendous advantage because there the nominal value is on the assessment of reserves that are also being produced. And, of course, what you're proposing to do here is to establish the nominal value today of oil reserves that may not be produced for another three to four years. This is a very difficult thing. So I would raise all of these caveats. Now, as I said, if this is a revenue measure and it is the intention of the legislature to touch this source of

revenue, it can be done by virtue of a nominal assessment even though you can't get at either true proven reserves or true value. But I think you must very carefully weigh this form of taxation, resource taxation, which has not only implications for a tax directed at the specific oil pool, namely Prudhoe Bay, for future leasing of State lands, but also I think to weigh it against all of the other tax alternatives which are available to the State. And, I don't know the circumstances of the State that well or how intense your revenue measures are or what your alternatives are but I would suggest that, in view of the difficulties with this form of a tax, that you look with a very very hard and careful eye at all the implications of this tax and the problems of administration of this tax before you decide that this is the form of revenue raising that you choose to enact in preference to any of the other alternatives that are open to you.

Third, let me turn to the State income tax and the proposal to eliminate the percentage depletion allowance in the computation of taxable income subject to your State corporate income tax. Those of you who recall my testimony before the special session when this was not an issue will also recally that I gratuitously suggested to the legislature in as strong language as I could, although it wasn't relevant to the special session, that you should at an early date review your State corporate income tax from many different angles. It is our feeling that the way your State

tax operates, namely that as a taxable income being the determinant on a formula basis from what is taxable income under federal statute, that is the allocation of income to the state, and then assessing the state rate 18% of the federal rate that was then in effect when you enacted your state rate, that this really doesn't come to grips with what will in the future be the pressing problems that you will be confronting especially when it comes to the taxation of corporate income from oil and gas operations. That you have to identify, you must be able to identify the income that is generated in this state and identify it directly, not by apportionment. Secondly, that income has to be within reach of your tax authorities. Third, you've got to have your own state policy with respect to what costs and expenses are allowable under state law for the determination of taxable income that is earned in the state and which is subject to the state corporate income tax. You may want to look at your corporate income tax rate structure to see what seems to be appropriate in the light of the profitability of corporate enterprise here in the State of Alaska. You have really a broad, I think, a broad range of questions to which you should direct your attention since you have on the books an income tax, corporate income tax law that was enacted some time ago under very, very different circumstances and without any thought that it would have special applicability, particular

applicability to new industries coming to the state that are most likely to have a level of profitability, a level of profit which far exceeds that of any other corporate enterprise in the State of Alaska. I think you would want to look at your corporate income tax from that standpoint. Now, when it comes to the elimination of percentage depletion as one item I wonder why this: why this one aspect of what really should be a broader range of questions to which you could direct yourselves? Again, if you eliminate percentage depletion I think you would have to make some estimate as to what effect this would have -- this is a very difficult thing because you are still operating under an apportionment. What you look at really is not how much federal taxes a company operating in Alaska paid. What you look at is that line on the corporate income tax statement which defines taxable income under federal law. Now the corporation may pay -- we have a federal income tax rate for corporations -- but oil companies may pay a much lower rate on that taxable income by virtue of offsets to the federal tax such as foreign tax credits, or investment credits, but there are a whole host of regulations under our federal income tax law which affect this critical line of the corporate income tax statement, namely, corporate income subject to federal income tax. And it's that line which then gets your formula put against it which has to do with the proportion of assets in the state, the proportion of salaries, and the proportion of expenses in the state translated into taxable income in Alaska. But there are so

many things under federal law which is why I feel that you really have to look at a -- take a fresh look at your state income tax law and look at a direct determination of taxable income earned in Alaska rather than the apportionment of the federal taxable income even with this adjustment. I don't see the particular applicability of this adjustment again, unless it happens to be a revenue raising measure. A change in a depletion allowance in the State of Alaska where it doesn't exist elsewhere in the United States would, like any change in taxation, have an effect upon the value -- the future value of your resource for which there will be competitive bidding when you open up the resources, there's no question about that. I wouldn't have the foggiest notion to what extent one can transfer this in numerical terms. I don't like to go on record before this legislature in always coming back to the idea that any change in taxation here in Alaska is going to cause a slow down in exploration or a reduction in future value of your lease sales although they always have that effect, but I don't think that this depletion allowance per se for the amount of money that may be involved would be enough to distroy exploration incentives. I just would suggest to you that you look very carefully as to the reasonability at this time of this particular measure as compared to a broad side review by your Finance Department or on the determination of the legislature of your whole state corporate income tax.

Let me move on from taxation to the policy with respect to royalty oil and gas and the regulations affecting pipelines which may affect the way in which you use or dispose of royalty oil and gas. First of all, and I don't want to dwell upon this, I've spent so much time on this in the special session that I hope that when my name is heard this statement is associated with it: The right and the determination of the state to be able to take royalty oil and gas is absolutely basic to your regulatory process. That you have established regulation over oil pipelines, you have established the Alaska Pipeline Commission and that, insofar as there is dispute over the relative respective jurisdictions of your Pipeline Commission and of the ICC the state is in a position to move royalty oil through that pipeline in intra-state commerce which makes that movement of the oil subject the jurisdiction of your Pipeline Commission which means that it has jurisdiction over all aspects of the pipeline operation for the movement of intra-state oil including the determination of tariffs. We've gone into that. You've got your regulatory bill, perhaps it is not as strong as you might have wanted it, but you've got it on the books and I think that the access to royalty oil and gas and the state's ability to take it in kind and use it intra-state is what gives the firm jurisdiction to your regulatory bodies. Now, beyond that

I think the availability of royalty oil and due course of royalty gas can be a very important factor bearing upon industrialization in the state of Alaska. If, over the long run, and without regard to the ups and downs of supply balances and prices -- energy prices -- if we are going to be faced with, as it now looks, with an absence of surplus, it is not an actual shortage but at least an absence of surplus, then companies that depend on oil or gas for their operation, whether they are oil refiners or petro chemical companies or other industries which are intensive users of energy, and must be insured a continuing flow of energy before they make a very great investment are now looking more and more to those areas where the availability of oil and gas itself becomes critical to the investment decision. You know, in the lower 48 states today we are desperately short of refining capacity. Desperately short. Eight months ago the Federal Energy Office put out an estimate of the volume of refining capacity that would be added by 1976. They did this on the basis of announced plans by various refining companies, and they came up with a figure of about 3.6 million barrels a day added refining capacity in the United States by 1976. I doubt very much if there will be a million barrels a day of added refining capacity in the United States by 1975-6 because how does any company

put the fantastic amount of money into major refinery expansion let alone a grass roots refinery where you start from scratch, with all of the environmental problems -- how do you do that unless you know that you have a guaranteed source of crude oil to process in that refinery? And where today can you get a guaranteed source of crude oil for that refinery? Which is why there is a parade of American oil company executives across the sands of Arabia going to the government of Saudi Arabia and to Teheran going to the government of Iran, looking to these governments to ask them to commit, to guarantee government crude oil to U.S. refineries or to U.S. petro chemical plants so that they can make that investment in the expansion of capacity. And price is always a problem because it bears on competition but today the guaranteed source is a tremendously important factor. I put it to you that Alberta already is beginning to develop a petro chemical industry in Alberta on the basis of the availability of gas which the province can guarantee because, unlike the United States, in Canada inter-state inter-provincial commerce is not under the jurisdiction of the federal government. Alberta has the right to determine how much shall be exported from that province elsewhere, which no state in the United States can do. But on that basis, by being able to commit gas and oil in Alberta for domestic processing, is being able to build a petro chemical industry in Alberta wherein Ontario and Quebec, much closer to markets, the petro chemical industry has always suffered in the past because they couldn't compete with low cost

feed stocks on the U.S. Gulf Coast. But this is not low cost oil and gas which Alberta is committing. What they are using as the basis for industrialization is the commmitted availability of gas feed stocks.

Louisiana has been offered, as the basis for the establishment of a large new refinery, a price above the going price for crude oil if Louisiana would commit 100,000 barrels a day of royalty crude to a refinery.

So I submit to you that your royalty oil and gas can be a tremendously valuable asset for a reasonable program of industrialization where that kind of investment in industrial capacity depends upon oil or gas feed stocks or upon the availability -- assured availability of energy.

I'm not trying to suggest that Alaska is suddenly going to become, over night, a second Pittsburg or a second U.S. Gulf Coast. What I am saying is that price apart that the availability of your royalty oil and gas and the willingness of the state to commit it in return for investment in the state is tremendously important.

With respect to the way in which the pipelines transport royalty oil and gas so that you are able to insure transportation services and to insure offtake at whatever points serve the major interests of the state, it would seem to me that the interests of the state are reasonably well insured by the combination of provisions in your Right of Way Leasing Act

and in your Alaska Pipeline Commission, your regulatory act. But then, I'm not a lawyer and I would not look askance at any attempt by the legislature to try to strengthen those aspects of your two bills. I would say that insofar as the industry submits to you that it is already required by statute or by terms of the lease to do this, then they should not really object to your going a step further to insure what you already have the right to do is doubly insured. But then, again, I'm never here as a spokesman for the industry. I could never quite understand why the industry opposed your regulatory bill, for example. It seemed to me, when I saw the action of this legislature to the industry, I would think that they would look upon your Alaska Pipeline Commission as their greatest safeguard against the action of the legislature because your Alaska Pipeline Commission is constrained to administrative proceedings, their hearings, every decision is subject to judicial review -- I would think that the Alaska Pipeline Commission is as much a protection for the oil industry as it is for the State of Alaska but somehow they didn't see it that way. Similarly, I would think that insofar as they submit to you that they are already bound to do all these things which you may ask them to do that they should not object If you are slightly skeptical about the extent to which you are bound and you want to strengthen the legislation. Now the only reservation I have in this is that you don't go in for an over kill. That is to say

the only reservation I would have is where the legislation may require in advance a level of expenditure in the course of construction which exceeds by far, by far, the costs that might have to be incurred if, after construction for example, they were required by law to make whatever connections are necessary. Now I'm not suggesting that this is the case. But what I am saying is that the only kind of over kill I could visualize is, if out of the process of strengthening your legislation and providing certain additional authority -- manditating your government to do certain things -- and providing authority to your Alaska Pipeline Commission to submit to Alyeska for example, certain stipulations that have to be met in the course of construction, I think you'd want to have some idea of what the additional costs of this may be as compared to making those connections in the future from time to time and from place to place as they may be required instead of providing in advance for the prospective connections in so many instances that perhaps may or may not be used. I think that I would want to be cautious about that aspect.

Now, on one other aspect of the disposition of royalty oil and gas, I think that certainly it is incumbent upon this legislature in developing a policy with respect to the taking of royalty oil and gas in kind to protect in every conceivable way what will be the long run interests of

the state. Certainly you want to make sure that all oil and gas which can be constructively used within the state will be used within the state rather than exported, which means that this is one of the criteria that you want to set down as the basis for any sale or disposition of royalty oil or gas.

But one caveat here, and again it goes to the language of your legislation, what are the criteria of Alaska state interests in royalty oil and gas? I suggested several of them as we went down the line: to make sure that you have oil and gas available for energy; to make sure that you have prices for oil and gas in the state which are commensurate with the well head values of oil and gas and don't far exceed these things, so that your prices here are commensurate with your own resource cost; that you have oil and gas available for industrial development -- what kind of industrial development -- there may be a string of alternatives. With a wide range of criteria there has to be, it seems to me, some administrative latitude in judging what dispositon of oil and gas is in the best interest of the state. It's not quite the same thing as an oil lease where you say, well, this is the block, these are the coordinates, this is the acreage and everybody come in and bid the highest bonus. I don't think it always follows that the disposition of 100,000 barrels a day of state royalty oil to the highest bidder, with no other terms considered, is necessarily in the best interests of the state. I don't think it necessarily follows that the 100,000 barrels of oil a day should go to the highest bidder who commits to refining it in the state is

in the best interests of the state. I think you may want to look at what he does with the products that are refined from it. And you may not always be able, in terms of the economics of projects, to say that everything which comes out of the refinery, whether it's a finished product or whether it's potential petro chemical feed stocks or whether it's a heavy fuel oil, must all be consumed in the state of Alaska. I think that you must look at all of this. So it's difficult to put it on a purely competitive bid basis. I think you must provide a certain administrative discretion in determining what is in the state's interests. Now this is a hell of a burden to put on the administrator because it means that he's always going to be second guessed by the legislature but this is true of virtually all administrative discretion. It just may be that in this particular interest more dollars and cents will hinge on the decision than is normally the case. But I do suggest to you that administrative discretion is tremendously important in affecting what, in the decision of the legislature itself, are the essential criteria for what is in the best interests of the state of Alaska.

Now let me finally turn to the very interesting discussion that I've been reading at a distance as to the alternative routing of the gas pipeline for the disposition of Phudhoe Bay gas. And here I must give you a specially tentative thought

at this stage in the game, because, in fact, I haven't really been exposed even to all of the information which is available to your legislature, and, in anticipating what my conclusion is going to be, I think that you have very, very scant information available to you.

1. From various points of view, there is very little question that a trans Alaska gas pipeline is very much in the interests of the State of Alaska. I don't know whether you still accept me as an honorary citizen of the state of Alaska but I have the habit of thinking as an Alaskan and it's not difficult for me to put them down. First of all there's the investment during the construction period and the employment which takes place -- this is not just the direct employment and the wages but everything else which comes with it -- and the very obvious concerns of the state about what happens after Alyeska is completed and you have this very peaking of economic activity -- well your gas pipeline gives you a certain ability to continue this level of related economic activity.

Secondly, hopefully you would get the advantage of relatively low cost gas for Alaskan consumption. But here I've got to enter a caveat -- a warning -- You can't really be sure that North Slope gas which reaches Fairbanks or which reaches other parts of Alaska, more populous centers, via the terminal at Cordova or via taps somewhere else along the line will, at that time, represent low cost

energy. Because, for Alaska, what you must compare is what will then be the delivered cost of North Slope gas, against 1. what will be the energy cost of oil which can be used as an alternative to gas. For example, on a btu basis 15¢ gas is equal to 90¢ (15¢ per mcf of gas) per barrel of fuel oil. So if you have 15¢ gas that certainly is a bargain compared to any present or anticipated future prices of fuel oil. But if you start talking about $1 gas, and you don't have any consumers in Alaska today that pay 15¢ for gas, when you start talking about a $1 gas you're talking about a $6 oil. And when you start talking about $1.50 gas you're talking about $9 oil. So you must not automatically assume that North Slope gas delivered into consuming centers of Alaska will automatically be a good energy buy as compared to the products derived from crude oil.

Secondly, you don't know by 1977-8-80 at which time there would be via trans Alaska route a major flow of North Slope gas, what the gas availability may already be in the south. Because between now and then there will presumably be extensive exploration elsewhere in Alaska. I go back to my old theme that with the resolution of the land claims and with the opening up of land -- resolution of the pipeline project -- we can expect over the years ahead a very substantial amount of exploration in Alaska, including the first federal lease probably next year in the Gulf of Alaska. Now here you may have proximate sources either of oil or of gas so you must think of what the cost to an Alaskan consumer may be, particularly in south Alaska, of North Slope gas

brought down compared to gas that may be available from closer in locations in the south.

Then, still on the subject of Alaska state interests I refer to the availability of gas as the basis for industrialization. If you were to take your royalty gas 12 1/2% of 1.6 billion cubic feet per day, which is the presumed volume of gas flow if you were taking the maximum amount of associated gas at 2 million barrels a day Prudhoe Bay production, and I'll have so many questions about what's been put before this legislature as the so called facts, will there be 2 million barrels a day out of Prudhoe Bay to which you put an 800 gas to oil ratio, because you may only have about 1.2 million barrels a day of oil production out of that Prudhoe Bay field with that kind of an associated gas ratio so that you would have less royalty gas. These are questions which are very much up in the air and I think that you must be very careful not to take at face value numerical representations that are made in one instance or the other -- but if there were 1.6 billion cubic feet a day at 12 1/2% that's 200 million cubic feet a day, that's well above the total gas consumption in Alaska today. Now, of course, your gas consumption will be going up over the interim period but so will, hopefully, gas production from other sources.

200 million cubic feet a day of gas for residential/commercial purposes, and partially committed for industrialization, could be a hell of an attractive chunk of energy to put on the market. This goes back to how your oil -- royalty oil and gas can be used for industrialization. So, yes the construction and employment factors, certainly the hypothication of royalty gas as a basis for industrialization, potentially low cost gas to consumers with a warning sign against that because that you would have to judge in the future -- one just doesn't know.

The next point: Now we start moving away from the things that are more obviously in the interest of Alaska and moving on to some of the more questionable areas. There's been a considerable discussion before you in previous hearings that I've had the opportunity to read about the significance of transportation costs to markets, debate over respective transportation costs, and discussion over what the value of gas would be in different markets and whether the value of gas in different markets would matter anyway, or whether your gas will be so valuable no matter where it goes that any tax you may put on the gas will be passed on to consumers in any event and therefore you don't have to worry about what route it takes or what the transportation costs are -- you put your severance tax on the gas and that will be passed on. That's not necessarily true for the royalty value

incidentially, but I want to make some comments about that. At the present time -- well, historically the Federal Power Commission had based the well head price of gas on an area pricing formula that was related to average finding and development costs of gas throughout the area plus an incentive factor. This was the price regulation of the Federal Power Commission. In effect they were placing a ceiling on that gas and the reason that they placed the ceiling on the gas was their concern that at a time when there was a lot of gas available compared to the demand for gas, these were in the early days of the expansion of gas transmission lines and gas consumption, their concern that there would be a lot of gas available and it should go at a low price, but that the fact that there were few dominant producers of gas might lead to a higher than necessary price at the well head -- that was their concern. Now the effect of depressing the value of gas at the well head was to so stimulate consumption of gas because it became a bargain among all energy prices -- to such a low price that we expanded our consumption of gas at a faster rate than any other energy source and we are now left with this huge gap between the amount of gas we would like to use and the amount of gas we have and we're faced with this nonsensical alternative of finding enough gas to bring the supply up to the demand no matter how much we have to pay. So the demand is there because it was cheap at first and now, no matter how much we have to pay to meet that demand -- well obviously the answer is that the demand has got to come down.

Also the price of gas has got to come up. And the way that's beginning to happen is by raising the value and the price of gas which the Federal Power Commission already has by allowing for new gas, higher than area prices, that is to say, companies can now negotiate with sellers over the price of new gas, and unless these are outrageous prices they will be approved by the Federal Power Commission. So we have already had the first unhinging of lower 48 gas prices from what has been area cost -- an area cost basis. We already have prices which are beginning to reflect better the value of gas rather than the cost of finding and producing the gas. Obviously providing incentives for more and more exploration. Now are gas prices, therefore, going to be decontrolled? Well, I think at the present time there would be great concern in the United States among consumers and among the r representatives in Congress that if there were no control over the price of gas that the price may go up fantastically because of the position of the dominant buyers in the market place. That is to say bidding, competitive bidding up of the price of gas well above what may be, over the longer run, the cost of finding and producing it. So that I think that there's a very real question as to whether there will be complete decontrol of gas, there may be a change in the administrative criteria so that we get more away from the cost basis and get more on to the value of gas and incentives for exploration. But, for example,

would it really -- as I say I think that there is a good chance that there will be a change in the nature of FPC gas pricing policy but I would say a very sharp political debate over decontrol as a whole.

Now if it comes to North Slope gas, would it really be acceptable to the Federal Power Commission if two competitive pipeline groups, El Paso that wants to build a trans Alaska line, liquify and export elsewhere by tanker, Arctic Gas which wants to move by pipeline through Alaska, through Canada and into the Great Lakes area -- would it really be acceptable that these two groups simply go out and compete with each other to contract for that gas supply of Prudhoe Bay? In terms of what is U.S. policy as to how our limited supplies of gas shall be used in the future and at what price it shall reach consumers. I submit that the Federal Power Commission is going to be very, very deeply involved in an evaluation of the alternative routes in two separate contracts. One, since the alter .tive routes would move the gas to alternative regions of the country what effect will that have on the over all disposition of gas within the United States, given the total supply that is available and what effect will it have on regional gas costs?

El Paso made a very good point that if their gas moves to California that West Texas gas which normally would otherwise have to go to California could be backed out and go to the Great Lakes area. But by the same token if North Slope gas

goes to the Great Lakes area, West Texas gas which flows through a variety of pipelines into the Great Lakes area, could also be diverted through the same or through alternative systems to different parts of the country. The Federal Power Commission is going to look at the effect of alternative pipeline routes upon the total disposition of gas and upon the effect upon regional costs and prices. And I think that you will find as a matter of necessity a far more intensive presentation of data before the Federal Power Commission by anybody who wants to build a pipeline to transport North Slope gas than has been thus far made available to this legislature. I think that the Federal Power Commission, as I said, is going to exercise an intensive degree of jurisdiction in this matter. I think you will learn from the hearings but I think also that the State of Alaska is not without reason to lay before the Federal Power Commission those things which are of intensive matters of interest. That these shall be relevant along with all other considerations in a Federal Power Commission decision. So that there is an area of concern for your here and I think that you must put yourselves in a posture where you both learn from the proceedings and you become a party of interest to the proceedings so that what is of concern to this state is made available to the Federal Power Commission.

Now, on that basis it seems to me, and just since I'm going to be asked this question I might as well anticipate it, I think, in my judgment, on the basis of the information that is available to you, I would not feel that an act or a joint resolution of this legislature in favor of one particular pipeline is highly merited just on the basis of what's been laid before you. That for you to resolve what the interests of the state are is one thing but to make the blanket decision like that goes a bit too far and I think that you would be well advised to wait a bit and both take advantage of the progressive disclosure of information as well as the opportunities to make the state interests heard.

But I've taken more time than I had anticipated and I think, have said the things that occurred to me as meaningful I really ought to give you a chance to decide what you're interested in and put your questions to me. Thank you for your patience.

Rep. McGill called a recess.

McGill: If anyone has any questions for Mr. Lipton will they please just let me know and be recognized.

Sen. Rader: Mr. Lipton, the interests of Alaska and the alternate gas pipeline routes -- from the testimony we've heard it seems to us that both the contenders will be presenting their arguments to the Federal Power Commission starting this summer. They expect the Federal Power Commission to make a decision within nine months to eighteen months perhaps, after they present those arguments. By the timing of that, if they present their arguments starting in July or June or August, and the state has no position, perhaps the Federal Power Commission will have completed its substantial deliberations before the legislature should get back in session. Which would mean that, if we took no position at this time that we might be too late to take a position at a later time, recognizing that we can be a party and then leave it up to the executive branch of the government to state a position for the state as we go along. Is there any alternative to that in your mind? As I take it from what you say based on the information that we have it would not be fair to go forward. If we wait, we may have waited too long as a legislature.

Mr. Lipton: Senator Rader, I see no difficulty with the legislature taking a position on those aspects of the gas pipeline which are directly and visibly relevant to the state of Alaska. That is, why, with respect to these various points

that this would be of importance to the state of Alaska. But this is a different thing from an enactment by the legislature which says that the State of Alaska whole heartedly supports one particular pipeline application. There's a difference between expressing the interests of the state -- now this can be done through joint resolution. I presume that in the absence of the legislature in session you have an executive department which is not exactly blind to the interests of the state and so on. But I just think that it is a bit previous to go on record without reservation, saying that, weighing all considerations -- and a lot of them may not be visible to you today -- the State of Alaska supports one particular pipeline application.

Now I appreciate the need on the part of one particular group to want very much the most unequivocal act from this legislature as a means of persuing its interests. I guess I read in the testimony that this is necessary to get the concurrence of the Board of Directors of the corporation. Most boards of directors find that the acts of the legislature of Alaska are anathema to them. It's nice to know that one board of directors wants a positive act out of the legislature of Alaska. But in the light of all of the uncertainties that are involved, it is very, very difficult for me to understand that the El Paso group, for example, is not prepared to pursue their application without -- and I'm not speaking for them -- please don't interpret -- without this act from the legislature which, even if they have it the whole thing still falls within the purview of the Federal

Power Commission and, when it comes down to it, knowing what the hearings before the Federal Power Commission are, that this one act of the legislature will weigh so heavily in the balance that it motivates the board of directors in advance. I can't speak for them. And if you're told that you must accept it. But I feel that for you to go -- I'm speaking at too great length -- for you to go on record as to what the interests of the state are, what the interests of the state are is one thing. For you to go on record unequivocally, without exposure to all the other pros and cons as endorsing without reservation one application, I think would be moving precipitously.

Sen Rader: You're not speaking too lengthly as far as I'm concerned. It seems as though it is difficult for us to state our interests unless we have some idea of the relative costs, for example. If you did read the testimony it's highly disputed as to what the cost would be going one way or the other. Only thing I guess we can say is that Alaska would like to see it come through Alaska providing the cost of that method of transportation is not exorbitant as compared to alternate methods. Can we say any more?

Mr. Lipton: I don't even think you have to say that. I don't think that the question of respective transportation costs . . . (break in tape) does not necessarily mean that you are saying that you are prejudging everything else including transportation cost, the effect upon supply balances in the lower 48 states and everything else. Somebody else

will decide that. This is your representation to the FPC or to anybody else who's concerned with what the interests of the state of Alaska are.

Sen. Salides: My concern is the binding effects clause, Mr. Lipton. One of the pieces of legislation in the Senate now calls for a possible lapsing of the binding effects clause. I would be interested in knowing whether we should, for perhaps three years is too short, if it should be a longer period of time permitted, or perhaps we should forget about the binding effects clause all together. That it is maybe better in than out. Would you give us your comments?

Mr. Lipton: I beg your indulgence. I would like to pass on that question now for two reasons. One, not being a lawyer I may even be inclined to pass in the future, but I haven't had a chance to look at that aspect of it. I only got the material very recently and I would at least like to think about it. But at this point I just don't feel that, lawyer or not a lawyer, I could make an intelligent comment.

Sen. Salides: Thank you very much, sir. I know that, and I must apologize for having asked, because I know that the material did get to you only this morning as a matter of fact.

Mr. Lipton: I'd really like to read it carefully.

Rep. Parker: I have a question Mr. Lipton on the oil depletion allowance -- the deduction from our state income tax. And I can't quite get it through my head why it strikes you as a strange place to start in reforming our corporate income tax laws in Alaska. As you pointed out, the level of profit and profitability of that industry is pretty unique among

the corporations at work in Alaska and with the background of what's happening on the national level as regards the oil depletion allowance it seems to me that that's a good place to start here. Why do you find that narrow?

Mr. Lipton: First of all, let me just say that I'm not sure that the oil and gas industries profitability in Alaska over all at this stage in the game is in any case unique unless it is for the fact that they are spending a hell of a lot more money than they are taking in at the present time. So that I don't think that -- the uniqueness will come about when you really start getting major exploitation of Alaska's reserves and therefore you basically have time to look at it. But the reason that I said that I thought that it was -- that I wondered why this was the place to start is that there are so many aspects of the transition from taxable income at the federal level and taxable income at the state level. There are so many things -- how you move from a to b that ought to be looked into -- that why seize upon the depletion allowance as just one aspect of it and if you do how much does it really mean in terms of current production? Will it not then be a temptation to forget about the very basic problem which is to review the whole state corporate income tax legislation. Why the rush to get to it now in anticipation? So that what I'm saying is that it is difficult for me to react positively to it at this stage in the game when you put all of these things together. Now I don't know if I'm responding directly to your question. I'm not trying to avoid anything. But the basic thing is that

aside from the fact that you may be able to calculate and even then I think it's very, very difficult -- I don't know if the calculation has been laid before you -- what the effect would be upon corporate income tax payments here in Alaska if you eliminated percentage depletion. Has that been submitted to you by the Finance Department? Has anybody made an estimate of that?

Rep. Parker: We have several estimates.

Mr. Lipton: That's interesting. It's very, very difficult. It's incredibly difficult. How do you isolate the companies operating in Alaska and determine really what -- you see you must know two things -- you must know what the effective rate of percentage depletion is that these companies claim on the federal income tax. That's very difficult to find company by company -- if not impossible. And secondly what happens under the allocation process to their taxable income at the federal level by the time it gets translated into taxable income at the state level, in view of the allocation process. That's why I say that this is one minor aspect in what ought to be the major preoccupation of your legislature over a reasonable length of time if it's carefully studied.

Rep. Parker: Mr. Lipton, how do you account for the fact that -- of the federal thrust to change this law now?

Mr. Lipton: Oh I think . .

Rep. Parker: The point I'm making Mr. Lipton, and my understanding of this is that -- not that deep as you've probably caught on. But it seems to me that if we have a deduction

which is questionable even on the national level and if the state is as as we are in looking for ways to come up with new money just to maintain our budget, that this is the natural place for us to start. There is a chance that this is needed to start with on the national level and, it seems to me, that if we wait for the federal program to move we put ourselves in the position of subsidizing the companies here when we simply can't even pay our own bills.

Mr. Lipton: First let me say that there's nothing in the nature of your question to suggest that you haven't exposed yourself pretty thoroughly to this subject. There are many moves afoot to change federal legislation. One has to do with foreign depletion -- there's an obvious reason for that. Why provide certain tax advantages for people to explore abroad as compared to in the United States. There's a move to eliminate depletion on domestic exploration on the grounds that it has not done the job that it was set up to do. In other words it hasn't provided the incentive to domestic exploration. And instead of having special tax advantages through domestic depletion, let's get rid of it and if necessary let the prices go up to a level to compensate for what would have been the savings through percentage depletion. We ourselves have very strongly urged that at the federal level and you might want to consider this at the state level, that in effect you take percentage depletion which has not been a powerful tool for spurring domestic exploration and convert it into earned depletion. That is to say that up to whatever level of percentage depletion is a statutory level, 22% now or the

industry wants it to go up to a higher percentage, some legislators in Washington want to reduce it -- but whatever the statutory rate of depletion is, that that amount of depletion can be taken only to the extent that the companies in the taxable year have invested money in qualified exploration. In other words they've earned the depletion. Incidently Canada has that law. Canada has a 33% depletion rate -- percentage depletion allowance -- but you get it only if you reinvest in exploration. Now you may want to consider that here in Alaska to the extent that both taxable income is allocable by formula and therefore depletion is allocable by formula and that that depletion will apply only to the extent that it is invested. I don't know. But if you're arguing about the pros and cons of the depletion allowance we would have said that depletion makes more sense if you earn it than if it just goes by the boards. Now there's a third proposal before the House committee in Washington to escalate the percentage depletion downward as the price of oil goes upward. So there are many many things and I think that the main thrust, of course, has been against the fact that the depletion allowance has represented major savings in taxation for the oil industry which might not have been so bad if a domestic exploration had taken place. Obviously it had not. So there's a question as to how effective it is. But I certainly don't want to make a case for your subsidizing oil companies by

virtue of foregoing taxation up here. Quite the contrary. What I'm saying is that you have the time, in view of the minimal impact that the elimination of percentage depletion is likely to have for the next few years, to look very carefully into your whole state income tax law.

Sen T. Miller: Mr. Lipton, I thought your comments regarding the position of the Province of Alberta were interesting with reference to its own gas and oil reserves. I think just a general conceptual question if I may, sir. Do you, on the national level, given the energy picture in the United States today see any pitfalls or danger signs for Alaska to watch for as an oil producing state as opposed to those in Congress who represent the oil consuming states, in terms of, for example, the possible configuration of whatever development we might try to do with our royalty oil and royalty gas. Is there a possibility, through possible mandatory allocations or lids on the amount of money the state can take from its resource. Are there dangers of these being imposed by the federal Congress in any way or do you see any problem in that area at all?

Mr. Lipton: Senator Miller, I don't want to forecast what public policy is going to be with respect to allocations for example. But I don't think that it's in the nature of our energy and oil balances over the years ahead that we are going to have for a long period of time, by which I mean into 1977-8 continued allocations. We may have but I would doubt it very much. I think that what's happening today is in response to

the acute supply problem that arose not only over the lag in the domestic availability but also the Arab oil embargo and a combination of circumstances plus the fact that we had fantastic increases in energy and oil consumption very rapidly which are bound to be leveling off over the years ahead. So I don't think that, aside from your problem today about how you fit into the allocations game, I don't visualize that you'll be faced in 1977-8, when oil and gas becomes available out of Prudhoe, with the possibility that the federal government is going to be worrying about your preempting additional supplies over and beyond what a national allocation scheme is going to be. But I could be wrong.

Now the other thing, constitutionally there are limitations on what the state of Alaska can do. For example, you can't have differential taxation on gas produced for internal consumption vs. gas exported. You can't interfere with inter-state commerce. By the same token I don't believe that the federal government constitutionally can qualify or circumscribe what the state does with its own resources so long as its not discriminatory.

Rep. Randolph: Mr. Lipton, in light of the energetic activity of the special session in the area of taxation and in light of the very rapidly changing situation and the fact that we don't see any great increase in our production in the next three years, would you give your opinion as to

whether this is the right time to be considering any significant new tax measures or maybe we better let things cool off for a year or two and take a long hard look at it and then when we do get production on the line, when it does mean something to us in dollars and cents, be ready to do whatever is appropriate then.

Mr. Lipton: Well, from the standpoint of industry obviously no time is a good time to raise taxes. From the standpoint of the state's revenue needs, almost any time is a time when you have to consider what you can get in the form of taxes. But if you're looking at tax policy I think that I would repeat what I've had occasion to say very often, I think that continuous amendment of your taxation is really not to be recommended. Now the temptation is always to do it because of your revenue needs and I can again say that that is a pressing problem that confronts every legislature -- even that in my own state -- but the assumption always that the last amendment to the tax whether it's an ad valorem property tax as you enacted, a special ad valorem property tax as you enacted in the special session to provide for your revenue needs which now seems to be insufficient, or the amendments to the oil severance tax which set up a new schedule different from the previous schedule or a change in the taxation on the gas with the idea that somehow you were coming to a new correct level of taxation -- I think is a mistake. There are times when the future is more

visible and there are times when it is less visible. And really what you're doing with your taxation, especially the severance taxation now, is working with a relatively small volume of state oil and gas production and, as I said in the case of gas production, half of it is consumed within the state. I would always urge against tax changes unless they are impelled by revenue needs where you've carefully judged all of the alternatives or where they are in a sense induced by major changes in the oil environment which make it very appropriate. Now, whereas I said in the past in talking about the oil severance taxes and royalties that anywhere the relation between prices and cost is an important factor as to the appropriate level of taxation or royalties. It also follows that in the last two or three years we have had a complete change in the historical relationship between oil and gas values and costs of production. A complete change. And the old, the magic royalty number 12 1/2% or the old levels of severance taxation which had obtained in the past are obviously looked upon by legislators everywhere as well as by sheiks and shaws as no longer appropriate to the changing circumstances because of the tremendous increase in the value of energy that has taken place. But you in Alaska, I still think, have time before you must make the next step of decisions excepting in so far as you must submit yourself to the pressure of revenues and then you balance very, very carefully all of the alternatives that are open to you.

Rep. Huber: Mr. Lipton, when you were talking to us about our income tax structure were you talking strictly from the present law on the books or were you also referring to HB 177 which I thought may have been called to your attention.

Mr. Lipton: I was talking entirely about the law that's now on the books. HB 177?

Mr. Huber: There's been a great deal of discussion on this floor in the past week and I'd just like to request that you look it over before you leave town.

Mr. Lipton: I'm sorry, I have not had a copy of 177 before. It's just been given to me and I will of course look through it and answer your question at a later time.

Rep. Meekins: Mr. Lipton, on 171 that doesn't have anything to do with oil and gas. It's the amendment proposed to put the depletion -- to take off the depletion allowance

state income taxes. You were talking about incentives -- if you tax oil in the ground then you would change the time table for some things and I was wondering -- part of the tax schedule on the depletion allowance and things seems to be giving incentives for different things. Isn't the current situation likely to give great incentive disregarding what the state of Alaska might do -- overriding incentives to explore or not to explore that will maintain on their own?

Mr. Lipton: I certainly would feel, and this is evidenced by the attitude of virtually all the important oil exploring and gas exploring companies that there is tremendous interest in the potential of Alaska. Now look, we've had three unfortunate years during which their interest in a sense flagged because the land freeze didn't really permit the opening up of land and so on. I don't think you need incentives for people to come in and explore here. I think the only thing that you have to be concerned about is that there isn't a concatenation of legislation which kind of subtracts too much from the incentives and even there you know that's . . .

Rep. Meekins: This is what my question is. Obviously there is some reason to put a tax on reserves in the ground which may bring you $50 to $100 million dollars a year or something -- it seems like a lot of money -- it seems like it would make a company think about whether they go out and discover another barrels or something because they wouldn't want to have to pay tax on the proven reserves before they get it out. But then again just like someone else said, you said I guess before that the reserves are increasing in value and it seems that there are so many other incentives that they're willing to spend $5 -$6 billion on the pipeline that might not be that big of a "disincentive".

Mr. Lipton: They're willing to spend $5 - $6 billion on a pipeline because they found a Prudhoe Bay. If Prudhoe Bay had not been discovered You'd find very little interest in exploration on the North Slope even where the structures look promising enough for . . .

Rep. Meekins: But they wouldn't have to pay a tax on oil and gas reserves unless they were successful.

Mr. Lipton: Yes, but let me make this point. Well that's why I said that when it comes to future leasing you can't expect to make any appreciable money out of a resources tax which is on the books because people who will be leasing any kind of land in Alaska will be thinking and therefore discounting what they would have to pay in the form of resources tax if they were successful. In other words, what you might make in the future on future resources taxes you'll not be making in terms of either a royalty rate or a bonus or whatever the case may be. Now I don't want to exaggerate this. This is something you can't calculate. Furthermore, when we say that any kind of additional tax legislation tends to effect incentives, what it means is that it tends to effect incentives at the margin. Now what is the margin? It means that something which a company might consider but is dubious about they might no longer consider if the Alaskan environment changes. How big is the margin? How much exploration would you lose? That's very difficult to say and all I can recall is that when the first proposal for the amendment of your old

standing severance tax came up which at that time was 4% including the special post-earthquake tax and the conservation tax and everything else -- all that lumped together came to 4% and we were opposed to recommend the substantial increase in the schedule of severance taxation and the industry attitude was that this would destroy or affect incentives and so on. I felt at that time that in theory yes but as a practical matter it wouldn't weigh heavily in the balance. I don't think that a resources tax per se may go so far as to affect it at the margin but the point I made was that it doesn't affect current production because it is already subject to the severance tax. It won't affect your revenues from the future even if it has no effect on exploration because it will have been discounted. So it's a revenue measure directed at Prudhoe Bay. Is this really what you want to do under the present circumstances in the light of all of the other alternatives?

Rep. Meekins: Another question about the incentives. I know that it may seem arbitrary to choose the depletion allowance of all the things that we could have chosen to start with but the depletion allowance is one of the most widely publicized and is something that we can figure out rather rapidly. And when it was found that the oil companies only paid $140,000 all 38 companies or whatever they were this year, that was a kind of selling point or an incentive to do something. Whether it made any real logical sense or not, that was not one of the motivations. But you know

when you consider all of these different things, and I know some of them but I can't consider all the things that we could start with, it makes sense to look at the whole package and I agree that we should do that and I hope we will but, lacking that, we do have a chance, because of amendments or some possibility of taking out the depletion allowance and just on the logic based on that question alone, not whether it is the most efficient or the most effective way to go about it, whether or not -- what is your advice as regards the depletion allowance. And take into consideration that what other arguments you maintain on the federal level really don't have much to do with Alaska because those incentives some 98% or something would still be in effect. Whatever reason for the depletion allowance I don't think has much to do with Alaska. If you were just limited to that narrow scope and that arbitrary decision, then what would you say?

Mr. Lipton: Look, for Alaska to eliminate the depletion allowance and the calculation of income subject to state corporate income tax is a way of increasing your corporate income tax take from oil companies. I have no idea -- I wouldn't even know -- how to go about estimating what the effect, if any would be on your revenues. I would absolutely be at a loss because you first have to ask of all the oil companies operating here in Alaska which of them are going to be subject in any event to state corporate income tax. Your allocation formula is what makes the whole transition. And you've got to look at it

company by company and none of us have access to the federal corporate income tax returns of individual companies. The worst thing I could do is to give you an answer now which I hope is a responsive answer. I'm making myself sound like I'm pleading for the oil industry. That's not my purpose. But you cannot look at individual figures on federal income tax paid by a company but you may -- used to be you couldn't get it because all they show is total income taxes which included foreign. Now more and more of the financial statements, the annual reports, are breaking down to show federal income tax paid. When you look at that figure and you compare that with what they tell their stockholders their total income is and say My God, what a low federal income tax they paid, you have no way of telling how much of that had to do with depletion, how much of that is the foreign tax credit and so on and so forth. There is no way of doing it. To translate it into the impact on the state would be very, very difficult. I don't know what effect this whole thing is going to have and the other argument, namely that for better or for worse the depletion allowance had a certain effect upon the income of the oil industry and if you eliminate the depletion allowance other things being equal prices are going to have to go up at least as a partial offset. Now you may say that the prices have gone up so much already why do they need an offset but this becomes a complicated argument. But there's no way of offsetting the effect upon corporate income of

an increase of the Alaska state income tax. The prices of their crude oil are not determined here in Alaska. It is determined elsewhere. So, to eliminate the depletion allowance is, to put it very simply, an increase in the Alaska state income tax from oil companies operating here but to an extent that I think is probably almost indeterminant. I don't know.

Rep. Meekins: We do have some figures. I don't know if they're accurate or not.

Mr. Lipton: I would like somewhere in the course of the next few days to look at your figures and to be able to discuss it with your various committees.

Rep. Meekins: Just one more question. Mr. Lipton, when you talk about allocation formula making a difference between the translation between the federal tax liability or federal taxes and state, do you mean allocations between the states of profits, is that what you're talking about?

Mr. Lipton: No. What you do here in Alaska I would suspect for virtually all the companies you're dealing with now is to take the federal income, their income subject to federal taxation and then you say well how much of that should be allocated to Alaska by virtue of their operations in Alaska and you have a formula which is based upon the proportion of their value of assets in Alaska, their total assets, the proportion of sales and expenses. And from that formula you impute the income which is presumed to have originated in Alaska and which is, therefore, subject to Alaskan taxation. I think this is an imprecise and a poor

tool on which to base your state corporate income tax when you're talking about the oil and gas operations in Alaska over future years.

Sen. Hensley: Mr. Lipton, I have a question on petroleum reserve No. 4. Our two senators have split on the issue of Pet 4, whether or not to support the development of the transfer of the control of Pet 4 from the Navy to the Interior Department and whether to develop the reserves. I'm not sure if you're advising either or both of our senators but they did -- Senator Stevens was concerned about the effect of the development of Pet 4 on Alaska state lands near Pet 4 but Senator Gravel wanted to see the transfer to the Interior Department under the terms of the mineral leasing act and I'm not sure what your thinking is or if you have an opinion on that subject but it seems to me that it is a subject that could have some effect on Alaska.

Mr. Lipton: Senator Hensley, I've always had certain difficulty in understanding the national security that is served by the establishment of Pet 4 as a Naval Petroleum reserve. In principle, if the United States runs out of oil elsewhere we will some day in the future develop Pet 4 which means drill the wells and put in the pipeline or maybe if we wait long enough Alyeska will be available because Prudhoe Bay will have been exhausted. But as a strategic reserve against emergency it really isn't worth a hoot in hell because when the Navy runs short of oil they can't get a barrel of oil out of Pet 4. It's a kind

of a stagnant concept. So I have a personal feeling that the national security has to be served through a whole wide range of measures over and above maintaining that reserve in its pristine unviolated state. Now, obviously if there were to be development and exploitation at Pet 4 this would have an effect upon the leasing of state lands around it but I'm not so sure that it would be a negative effect. It may very well, by the stimulation of activity provide a spur to the leasing of proximate state lands because obviously if you are going to develop major reserves there there's going to be a second pipeline out of the North Slope.

Sen. Hensley: You feel then that, from the standpoint of energy demand, that there would have to be a substantially greater demand for additional crude within the country before we could get some action on the retention of this reserve by the Navy. It seems to me that we're in an era of aircraft rather than seagoing ships.

Mr. Lipton: There's a -- the issue of our petroleum reserves is not only a matter of national security, it also involves a very, very sharp conflict in our national legislature over who would develop it and the possible windfall gains to the oil industry which has just experienced the most fantastic increases in profitability if this were to be opened up so it's a very, very hot political potato for a lot of different reasons. I have no idea how the debate would go and when you get such a division of opinion for so many different

reasons my instinct tells me that there won't be any action on it because it takes a positive effort to change what has been public policy.

Rep. Fink: I have a couple questions, Mr. Lipton. Are you fairly well acquainted with this multi state compact for taxing -- the multi state compact on taxing between the states. Well it just has to do with apportionment of income and expenses and the current litigation and whether or not it is a valid law. It seems to me that in many cases the State of Alaska income tax law might be changed depending on the outcome of this litigation -- whether or not it will hold up -- and whether or not we should go our own route or should accept

It seems to me that we're a couple years away from that being resolved.

Mr. Lipton: Mr. Fink, just give me a moment will you please. The practice by the State of allocation is not a universal practice. The last count which our staff made suggests that there are 41 states that have some form of corporate net income tax and despite all my vehement protestations my own state is not one among them. But there are 41 states that have corporate state income taxes and there are 24 that use net income as defined from the federal income tax as a base. There are states which in effect have corporate income tax laws where there is within those states a separate identification of income within the state which puts it within the reach of the state taxing powers so it does not have to be made by the allocation method.

Rep. Fink: Well a year or two ago we passed a law becoming part of this multi state compact and I know that that law is going to be contested and it seems to me that whether or not we wish to continue the multi state compact route or go the other route -- if the law is thrown out obviously we don't want to go that way. The other one -- I wanted to see to what extent you can give us the advice of your firm as to what might happen in the next couple years and if you could touch on the things that would effect Alaska directly and the United States in general. That last piece that you put out with regard to what would happen to the economics of the world based upon the cost of oil seemed to paint a very, very dire picture as to what was going to happen which obviously tells us that it is based upon if there is no change. One of the things I'd like for you to comment on if you would is do you anticipate that, for example, the oil embargo will be lifted. Do you anticipate that there will be a roll back in world prices or do you anticipate that there probably will not be. You mentioned that coal would be a very important factor in the United States and yet it appears that we have several problems today and that would be the various laws against strip mining and the difficulties of the clean air act. Just yesterday in the paper there was an article where Secretary Morton appeared before the Senate committee and I know Senator Stevens asked him the question in regard to some of the problems we have in

Alaska, for example, Corps of Engineers impact statements on drilling off shore, and Morton seems to indicate that the administration is trying to re-evaluate this whole picture and we've also heard the same from the President that he is going to do some re-evaluation of some of the federal policies and I presume it has to regard the two items of energy and environment. I know there aren't any absolute answers but your firm is quoted in the national papers all the time and I assume that you're a lot more up on this than we are. Can you just give us some kind of a picture? some alternatives or something?

Mr. Lipton: Mr. Fink, the memorandum that you refer to which was called "Implications of Exploiding Oil Costs," has gotten a tremendous amount of publicity because, not through our efforts, but through some recipient, it got into the public domain and its now become an official document of the congressional committee so it will be published and is in the public domain -- this has been followed, and you will get it shortly, by a memorandum which we call "The Implications of Austerity in World Oil." Now basically what I was saying about the two possibilities of slow down in energy consumption vs. enforced austerity in world oil and what the effects would be are based upon the thinking that our firm had developed since January in response to this terrific turn around in the circumstances of world oil. Now you ask, what are the chances of a roll back? First of all let me say that the fantastically

high prices which resulted from competitive bidding on a relatively small volume of government oil that went as high as $17 a barrel for some Iranian oil and $20 a barrel for Nigerian oil have already begun to recede. This is the result of two things -- well, it's really the result of three things: First of all, there has been a slow down in reaction to the shortage of oil and fantastically high prices in oil consumption all over the world. There's been tremendous economies in the consumption of oil including in the United States. Secondly, production has been increasing over these last six months. That is to say, production from areas outside of the Arab countries, through the natural expansion and the Arab countries themselves with the exception of the embargo have restored a major part of their cutbacks so that when consumption slows down and production begins to increase the shortfall is less and therefore the competitive pressure to buy oil at any price is even less. On top of that American companies had under our own pricing policy been inspired to go out and buy on foreign markets as much oil as they could get to fill their refinery needs because they were permitted to pass on in the United States in their product prices, the full cost of their purchased foreign crude so in a sense we inspired American companies, not so much the major internationals but other refiners, to go out and bid competitively for that oil and bid against the Japanese and the Germans. Now recently

we have a new crude oil allocation policy and the crude oil allocation policy says that any refiner who has a surplus of crude compared to the national average must sell some of that crude to those refiners who have a shortfall of crude compared to the national average and must sell it at a price equal to the average price of the crude invoiced in. Complications aside, what it means is that if you buy a hell of a lot of foreign crude at a fantastically high price and then bring it into the United States and have to re-sell it to somebody else at a lower price then you certainly don't want to go out and bid for that foreign crude. It goes even beyond that. A lot of the major oil companies are finding that they are better off using foreign crude in foreign refineries rather than importing them into the United States if they become so called surplus refiners. So putting it all together we've had a very considerable deflation of foreign oil prices but only around the edges. The main stream of foreign crude still runs that's out of the Middle East and very much higher out of Africa and now Venezuela. So the real question is not whether around the margins, around the edges, the prices come down but whether the prices for the mainstream will be rolled back from the present level. Now, the hopeful sign there is that Yamani (sp?) who's the Minister of Mines for Saudi Arabia has indicated that he feels that the price is too high and that he's prepared in a sense to roll it

back and if he's prepared to in a sense increase Saudi Arabia production he can really force the roll back on everybody else too even though Iran and Libya and Algeria say hell no, today's prices are too low, not too high. Because the capacity of Saudi Arabia to expand is very great. But I think that there will be some roll back. How appreciable it is, I don't know. The real question is if it's roll back far enough or at least accompanied by deferred payments to this austerity in world oil doesn't have to come about and we don't have this kind of a crunch.

Now as to the questions you raised about coal. It's certainly true that there are near term limitations on our ability to exploit our vast coal reserves. First of all because of the sulfur restrictions on the burning of high sulfur coal and strip mining restrictions on our access to the low sulfur coal -- most of which is in the west and it's close to the surface and could be strip mined. The federal government in its Operation Independence is talking about really very very substantial increases in coal production over the next five to six years. We ourselves in our own projections are rather more conservative. We think that the pace at which there will be either investment to meet reasonable sulfur restrictions or the pace at which the federal government will agree to the strip mining of federal coal lands in the light of all of

the environmental problems -- that it will be a moderate rate at which it takes place. It will not be a crash program. But we still see very substantial increases in coal either to be directly burned or by 1980 at least the beginnings of gasification of coal. But certainly we are not going to meet all our energy problems within five years by the exploitation of coal reserves that are so great that if we had time we could do so. The big increases in coal production will come in the 1980's not in the 1970's because of these very environmental problems that you raise which is why I think that we will not achieve self sufficiency in energy in the 1970's. Hopefully we will mitigate our dependence upon Middle East oil but we will need a relatively high price level for energy in the United States in order to achieve that. And appropros of your gas problems it also means that if we're going to have a relatively high price level for all energy that gas which had been sold at a discount from oil for example will have to be sold at a premium above oil. The shortage of gas means that it will be used in those end uses where it is most valuable not where it is least valuable, which means residential and commercial uses rather than being burned on the boiler. If you think about it there -- we are talking about the possible movement of 1.6 billion cubic feet a day of North Slope gas to the United States. By 1980 if Mackenzie Delta comes to fruition and if the arctic islands really turn up sufficient gas reserves we might be importing

maybe 4 billion cubic feet a day of additional gas from Canada because under those conditions they would be surplus. So we're talking about 1.6 or 1.4 billion cubic feet a day out of the North Slope and out of the Canadian arctic maybe . . . we're burning more than 10 billion cubic feet a day of gas a day under the boilers on the U.S. Gulf Coast. How much reserves would we have to find in order to be able to create a capacity to produce 10 billion cubic feet a day of gas. Now obviously if you look five, six, seven years ahead we are not going to be using gas in the same pattern as we are today which is one of the things the Federal Power Commission is going to be most concerned about when they look at the dispositon of North Slope gas among regions and the patterns of oil and gas consumption by end uses in these various regions. But gas is going to sell at a premium -- if you're talking about oil, say $7 U.S. oil being the numerare for energy in the United States then gas is going to sell at a premium not at a discount below.

Rep. Fink: Can I assume that you do not anticipate any kind of severe economic situation to cause any of these laws to be changed so that coal could be used . . .

Mr. Lipton: No. I do think that just as the pendulum has in past years swung very sharply in the direction of maximum environmental protection -- whatever the cost -- the tightness of energy and its effect upon our environment is going to cause a rethinking of how we make our trade offs. I think there'll be some relaxation in our general approach to

environmental -- but I hope not too much. I'm a strong environmentalist. But I think it's in the cards.

Rep. Warwick: Mr. Lipton, we've set up a computer model on which we've put our revenue projections and budgetary projections on and we've pumped into that various assumptions. Now the most likely assumptions have projected about a $200 million deficit shortly before the Alyeska line comes on stream so we're in a position now of trying to determine what to do about that deficit. Either we substantially cut back spending which would be rather difficult realistically or we initiate some plan to raise a substantial sum of money, $200 million, and it seems to me that there's probably only two ways to do that. One would be to have another lease sale, a sizeable one, or maybe we could sell some of our future royalties -- interests in the North Slope. Do you have any comments on the desirability of either of these? I should say, the preferability of one over the other.

Mr. Lipton: Mr. Warwick, this is a very difficult question for me to answer because every time I have been up here the same set of circumstances really confronts the legislature and the matter of meeting projected budgetary deficit was a factor in the amendment of your severance tax -- which then when you put in your cents per barrel floor under it -- and this was certainly a factor in your ad valorem pipeline tax and so on -- so it's very difficult for me to know how

the State of Alaska goes about from year to year meeting through current legislation what are anticipated budgetary deficits in the future. When it comes to leasing, that means leasing in 76 or 77 or so how do you forecast what kind of income will come from the leases? I think I saw somewhere a projection that maybe $800 million could be raised through progressive leasing of state lines -- state lands. Now I don't know whether that projection is on the basis of the September 69 lease sale on the North Slope or whether it was on a projection of the first, second or third lease sales on the North Slope which turned up nothing on that order of magnitude. It's difficult to project what you're going to get out of lease sales. You stop and think about it. In September 1969 when you raised this fantastic money for the state out of lease sales I'll wager that there's not a company that provided you with that bonus money but that regrets it tremendously today in terms of what they proved up on the acreage they bought for those bonuses. The big oil finds have been on leases that were from the early North Slope lease sales where you got $160 an acre for your land. Now, are you going to get a lot of money out of lease sales proximate to Prudhoe Bay or other stuff on the North Slope which is available to you -- it's very difficult to project. The big revenue for the state comes from success not from the leasing of wild cat lands. It's the success that

one inspires other people to come in near by and pay big bonuses and two that gives you royalty and severance tax income in the future. So I would just caution you as to how much money you could expect realistically to raise on future lease sales but then I'm sure you're asking the same question of Mr. Herbert and Mr. Berrill and I don't want to say anything which contradicts their estimates. They're much closer to it than I am. All I can say is that if you're looking at a projected deficit. then from my standpoint -- I really have no answer except to say that insofar as it involves any form of taxation involving the oil industry which is what you bring me up here to talk about what I urge is that you look very carefully on all the alternatives and measure the necessity as against all of the alternatives and beyond that I really can't be more responsive.

Rep. Warwick: What about timing. Do you think the timing-- say this current year would be right for a lease sale -- one which we could expect to raise a substantial sum of money from.

Mr. Lipton: Well it depends upon what land you put up. If you look around the state -- the state has not really made its selection of the bulk of the federal land to which it is entitled under the Statehood Act. That has to wait upon the native claims selection. What is remaining in state hands for leasing? Around Cook Inlet there is disputed area with the federal government. On the North Slope you still have some local federal lands. They may be very attractive

especially if they are gas prone areas. I'm not a geologist. I really can't answer that.

But the timing. There's nothing wrong with the timing. The question is what's available for leasing. I would say that if it's -- the further north it is the more it depends upon Alyeska or a gas pipeline decision, the later you lease the more bonuses you would get out of it. Because otherwise companies are faced with paying dead rents and maybe even a resource tax for a considerable period of time so they may not be too inclined. But if it's elsewhere where it doesn't depend upon the pipeline from the North Slope I would say that there probably is no better time. There's nothing wrong with the timing.

Rep. Warwick: In directing your attention to the depletion allowance and your resource tax which would be an oil and gas tax in place, I was under the impression that you felt that if we enacted either of these measures it could have a serious impact on any future lease sales -- maybe even as much to offset the additional revenues that we would gain by initiating these taxes. Did I read you right?

Mr. Lipton: No. I don't think I said it and if I said it that's not what I meant. For example the resources tax. I'm not really implying that you will lose in the future sources of state income that will more than offset what you can gain in the interim as a resource tax. That's not what I'm saying. What I said was that the only practicable effect of the resource tax is the revenues that you will get from the Prudhoe Bay reserves in this interim period.

That is to say, it's specifically pointed at them because if a tax stays on the books beyond 77-78 and therefore becomes applicable to the reserves of different oil fields that are found subsequently -- that so long as it is on the books any company which is bidding on future lease sales will take that into account. I did not say that you would lose more in the future than you're taking in in the present. Nor did I mean to imply that if you eliminate the depletion allowance as -- the percentage depletion allowance -- as an item in your state corporate income tax -- that this would so inhibit exploration that in effect it would cost you more than you would take in. My real speculation is how much you'll ever take in on it, and whether this becomes the last step in the amendment to the state income tax law which I think ought to be looked at as a whole rather than as a part.

Mr. Warwick: What about selling an interest in our future royalties? Do you see any disadvantages to the state in using that as a method of raising a substantial sum of money for a short period of time.

Mr. Lipton: Mr. Warwick, I don't quite know what that means. If you're talking about selling future royalties what you're really saying is that the state is going to borrow money from security future royalties. The state can borrow money a thousand different ways and if it wants to borrow money

see I'm not even familiar with your constitutional pro[illegible] here so you're asking me to talk in different areas. I want to address myself to the one part where I think I may have a certain exposure and competence, not to all parts. The state borrows money and obviously wants to borrow at the lowest rate of interest. There are a lot of ways of doing this. Now I don't know what effect the hypothication of future royalties would have on the interest rate that you have to pay. I don't think at the present time that Alaska's state credit is that bad that in a sense if you go into the money market, the capital markets to borrow money to the extent that your constitution permits you to do it. In a sense, selling future royalties is almost like a tax anticipation certificate. Instead of being in anticipation of the taxes it is in anticipation of royalties. Maybe you can do as well by a tax anticipation certificate if you are allowed to do that over more than one budgetary year, I don't know whether or not you're allowed to do it. But I don't know really that there is any such thing as selling the royalty unless you want to sell not specific royalties but if you want to hypothicate to a speculator an undivided interest in some po[illegible]'on of the state royalty I'm sure you can do that but I'm also sure that if that's what you're proposing as consultant to the state legislature I am dead set against it. I would not want you to hypothicate -- if you have a 12 1/2% royalty, say to somebody that for a given sum of money I'll give you 2% of it. You don't know what

that's going to cost. You know how much you're go[illegible] receive in payment but you have no idea of what it will cost you in revenue in the future in view of the uncertainty of future oil prices. You may be giving away the birth right of the state by doing that.

Rep. Warwick: One other question relating to the legisla[illegible] advocating say a trans Alaska gas line as opposed to a tra[illegible] Canada line. El Paso has indicated that it wants Alaska's unequivocal support of this line before they invest another I think around $20 million into engineering design and other related items. Why do you think that they would want Alaska's unequivocal support?

Mr. Lipton: Well if I were contemplating that kind of an expenditure I sure as hell would want it too. And I think Arctic Gas, if they sensed the tone of this legislature and they thought they had any chance of getting it they would ask you for it too.

Rep. Warwick: How does it benefit them?

Mr. Lipton: Well I think it's one more item that they can throw on the table when they make their submissions to the Federal Power Commission. Incidentally, I might mention that the first submission on a gas pipeline will be made not to the Federal Power Commission, it will be made to the Canadian National Energy Board by the Arctic Gas group probably this month. This is in connection with the gas pipeline down from Mackenzie. Now they of course are going to have to say an awful lot of things about Alaskan gas and if they had the resolution of the Alaska

State Legislature that it was in the interests of Alaska to have the gas line go through Canada and tie in with Mackenzie Delta, boy they would be down here urging you to pass that resolution so that they could lay it before the National Energy Board. But I think that they are intelligent enough to know that they couldn't get that kind of a resolution from you. El Paso hopes that they can get that kind of a resolution from you in their behalf. It's a value to them in their representations and submission to the Federal Power Commission.

Rep. Warwick: I think most of here have come to a preliminary conclusion at least that -- or I should say on face value that the trans Alaska line appears to be much more attractive than a trans Canada line. What would you suggest that we do? A gas resolution qualifying . . .

Mr. Lipton: I hope that there's nothing I've said which implies that we think that the El Paso trans Alaska gas line ought not to be supported. What I'm saying is that I don't think that there's enough evidence available to you on balance as to all of the implications of it, including incidentally the relations between the United States and Canada and so on. Maybe later on before the committees we can talk about all of the Canadian implications and whether or not Canada is a security risk compared to other sources of gas. All I said was that I don't think at this stage of the pipeline development activity that the legislature of Alaska should commit itself without equivocation

to complete support to one project or the other. It's perfectly permissible for you and I think it may be of value in saying that from the standpoint of the interests of Alaska this is what a trans Alaska pipeline would mean to us. That part of it is all right. You're talking to the specifics of Alaska's interest in that kind of a pipeline but you're not saying and I think it would be very presumptious, and you may want to recant it later on I don't know, I'm not saying that you will, but I think there is not enough evidence laid before this legislature by either of the pipeline groups to be able to make a judgment that, aside from the obvious interests of Alaska, that the total balance of consideration says that Alaska should support one pipeline as compared to the other wholeheartedly. Let's wait and see how much more is thrown on the table before you make that final commitment. But there's nothing wrong with saying that as of today in terms of construction and employment, in terms of the possible use within the State of Alaska of royalty gas, possibly, but I have qualifications on that, the low cost gas that would be available in the state for all of these reasons Alaska feels that there is a case to be made for a trans Alaska gas pipeline. But that's not the same thing as saying that we have weighed everything -- because what you have laid before you I submit is less than the whole that will come out in due course. Give yourself every opportunity to listen to it. I think you lose nothing by it.

Rep. Warwick: As far as the FPC is concerned there's no sense of urgency on the part of the state to pass a resolution unequivocally endorsing a trans Alaska line?
Mr. Lipton: I don't think so. The question is whether it is absolutely necessary to El Paso and I can't speak for that. But I would hate to think that a $3 1/2 billion investment in a gas pipeline, in liquifaction facilities, in liquified natural gas tankers, and in gasification plants in California -- all of this hinges on whether or not this legislature passes a resolution of unequivocal support. If that's the case I wonder really about the project. I just can't believe that anything of that enormity depends upon whether or not you give unequivocal support. And again let me hasten to say that I'm not being negative. What I'm saying is, give yourselves time to see all of the evidence.
Rep. Warwick: I seem to recall, probably three years ago, when, well four years ago now, when I first came to the legislature, that you and Mr. Levy indicated that -- we were talking about a trans Alaska gas pipeline at the time, you seemed to indicate that at the time you thought the economics of it precluded it. Do you still feel that way or do you have any comments. . .

Mr. Lipton: I don't recall to what extent we spoke to that point but if we did we did it on the basis of what are normally the transportation costs involving moving gas over water and so on but I don't think that we wanted to be definitive about the whole thing. Look, if two or three years ago we were unable to estimate -- we, the world, including the members of .yeska, were unable to estimate within 150% what the cost of an oil pipeline was going to be, how closely do you think that at this stage in the game anybody can estimate what the cost of an El Paso or a gas Arctic project are. Do you remember what the first figures were on the cost of the Alyeska gas pipeline? moving 200 million barrels a day? and what they are today? Now if -- and incidentally this didn't involve the added complications of the tankers which incidentally are presumed to be later to what we have and which involve contracting for their construction -- El Paso has some experience in the run up, unexpected run up of costs involving the transportation of liquified natural gas from another source of supply. In view of all of these to talk today on the basis of representations that are made to the legislature that this transportation cost is better than the other transportation cost within 5 and 10¢ per mcf, I would rather wait and see on that as to what kind of evidence is laid down before the Federal Power Commission, where incidentally there will be interveners in the

right of a very careful look at everything which is submitted.

McGill: If there are no more questions, thank you Mr. Lipton. Meeting is adjourned.

STATE OF ALASKA
THE LEGISLATURE
LEGISLATIVE AFFAIRS AGENCY

POUCH Y · STATE CAPITOL
JUNEAU, ALASKA 99801

October 31, 1973

The attached transcript contains the remarks made by Mr. Milton Lipton on October 22, 1973 before the Senate Resources Committee. It is a verbatim transcript of Mr. Lipton's remarks. There is occasionally a word missing or other minor gaps in certain places, which are due to the speaker's testimony being indecipherable at that point. However, it is believed that these occasions are rare and the transcript presents a fair picture of the thoughts expressed by the witness before the committee.

Senator John Sackett
Chairman
Resources Committee

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SENATE RESOURCES COMMITTEE

Special Legislative Session

October 20, 1973

Mr. Lipton

I'll try to get my introductory remarks to the point of the issues which you are considering here with respect to the legislation submitted by the Governor. First of all it is very obvious that there is considerable urgency in getting on with the construction of the pipeline. This is clearly evidenced by Congressional action to authorize construction. And I think the action by Congress implies not only an appreciation of the hightened concern by the nation as a whole for the potential contribution of North Slope oil to the nation's precarious balance in essential energy supplies, but also a feeling that it is imperative at this stage to avoid further unecessary delays on account of litigation in the courts. And I think that the same spirit, the desire to avoid unecessary delays, is reflected in the negotiations between the Governor and the companies. There is no doubt but that the State and the companies have a very common interest at least in getting on with the job.

You must independently review the proposed legislation in the light of the many issues involved so in my introductory remarks I would like to address myself to the question - what have been the major concerns which have impelled past legislation, to what extent are these concerns still relevant to the State of Alaska, and to what extent do the proposed changes in the legislation adequately take care of the concerns of the State and to what extent may you want to consider variations, deviations, or at least review what is being proposed.

The first thing that I would like to stress is the public interest that is inevitably and irrevocably involved in the pipeline. This is a circumstance which is unique to Alaska, it is of tremendous importance to Alaska and it just does not obtain elsewhere. This is one of the reasons why in your legislation you must be circumspect to a degree that perhaps other states need not be. The contrast between the pipeline that is proposed to be built along a corridor from the North Slope to Valdez contrasts with any other transportation circumstances in the lower 48 states. There was never a time when it was not possible, quickly and expeditiously, for any crude oil producer having a significant flow of crude oil without access to pipeline capacity to undertake to build a new pipeline. Or for any refinery without access to pipeline that would bring crude oil to

his refinery not to undertake the construction of a pipeline. There is today for example a very serious shortage of pipeline capacity into the Midwest area. CAP line, which until Alyeska was the largest undivided interest crude oil pipeline in the United States is expanding its capacity under different investments by the various companies participating. Its not a proportional expansion of capacity but to reflect their several needs. There are refineries located in the mid-continent area of the United States that have historically drawn their crude supplies from Oklahoma and Kansas where crude production is going down that are prepared to build their own pipeline from the U.S. Gulf area into the mid-continent area. There was a new fairly large capacity pipeline just completed to carry products from the gulf coast area to new consumer markets in the mid-west. So that although individual pipelines have, in a sense, a monopoly over their own rights-of-way and are regulated, the circumstances of investment construction in the lower 48 make it possible for competing or alternative forms of transportation to be provided. This is simply not the case with respect to the crude oil resources of the North Slope and the access to export markets in southern Alaska. That pipeline corridor will convey to whatever company builds that pipeline an

an irrevocable right for the transportation of crude oil. The state has tremendous interest in this pipeline. It has interest in seeing that the facilities are operated in the most economical, efficient fashion. That the facilities, whatever their capacity, may in due course be expanded to meet the needs either of incoming production or facilities provided to expand the delivery of crude oil, for example, to intermediate points within the State, such as Fairbanks. My point simply is that company interests may not always correspond in toto, or at a moment in time to the concerns that are of primary interest to the State.

I had the privelege of listening to Mr. Spahr's testimony before this Committee yesterday afternoon and I was quite impressed with his very careful and precise statement of how a company balances all of its investment decisions against their many alternatives, which means in effect that the economic interests of the State, from time to time and in various respects may not coincide with the inclinations of the individual companies who are participants in the pipeline.

There is no way in which the State, through its regulatory machinery, can impose arbitrary or capricious demands upon the pipeline, either to deny them the right to do things or to compel them to do things, because the pipleline always has recourse to the state courts, under the due process of law, against capricious, arbitrary or confiscatory demands

made by a regulatory authority. There is likely to be a wide range of business transacted by that pipeline which involves intra-state commerce and which involves State interest in the totality of its commerce. And, to the extent that the State has an interest and can exercise jurisdiction, it would seem to us that the legislation enacted by this legislature should claim for the State such jurisdiction, subject both to the prior jurisdiction that the ICC may have, and subject also to court review of how the State exercises such jurisdiction as is available to it. But, I would not think that the claim by the State, in its legislation, to exercise regulatory jurisdiction, should be such a disabling factor that in advance they would say that we will not submit to the legislative exercise of this power and go ahead with the construction of our pipeline unless it has been previously reviewed in the courts. The exercise of the State regulatory authority is always available to them subject to judicial review. I would not think that this one, among the many issues would be the one that would be such a stickler that it would involve prior litigation and unecessary delays on the subject of the construction of the pipeline. This bears upon aspects both in the proposed amendments to the Pipeline Commission Act and certain proposed amendments in the Right-Of-Way Act.

The second overwhelming interest of the State I think is in the tariff which the pipeline will eventually establish.

The estimated costs of the pipeline goes up by leaps and bounds. The figure that is now being used in the range of 4 - 4 1/2 billion dollars which makes it both an incredible industrial undertaking and private investment. But it ought to be seen in context. There has been over the past three years, according to estimates, an increase of 3 billion dollars in the construction costs of the pipeline. On the other hand, the increase in wellhead values in Alaska, as measured only by the increase in postings already put into effect in California, are on the order of 60¢ a barrel, and 60¢ a barrel on 10 billion barrels of recoverable oil, means at least that the capital assets which underlie all of the incentives to construct this pipeline have gone up by about 6 billion dollars in the same period of time. Insofar as the economics of the pipeline are irrevocably tied in with the economics of crude oil production, the increase in the construction costs of the pipeline, occasioned by inflation, environmental considerations, regulation, etc. are not disproportionate to the tremendous increases in the value of Alaskan oil, which have already obtained by virtue of the run up in energy prices and crude oil values in California, and also with respect to foreign oil at the price which it can be

brought into the United States.

These higher wellhead values, reflecting world oil prices, are no reason for the legislature to have less concern than before about the relationship between a pipeline tariff and a wellhead price at which their severance tax and royalties are assessed. The mere fact that the oil is worth more is no reason for you not to insist that the maximum worth accrues to the State, and that it not be unecessarily depressed, even if its depressed from an unexpectedly high level by virtue of the tariff which is established on the pipeline.

It is not the issue that one questions the good will or the economics of the company. The real question has to do with how the State, given its economic interest, exercises its responsible legislative authority to protect the interests of the State in the event that company interests, for one reason or another, are found in such a way that the State feels its own interests are being bypassed. It is for that reason that we have felt very strongly that the State should be looking at a package of legislative means that not necessarily by themselves but together, would always conduce to the most favorable tariff, in light of the States economic interest.

One of the specific issues involved is one that came to the fore in the Right-Of-Way Leasing Act of 1972 was the percentage lease rental and the many provisions associated with it. If you recall our testimony last year, this was

one area in which we had certain reservations. It certainly was, to our mind, an imaginative approach on the part of the State, since the main intent and purpose of the percentage lease rental formula was not to raise revenue for the State. Quite the contrary, the intent and purpose was to hold out an alternative of pains or rewards to the pipeline participating companies. Pains in the form of a very high lease rental if they set too high a tariff, and rewards in the form of an appreciably lower lease rental if they set the lower tariff. We had however, considerable uncertainty as to what the company response would be to it. It was then very, very difficult and it remains very, very difficult to compute, company by company, the way in which the impact of the percentage lease rental would fall upon the company, not knowing in advance what the ultimate proportions would be between a company's equity in the pipeline and a company's equity in the crude oil, that is whether they were a net buyer or a net seller. And not knowing what the tax exposure was of individual companies with respect to income earned on production, which has the advantage of depletion allowance and the disadvantage of severance tax royalty, or what their income tax exposure might be on pipeline operations given accelerated amortization, investment tax credits, etc. This is a very difficult corporate computation. So there was considerable uncertainty as to whether the incentive that was intended in the percentage lease rental would actually

work.

Then there was the second problem about the pyramiding of lease rentals. Any rental payment that a pipeline company makes, insofar as it is subject to ICC jurisdiction and insofar as it sets its tariffs subject to the Icc rate making rule, if it pays a rental it is in effect able to recover that rental payment through the tariff. So that the higher the rentals are the higher the tariff would have to be.

Third there was the legal issue, and I think that, under the circumstances, where this has been made by the industry, one of the pivotal issues in their litigation I suspect that the legislature would want to consider very. very carefully the extent to which the percentage lease rental formula and all the provisions associated with it are essential to the interests of the State or whether there are other alternatives.

The second innovation that was introduced in the legislature last year and is now subject for your review, is the option of the State to buy up to 20% equity in the pipeline. Last year we were rather negative on the subject of 100% state ownership for reason which we would still enunciate. But we did feel that there was a very cogent reason for the State to have an option to buy a participation in the pipeline. in due course. What we had recommended, and what was enacted into your legislation last year, was an option to acquire up

to a 20% undivided interest in the pipeline. The reasons for that were, if the State exercised its option, it could use its ownership of some percentage, and it does not have to be a very large percentage, it could be less than 20%, to utilize its ownership of transportation facilities to leverage all tariffs downward. The State could set a tariff and say that this is an appropriate yardstick that others can follow. Or the State could set a tariff and if the tariff were lower than the company's tariff presumably all shippers would elect first to move their oil where the transportation charge is least, and on that basis the State would be in a position, with its relatively lower tariffs, to say that this is what determines the value of oil on the North Slope, and use that as the basis for its severance tax and royalty calculations, with the onus being on the company to prove that a higher tariff is necessary. Or if all else fail alternatively for the State to say we too will charge a high tariff and in effect we will recover in the profit on the oil that we move through our share of the pipeline what we may have lost through severance tax and royalty revenues because a high tariff depresses the value of the oil on the North Slope.

The attractiveness of the option provision was that having the option it would not have to be exercised.

That what the State could do by its option, plus what it might do through its taxing authority, that all of these would be conducive to a reasonable agreement between the companies and the State as to what a reasonable tariff would be, which might very well be at an ICC rate, depending on what ICC rate making policy is in 1977 and 1978. Or it might be somewhat lower, but at least it provides the State with a negotiating leverage and it would be one of those tools which hopefully the State would never have to exercise. The negotiations between the Governor and the industry have changes quite substantially the whole concept of the State's right to acquire an interest in the pipeline. Last year the company representatives were absolutely adamant that State ownership or State participation or State option were absolutely unacceptable and this was very largely couched in terms of the financing problems that would be posed.

I would like to call attention to arrangements that have been made elsewhere which involve government participation in a pipeline and a government option to buy. I'm referring now to an arrangement which has been made between a consortium of oil companies called SINCRUDE and the Province of Alberta in Canada having to do with the right to produce and transport a synthetic oil processed from the tar sands of the Athabascan tar belt. Will have to be a pipeline which connects the Athabascan Tar Sands Development

Project with the City of Edmonton where the oil will then move into other pipelines. The Province of Alberta is given, de nova, from start, an 80% equity in the pipeline. The companies which are participants in SINCRUDE commit their shares of the oil to that pipeline, without reservation. Secondly, and this does not have to do with pipeline but it has to do with an option, the Province of Alberta has an option to acquire, after the start of production, an undivided interest in the production itself, of not less than 5% and not more than 20%, with a formula that determines in advance what price will be paid by the Province of Alberta for the acquiring of that option.

I must be very careful to distinguish between the magnitude of what is involved here. The Alyeska Pipeline with an investment of some 4 - 4 1/2 billion dollars is a much larger pipeline facility than either the Athabascan pipeline or even the producing operations. There are differences in the magnitudes and degrees, but surely the principle of a definite participation in the pipeline, or the option to acquire a participation is not without precedent. If there are problems involved in the financing of the pipeline because there is an outstanding option for the State to acquire it, I would believe that those financing problems could be resolved if the terms and conditions of acquisition

under the option were spelled out. That is to say their investment, their costs, plus interest on their investment up to the time of the States taking over the pipeline, will be paid to them, and that the State thereafter undertakes commensurate obligations for whatever the outstanding debt may be.

The principle of an option to buy is not without precedent. This consortium of oil companies, who together constitute the SINCRUDE group, contains within their membership of four, two; the Exxon Corporation, through Imperial Oil in Canada, and Atlantic Richfield, who are major participants in the Alyeska Pipeline. So that insofar as the purpose of an option still commends itself to the Legislature as a significant factor in the protection of the State interest, which probably may never be exercised but which nonetheless represents a prudent approach by the Legislature. I think it may also be considered that the precedents which have been transpired, and if necessary, agreement by the State in advance on what the formula for payment will be, so that it is carefully spelled out, I would think that at that stage of the game it should not be a completely inhibiting factor with respect to the financing of the pipeline.

The third broad area at issues has to do with taxation. Obviously the taxing power of the State is the ultimate power that the Legislature exercises with respect to any of the

issues which may be involved with respect to Alaskan oil.

There is now tabled before you two major tax measures, an ad valorem property tax and an amendment to the severance tax. No legislature can bind itself through its term of office, let alone bind future legislatures, so whatever is enacted in terms of tax legislation is susceptible to amendment at any time. Certainly an oil company, more than any company in the world, is aware of the taxing power of sovereign states or States. In the context of the package of legislation that is submitted to you, it would appear that any tax legislation that you enact in this Special Session of the Legislature, implies some kind of a commitment. Here there have been negotiations, tax proposals have been made, in a special session of the Legislature you are being asked to amend or pass legislation which seems to be part and parcel of a whole package of legislative items, and certainly the industry, no matter how much it feels is subject to amendment in the future, will not be remiss is recalling to this or subsequent legislatures, that what you enact today was part of a package.

Therefore it seems to me that this particular legislature ought to be especially careful in what it does in terms of their tax decisions, and certainly the legislative record ought to show that a present enactment represents the sense of the Legislature to the extent that it is able to look ahead and see the circumstances under which the tax will be

operative. From the visibility of today, I submit that 1977 and 1978 might not look at all the way you or I think its goirg to look with respect to the economics of North Slope production or the economics of exploration and development elsewhere in the State. So in a sense, if you are enacting tax legislation today, you must also be alert to the fact that the interests that the State will be looking at 3 - 4 - 5 years hence may appear very differently than the best perspective any of us can hope to have on the future from today. So that the tax legislation will be subject to review, no only as a matter of legislative perogative, but also as a matter of very basic equity as circumstances may be changing.

There are three categories of taxation which are relevant to your Legislature.

(1) The first is a severance tax with amendments set before you. We have always looked on the severance tax as a tax which captures for the State a portion of the economic interest in its natural resource, and which was sufficiently broad guaged so that it really wasn't directed to the production of one specific company or the production of any specific _____. Two to three years ago we felt that what the legislature did ought not to be constrained by the particular circumstances of Cook Inlet at that time, nor ought to be so flamboyant that it was directed entirely to the hectic

expectations of North Slope development, but that in a sense it represented a fair and equitible tax given the circumstances of current, prospective and future production out of Alaska. Out of that came your tax which was the percentage of wellhead value and which contained four different brackets which related to average wellhead activity.

Last year your severance tax underwent substantial change with the introduction of cents per barrel which was designed as a floor below which the State's revenue would not fall whatever transpired with respect to wellhead value of the oil.

There are two different ways of looking at the cents per barrel aspect of the severance tax. One is as a means of offsetting depressed wellhead values. That is to say, if the pipeline tariff is high and the wellhead value is depressed, then if you can't get it as a percentage of wellhead value then you get it as cents per barrel. It is a response to what you might have considered an unjustifiably high tariff which depressed wellhead value and hence your severance tax. Of course you can get that also by changing your schedule in percentage of wellhead values. But as an offset to cents per barrel, or the severance tax however its enacted, as an offset to the lowering of wellhead values through the high tariff, it is a blunt instrument because it affects every producer in the State with higher severance tax obligations irrespective of whether or not that producer is a member of the pipeline or not.

As a revenue measure, every severance tax bears on producing profits. But it bears on it indirectly, that is to say it is a percentage of gross value. And as a revenue measure it comes out of producing profits, but it can be a different proportion of producing profits depending upon the relationship for individual fields and individual companies and individual circumstances, of the relationship between gross value and net value of the oil. Therefore it is not an income tax though it does fall upon it. It is a revenue raising measure that is always available to the State and is susceptible to whatever rates the State may want to impose, which the State can adjust whenever it chooses if it is dissatisfied with wellhead values. But this is an economic judgement.

The royalty offset feature in the last amendment of the severance tax was obviously a legal issue of considerable general concern to the industry. Because what it implied to the industry was that here in Alaska, and potentially elsewhere, royalty payments which they entered upon by virtue of contractual lease arrangements, might in effect be changed by the State enactment of severance tax legislation.

You can of course achieve whatever level of tax income from the State directly for severance tax or even higher severance tax to offset what you consider to be a loss of royalty income, not by a royalty offset but simply by a high

severance tax.

The legal attack upon your last severance tax enactment could be voided by a very simple amendment, that is to simply eliminate the royalty offset and leave all the old schedule, in which case the industry would be paying a very considerably higher severance tax than they paid under their old tax or they are paying under the governments proposed legislation. To avoid the legal issue of the royalty offset is something I think well worth considering, because you can exercise your severance taxing power at any time.

(2) The ad valorem tax is very clearly to raise revenue for the State and particularly as an interim source of revenue and is one among various ones that you might consider. The only thing that I would like to mention about it is the observation that an ad valorem tax imposed upon a pipeline is recoverable by its tariff. It is a cost of doing business by the pipeline and under ICC regulations, and I suspect under your own State of Alaska Public Utility regulations, an ad valorem tax becomes a cost of doing business and therefore can be added onto the tariff.

By way of rough calculation, on a 4 1/2 billion barrel pipeline a 20 mill rate would yield about 90 million dollars per year in tax revenue ad valorem tax on the pipeline itself, which in effect would mean about 20¢ per barrel addition to the tariff. The ad valorem tax would be passed on to someone else in the tariff of the pipeline. Insofar as the pipeline

tariff is higher and the wellhead values are lower, the State itself would bear 20% of the burden of the tax because it would reduce the royalty severance tax income. The tax would become a burden on those producers on the North Slope who are not participants in the pipeline but who have to transport oil because the tariffs to them will be higher. They would bear a portion of the burden in proportion to the amount of oil that they produce and ship relative to the amount of oil that is produced and shipped by companies who are also participants in the pipeline. The rest of it would be borne by the pipeline companies themselves as its passed back to the cost of transportation of their own crude oil.

The same holds true not only for the ad valorem taxes that the pipeline will pay in 1978 when the pipeline is in operation, but I suspect that the same thing holds true for all the cumulative ad valorem taxes that the pipeline will be paying between 1974 and the start up of operations, because those taxes are also recoverable costs of doing business and in due course will have to the companies as pipeline operators in their tariff.

All of which is not a reason in and of itself for you to say no more ad valorem tax. This all depends on when you want your revenues and how you best decide the State can raise its revenues.

(3) Finally, a few words about what I think is the most important aspect of taxation which is available to the State, that is your State income tax.

I think the Legislature, in due course, its certainly not required at this Special Session of the Legislature, must review its legislation to insure that incomes earned in the State are within reach of the State's income taxing power. This does not imply anything about the way you levy income tax, or whether there are any changes, but it does imply that you will scrutinize your income tax legislation very carefully.

In the end the income taxing power of the State is the means by which the State can insure that there is in the future a reasonable partition, or sharing, of what are the ultimate economic benefits of resource production in the State. I'm not only talking about crude oil but I'm talking about what hopefully will be a major exploratory and development program now that lands are beginning to be available for the reopening of leasing operations. Through your income taxing power you have the final means by which the State can decide, but not arbitrarily, never by itself, because its all subject to the essential incentives of investment by private companies in exploration and development. But within these limits the State has a means to participate in a reasonable and equitable way in the benefits that will come from Alaskan resource development.

SENATE RESOURCES COMMITTEE

October 22, 1973 Hearing

TESTIMONY OF MR. MILTON LIPTON

The legislation that's directly before you is the Right of Way Leasing Act but before I address myself to that specifically, I would like to say something about the entire package of legislation. It has been stated by industry, of course, that it is a package and they will review whatever decisions come out of the Legislature as a whole. I think it's true even more so for the state than for industry that the whole complex of oil legislation that's before you determines the extent to which the interests of the state are protected or the extent to which the interests of the state are yielded.

I don't want to take too much time on other aspects of it and get to the Right of Way Leasing Act as quickly as possible. So let me start out by saying that, in our opinion, having looked at all the legislation carefully, having listened to a great deal of the testimony that was made before the various committees, we now feel that the pivotal piece of legislation which determines the extent to which any compromise is satisfactory to the interest of the state, is the Alaska Pipeline Commission Act. This is your regulatory bill, a strong bill that was enacted in the 1972 session of the legislature, a bill for which the government and industry have submitted proposed amendments which largely convert what had been intended by the legislature in the first instance as a regulatory bill into an entirely different instrument for

the state, namely a device whereby a commission of the state simply represents the state in hearings before the Interstate Commerce Commission. The amendment to the bill as proposed and as pointed out by Professor Witherspoon yesterday afternoon, in effect, specifically denies (if the amendment is passed) by act of the Alaska legislature any and all jurisdiction which the state of Alaska might in the normal course of events, exercise over pipeline activities in this state, if only a pipeline such as transAlaska subjects itself to or is subjected to the jurisdiction of the ICC.

Now let me explain the reasons for our thinking that this particular act, as it now stands, the Alaska Pipeline Commission, is one of the most important tools available to the state of Alaska in protecting its interest. First of all, the act that's on the books claims very extensive jurisdiction for the pipeline commission which is being established. The jurisdiction extends to various aspects of regulation extensions of services, connections, expansion of capacity, potential abandonments --- so that with respect to these various aspects of pipeline operations the state of Alaska claims jurisdiction for its pipeline commission. Secondly, it vests in this pipeline commission wide authority to pass upon the validity of tariffs which are set by the pipeline. There is no claim made in the existing act, which is on your books, that the state of Alaska can regulate tariffs for the movement of oil in interstate commerce. This falls within the jurisdiction of the ICC. But there will undoubtedly be movement of oil in intrastate commerce, as for example from the northslope

to Fairbanks. There will probably be movement of oil in intrastate commerce from the north slope to Valdez which will remain within the state, for example, if the state should contract to take royalty oil and sell it for a year or two years or five years to the Tesoro Refinery or any other refinery which may be then or in the future be constructed within the state. So the state need only claim jurisdiction over the operations of the pipeline which affect intrastate commerce and jurisdiction over tariffs which involve the movement of oil in intrastate commerce.

Now what's the value of this? Insofar as there may be in the future an issue over the tariff set by the pipeline and this has been pivotal to your deliberations for two years now, insofar as there should be an issue over the tariff, there has really to be two things -- one, a determination as to what the appropriate tariff is, and secondly, a decision by the state as to what it will do to try to enforce what it believes is an appropriate tariff. How does one go about determining what is an appropriate tariff for the pipeline? I don't believe that the legislature in its deliberation is going to want to tackle the job -- that fantastically difficult and complicated job -- of determining what is fair value on a pipeline -- what goes into the capital base and what is not allowed in the capital base, and of what rate of depreciation is appropriate, and everything else --. Or what is a fair return -- this is an incredibly involved problem which the ICC struggles with or avoids by not doing anything about it,

as the case may be. In any case this is really not a problem of the legislature.

But you have established in the existing legislation a pipeline commission which has jurisdiction to determine the fairness and adequacy of tariffs insofar as it involves intrastate commerce. It would do so by holding hearings. If a rate is filed for the intrastate movement of oil, your pipeline commission may accept that rate as it's filed, or it may protest that rate in which case it has administrative processes by which it holds hearings, by which if it renders a decision it must support and justify why that particular decision was issued. And it provides opportunity for the pipeline companies to protest any tariff decision, or any other decision of the pipeline commission, insofar as the pipeline companies believe that it runs counter to due process of law, which means that the administrative decision of your pipeline commission will be tested in your state courts, or if necessary in a federal court.

But if in fact, your own adminitrative and judicial process has come up with a tariff which is lower than the tariff set by the pipeline companies it can be then enforced upon the intrastate movements, and the legislature and the state of Alaska is in a position to expect that the companies will apply an equivalent tariff to interstate movements also. Now that may not be enforced but I put it to you that on the day that it is determined by the state of Alaska, through its administrative and judicial processes, that a tariff is appropriate

for the intrastate movement of oil from the north slope to Valdez -- if on that day the companies refuse to reduce the tariff, which means to increase the well head value on all the oil that moves in interstate commerce, then the problem of the legislature in recapturing the interest of the state is a simple one, at that point you have the taxing power and know exactly at what level and what rate to exercise it, because you have through the instrumentalities of your own legislation already created the means and device by which an appropriate tariff can be determined; by which your own courts will reject the findings of the pipeline commission if they are arbitrary, confiscatory or capricious, but if administratively and judiciously that tariff is upheld, then the legislature has the guidelines precisely how to go about recapturing the interest in the state through its incontrovertible sovereign powers - that is to say the power of taxation.

It's for this reason that we feel the regulatory bill is absolutely the heart of the entire package. Furthermore, it is our feeling, and here of course it's difficult to speak for companies because, as they said, they would go back and review the whole package, but insofar as the companies feel that there is a claim of jurisdiction by the state which is unconstitutional because it involves interstate commerce or insofar as they feel that there's a decision by your pipeline commission in an area where it has jurisdiction but which decision goes against the law because it violates due process, they always have recourse to the courts. They need not litigate this issue in

advance because the mere fact that this law is on your statute books and I'm referring to the 1972 pipeline commission act, the mere fact that this law is on the statute books does not impose in advance the kind of disabilities upon their intentions to construct the pipeline that will require extensive litigation at this state of the game. Furthermore, as we have pointed out at the previous sessions of the legislature where regulatory bills were before you, there is legislation to this effect on the books of other major producing states and these have never involved extensive constitutional issues so far as we know. Well then, this pipeline commission act we feel is the guts of any compromise which the legislature may wish to substitute in lieu of the compromise package which has been put before you by the executive department.

Now let me pass on then to the Right of Way, but before I do, let me say a few words about the other bills and then come to the guts of the legislation which is before you which is the Right of Way Leasing Act. There are three different tax measures before you and I don't believe that any of them are in any respect crucial to the willingness of the companies to abandoning litigation or to going ahead with the construction of the pipeline. The severance tax, of course is in the course of litigation and it's in course of litigation because the 1972 amendment to your severance tax law contains a royalty credit feature which the companies feel would establish a very unacceptable precedent if it were, first of all applied here, and secondly if it were emulated in other states. I think they're misguided in their concerns; I think the state of Alaska has very little interest, really, in maintaining the

royalty offset provision. It's applied actually by the state of Alaska in a very generous way so that the relatively high cents per barrel tax, which was imposed in your 72 legislation is evaded and reduced by virtue of the royalty credit. You could settle the legal issue in five minutes by repealing the royalty credit and leaving everything else stand, in which case the companies would be subjected to considerably higher taxation than they were previously and that they are in the governor's proposal. So that the removal of the royalty credit feature in your severance tax which the companies are so eager to obtain, we would surely recommend that the legislature give to them. Perhaps the easiest way of doing it is to give it to them by accepting the severance tax amendment which is before you. But I caution one thing: I don't believe that this is the time for the Alaskan legislature to enact a severance tax schedule, whether it's a percent of value at the wellhead or cents per barrel or a combination of both with the idea that what is enacted today is going to be appropriate to whatever the volumes and values of oil may be that are going to be produced in 1977 and 1978. So if you prepare to accept the proposed severance tax amendment as part of a compromise package, I would strongly suggest that it is part of the legislative record in your committee hearings and in your debate that in no sense does this represent a commitment on the part of the legislature that these particular tax rates are the rates which will obtain five and six and seven and eight years from today. We will have time to review that. So that in a sense what you are giving by accepting the proposed amendment to the severance tax is a willingness

on the part of the legislature to avoid extensive litigation on the royalty offset feature which we think is of very little interest to the state of Alaska, in any case.

Now, the severance tax of course is one of your important weapons. I mentioned in previous hearings before this committee and elsewhere, that eventually your income tax is an important thing but that's not up for discussion. It's not an appropriate time for the legislature to review your state income tax legislation although I strongly urge that at one of your sessions you review with your commissioner of revenue your entire concept of corporate income taxation here in the state. The conservation tax bill which is before you, I think is unncessary. We had recommended that the conservation tax which had been on your statute books in the past be eliminated and simply subsumed within your severance tax. It's an added piece of legislation that we don't feel strongly about one way or the other, but it complicates the whole process of paying and collecting monies as between the state and the industry. On the ad valorem tax, as we see it, this is a revenue measure designed largely to yield income to the state over interim years before Prudhoe Bay production begins, before the pipeline is completed. It falls within the province of the legislature to decide how, when and under what conditions it wants to raise that amount of money.

It's the combination then of a strong regulatory bill and the fact that you have continuing flexibility and authority

to tax via your severance tax or eventually through your income tax that we believe yields the greatest control by the state over the operations and the tariff determinations of the pipeline so as to protect the interest of the state.

Now let me get on the Right-of-Way Leasing Bill. We have gone through this bill chapter, book and verse, section, sub-section and paragraph and I think we are prepared to sit down with this committee and other committees of the legislature to discuss it in detail. I don't believe we have time to go through each and every aspect of this here, but I will report on those which we feel are most critical to whatever compromise package comes out. The first issue, as we see it, involving any amendments to the Right-of-Way Leasing Act is how much of the regulatory power that the state wants to exercise shall be done by indirection in the form of stipulations and agreements as conditions of leasing. The industry is challenging the 1972 Right-of-Way Leasing Act in the courts on constitutional grounds, claiming that in effect regulation achieved by indirection which cannot be exercised by the state directly is an illegal exercise of the leasing powers of the state of Alaska. This is one of the major issues under litigation. We obviously are not in a position to pass any judgment whatsoever on the merits of the case in litigation. I think there is a spirit of compromise abroad, I see it very much in the proposals of the Governor's Office, I'm not quite sure I see that much spirit of compromise

in what the companies are proposing in their package, but nevertheless, there is a spirit of compromise abroad and certainly we would feel strongly, and I hope the legislature does also, that it is desirable to avoid unnecessary prolongation of litigation, and the possibility that such continuing litigation may delay the start of construction. So if it is possible to avoid litigation without unduly sapping the legislative enactments that are vital to the state interest, we would feel that there is some merit in the legislature going ahead with the executive departments decision that a compromise is now in order. So on then to the question of the regulatory items which are introduced into the Right-of-Way Leasing Act by virtue of stipulations as a conditions of lease. One, the most important one in our opinion, which is largely eliminated is in section 120 (a) (3) that's the common carrier section. For many reasons it is of importance to this state that it is understood beyond any doubt that the transAlaska pipeline is a common carrier; a common carrier not only for purposes of regulation of interstate oil movements by ICC but a common carrier also for purposes of regulation by your pipeline commission. There is merit, that as a condition of the lease the pipeline stipulates that it is a common carrier period --without reservations, without qualifications, or anything else. Now this is so common, this is so common in state and federal regulation, that it is really surprising to me that any amendment to the existing Right-of-Way Leasing Act should in effect qualify the common carrier status here. It says first of all, that there will be common carrier if the

the commission so determines at the time the lease is issued. I don't think this should require a determination by the commissioner. Under these circumstances the pipeline is a common carrier -- without hearing, without determination, or anything else. Secondly, I don't think it is necessary in the Right-of-Way Leasing Act to stipulate what obligations fall upon a common carrier and certainly not to qualify the obligations incumbent upon a common carrier. 120 (a) (3) says that it will accept, convey, transport without discrimination, crude oil. This is something which will be covered by your pipeline commission in the course of regulation if it is a common carrier. Certainly not in advance to limit the jurisdiction over a common carrier by your own pipeline commission by saying that the imposition of common carrier status does not require the lessee to accept tenders of crude oil, except at points where there exists public, etc. etc. Do not qualify the obligations of a common carrier. This is a function of your regulatory agency and insofar as your regulatory agency in its individual decision from month to month or year to year may either deny rights to a common carrier or impose obligations upon a common carrier which the pipeline owning companies feel are unduly onerous, they have recourse to the courts. So I don't think that one should qualify the obligations of a common carrier. I think that your 120 (a) (3) should simply stipulate that as a condition of obtaining a right-of-way over state lands, the lease for the right-of-way over state lands, the pipeline carrier itself, submits itself as a common carrier. Not only for the ICC

jurisdictional purposes but for the purposes of the exercise of jurisdiction by your pipeline commission.

120 (a) (4) in the recommended legislation removes the common purchaser provision from your 1972 legislation. At that time it was a permissible feature of your law. In place of the removal of the common purchaser status as a condition of leasing, the Governor has sent down a special bill that would make it possible to establish under certain conditions and subject to certain provisos, common purchaser status for companies owning the transAlaska pipeline. We do not feel now and we felt for a long time that there is real doubt as to how important common purchaser provision is in the state of Alaska, under the conditions where your oil is being produced and transported. Common carrier, yes, because it provides access to transportation and an equitable basis for everybody who is able to achieve production in the new state. Common purchaser for many reasons we have reservations about whether to leave it or not. The bill which is proposed to you we think is a weak and rather attenuated version of a common purchaser act, as it is applied in other states in the United States. Our recommendation at this stage of the game would be that you can afford and should yield the common purchaser provision as a condition of right-of-way leasing and probably simply pass over this special piece of legislation which establishes a common purchaser provision and hold that over to future sessions of the legislature as not being important at this time. When and as common purchaser provisions become meaningful in the conditions of the state of Alaska, at that

time to enact not the legislation that's proposed by the Governor, but a strong common purchaser act which is appropriate to the circumstances at such time. You will have ability and time to do that in the future. I don't think it's an essential point of the compromise, either from the companies' standpoint or from the State's standpoint.

I'm bringing before you here only major things or illustrative aspects of it. 030 - 040 -- these are repealed in the proposed amendment. In the proposed amendment to the Right of Way Leasing Act 1972, section 2 repeals 030-040. Now, 030-040 in the act that is now on the books governs the abandonment of or reduction or impairment of service and temporary emergencies services, and so on. It has to do with the authority that the state claims for itself and buttresses that authority by virtue of this being a condition of the lease. I would think that it might be appropriate, again in the spirit of compromise, that 030 and 040 be retained but that the language be rewritten to say that insofar as these are imposed upon the carrier, that they are in accordance with the jurisdiction and orders of the Interstate Commerce Commission or the Alaska Pipeline Commission, as is appropriate to the case. Which means in effect that the companies, although they are governed by these two clauses, nonetheless know that these two clauses are in accordance -- what is obligatory upon them is in accordance with the regulations that may be promulgated, either by the ICC if it involves interstate commerce or by the Alaska Pipeline Commission if it involves intrastate commerce. I put these out only as illustrative of the

aspects of regulation within the Right of Way Leasing Act which is at issue in the courts -- where we think either the state should stand firm, such as in the matter of common carrier, or where we think the state may very well yield. In general I would think that insofar as the state can achieve a right of way leasing act which avoids litigation but does not give up essential rights which the state still retains through, and I repeat, the combination of a strong regulatory bill and the ultimate enforcement of state regulation through its taxing power, that the legislature can yield on certain of these items in the Right of Way Leasing Act.

This by no means exhausts the regulatory aspects, but in the interest of time I want to move on to other things and as I said we're prepared to go through section by section with our specific recommendations to you.

The second major issue in the Right of Way Leasing Act is the percentage lease rental formula. There are two different impressions abroad as to the purpose of the percentage lease rental formula. Prof. Witherspoon yesterday afternoon suggested that he looked upon it as a revenue measure for the state. That if, in fact, the value of state lands were to be appreciated by the construction of the pipeline then the state like any other owner of land should be in a position to bargain for a fair share of the value of the land when it is being put to a superior use. I have no quarrel with this in principle; however, our position always has been that the leasing of state lands for pipeline right of way should not be regarded as a revenue device by the state of Alaska. We have always recommended that the interest of the state of Alaska is in the lowest possible cost transporta-

tion and the state of Alaska should not in and of itself undertake measures which inherently tend to increase costs of transportation, insofar as producing operation in the development of Alaska's resources provide the base for state taxation. It should be other than through the rentals of the right of way leasing of state land. So we have always urged the lowest reasonable rental for the commitment of state land to right of way. I would point out, for example, that even private property insofar as it's condemned by eminent domain for public utility or pipeline purposes does not convey even to a private owner any right or any entitlement to the enhanced value of land if it's put to other use. So we would recommend that however one looks at the rental for right of way lease that this not be regarded by the legislature as an aspect of its taxing power or as a means of gaining state revenues. That comes from other taxing devices in the state.

The other aspect of the percentage lease rental provision in the right of way leasing bill was that it was to be looked upon as an alternative -- either pain of paying or inducement to the companies to bring their tariffs down to a level which is compatible with the interests of the state; that is to say, a tariff that is lower than the maximum it might obtain under the ICC rate-making rule, certainly high enough to be rewarding for their investment and their risks but a level which is appropriate to the circumstances of pipeline operation in the state. And insofar as they increased their tariffs above a certain level, they were in effect subjecting themselves to the pains of progressively higher lease rental.

This was the percentage lease rental formula. This is one of the major items under litigation. For very obvious reasons the companies regard this as not only as something which is onerous to their circumstances in the state of Alaska but a precedent that if it were followed could lead to all kinds of things in their operation elsewhere. We have reservations about the effectiveness with which the percentage lease rental formula would operate for its major purpose, that is to say, in and of itself to induce the companies to bring the tariff down. It might for some companies, it might not for others. The extent to which it does for any of them would be largely contingent upon their respective equities in the pipeline as sellers of tr.nsportation services and in production as buyers of pipeline transportation services. There is an element of unpredictability in the operation of it. And while it was from the beginning, in our opinion, an imaginative and constructive approach and we're not saying even today that if properly effective it might not be a useful tool in right of way leasing legislation; but in the context of the violent litigation associated with this aspect of the right of way leasing bill, with the chances that continued litigation over this aspect of the bill may delay construction of the line, and on the presumption that what you have is not an emasculative regulatory bill but a strong regulatory bill, then we would feel that the legislature could give on the percentage lease rental and adopt the alternative to it as is proposed in the amendment to the Right of Way Leasing Act of 1972 by the Governor's amendments. Again, I say

that there are questions about how effectively it would operate in practice. Notwithstanding, there might be reasons for the state to hold to its case, to fight through the issue of litigation, if there weren't such a sense of urgency about getting the pipeline built, if there might not be such a large cost to the state in litigating. And whatever is done by way of amending the Right of Way Leasing Act in order to assuage the fears and concerns of the pipeline companies, either because of what it does or the precedent that it sets, I would say that what the legislature may do in terms of amending the Right of Way Leasing Act, in our opinion should be contingent first upon the retention of a strong and effective regulatory bill, that is to say Alaska Pipeline Commission Act. A strong regulatory bill which is backed then also by the state's taxing power and so that although you yield another tool in the entire package of legislation which was designed in 1972 to effect and enforce the state interest, really yielding to industry concerns, you do so here in the interest of avoiding undue litigation and the danger of delay on the pipeline.

The third aspect of the Right of Way Leasing Act to which I'd like to refer is the option to buy a percentage interest in the pipeline. The option to buy a percentage interest in the pipeline. I will not take time now to review the reasons why we have supported the insertion of the option to buy in the 1972 legislation. I think they're fairly familiar and

they've been reviewed I believe in previous sessions of this committee. We still feel that the option to buy a percentage interest is an important feature of right of way leasing. I think that insofar as the companies have allowed the purchase by the state of an interest in the pipeline to appear as a condition of the lease, even in the proposed amendment by the Governor, suggests that it is not a disabling aspect of the legislation from the standpoint of constitutionality of the legislation -- I don't know. But certainly the alternative which appears in the legislation which is section 120 (a) (7), the alternative which is substituted in the proposed legislation in our opinion represents nothing whatsoever for the state.

I think to amend the Right of Way Leasing Act to include the amended 120 (a) (7) would be to retain nothing for the state in this respect. I certainly would not recommend that part of the amendment. An opportunity to negotiate for an equity in the pipeline under highly qualified conditions, means that the state has an opportunity to negotiate when it serves the interests and purpose of the companies, which is really not what is intended in the option to buy as contained in the existing law. We do feel, however, that the legislature should give very serious consideration to the advice laid before it by Mr. Spahr of Standard of Ohio, that the option as it stands in the

legislation today may pose difficulty to the financing, or at least the financing at attractive terms, of the pipeline. Because of the uncertainty in the minds of prospective lenders as to what the capacity of the state as a possible future owner of a share of the pipeline may be to carry out obligations for the debt that is incurred at the time of construction which carries over and then may have to be shouldered by the state if the state buys the pipeline. I can appreciate that concern. But I would like to point out first of all -- and I have said this in general and I like to be very specific -- that there are precedents for this. The illustrations that I have made before various committees of this legislature the last two days, I would like to refer to very specifically here. There is the agreement between a consortium of oil companies called Syncrude and the province of Alberta in Canada which determines the basis upon which they get the lease to produce oil from the Athabasca tar sands and transport that oil via pipeline from Athabasca to Edmonton where the oil would enter into the major pipeline systems that traverse Canada and enter the United States. First of all, this has to do with ownership of the pipeline. This synthetic crude pipeline shall be constructed and owned as to an undivided 80 percent thereof by Her Majesty and/or an entity or entities hereafter formed by Her Majesty.

So that from the start, the province of Alberta is being given 80 percent participation in the pipeline. Now, an eighty percent participation in the pipeline--where is the oil going to come from? The province of Alberta is going to inance its 80 percent share of the pipeline just as a private company would. But how do you finance construction of a pipeline if you are not sure you are going to have the oil to put through? The lessees, and her Majesty, and the respective assignees of any interests in the Syncrude projects will dedicate their respective shares of the Syncrude oil recovered from the project to the Syncrude pipelines. That is to say, where the oil being produced by that project is committed to the pipeline irrespective of the fact that Her Majesty's government, that is to say in the province of Alberta, has 80 percent interest in the pipeline. So the percent of interest in the pipeline is there, the difference, of course, being that the state of Alaska in its Right-of-Way Leasing Act had wanted an option.

Now the issue of an option comes up. In this same agreement between the Syncrude consortium and the province of Alberta, the lessees, the Syncrude group including Exxon through Imperial Oil Canada, Atlantic Richfield (these are familiar names to you), Cities Service, and Gulf Oil--these lessees hereby grant Her Majesty an irrevocable option to acquire an interest in the Syncrude project. This is in the producing operation including the project sites, the leases and rights granted thereby, and all facilities acquired or constructed as part of the Syncrude project, which interest may equal undivided percentage interest of not less than 5 percent and up to and

including 20 percent. The option may be exercised at any time during the period from the date hereof and up to and including that date which is 6 months after the date of start of production or the 31st day of December 1982, whichever is the earliest.

Now as to how this is paid for, the payment by the government of Alberta to the members, the private companies, that make up Syncrude: Such costs shall be computed (in accordance with the accounting manual) on the basis of all of the costs which they, the companies, have incurred up to the date of the exercise of the option and shall include interest compounded annually at 8 percent. No portion of such costs shall be attributed to the reserves of leased substances. The province of Alberta could thus be buying in at what is the investment costs of the company plus the payment of 8 percent interest for all time that is elapsed. An interest in the producing operation of between 5 and 20 percent.

Why do I introduce this? Simply because I'm trying to suggest that there is precedence where the companies are prepared to undertake both to accept government participation in the pipeline and whereby companies are prepared to accept an option for governments to participate in what is essentially private operation. That the financing of this project does not seem to be inhibited whether by the government's participation in the pipeline or by the government's option to acquire an interest even in producing operations. Now I grant you that there is a very significant difference in the capital costs of the two projects. The TransAlaska pipeline will probably involve an aggregate initial investment on the order of ten times as much as the Syncrude operation. But that doesn't mean that

individual bond holders are lending ten times as much money. The problem of the bondholder, whatever the number of dollars, always is what security lies behind; what security is there which insures that the viability of the operation will provide for interest and sinking fund contributions. To get back to the crucial point, if the option is retained in the Right-of-Way Leasing Act, the existing legislation may be amended so as to stipulate in advance, first of all, what the basis of compensation will be so that there is clear protection that no member of the Trans Alaska group will in effect suffer deterioration of its capital position by virtue of the exercise of the option by the state. And that in negotiating that option, the commissioner shall be prepared to enter into such stipulations by the state as provides the assurance necessary for the indebtedness that bondholders will be entering into prior to any possible exercise of the state's option. We feel that the right of the option to obtain an equity is a useful aspect of the entire package of legislation which you enacted in 1972. We think there may be a question about the way it is now written, whether or not the companies have as much, what shall I say, protection for their borrowing capacity as they would like to have. This protection can probably be provided both in the legislation where it refers to the terms at which the price will be paid and in the lease negotiation itself where the commissioner is authorized to give certain commitments on the part of the state of Alaska. Existing legislation also requires considerable other steps before an option can ever be exercised, including the positive act by the legislature and a referendum by the people of the

state of Alaska if there is to be debt financing. So I think there can be fair protection all around.

This again, represents in our judgment an approach to the issues which confront the state of Alaska. The issues being, must you continue litigation and risk the fact that prolonged litigation may result in delay in the pipeline? Or must you accept a negotiated package of legislation such as submitted to the legislature by the Governor? Or is there an alternative package of legislation which in your judgment represents the protection of the vital interests of the state of Alaska insofar as resource development and pipeline development is concerned, and probably represents a package which the industry can accept? It may pose uncertainties for industry but insofar as they may be obliged or feel they want to litigate, they need not do it in advance but can start construction of the pipeline and be prepared to litigate specific aspects of it as they become relevant. For example, if your pipeline commission, sometime in the future, issues an order which is deemed to be an unreasonable, in violation of due process, the companies can protest such order in the courts, and upset it if their protest is upheld. I think that what we are suggesting here is in the spirit of the negotiations between the Governor and the companies. It certainly represents a yielding on the part of the legislature, if our recommendations are followed, which go a considerable way to meet the issues posed in litigation by the companies. But I do believe it retains for the state of Alaska in two critical areas--namely the regulatory bill and the ultimate ability to enforce the intentions of regulation by the state's taxing

powers. Plus the retention in the Right-of-Way Leasing Act of certain conditions including the common carrier provision. It means yielding on what had been one of the most provocative and imaginative aspects of the legislation which is percentage lease rental. It means compromise on the option to buy so as to provide certain added protection for the companies. In our judgment, I think that this combination of action by the legislature would secure the interests of the state, and in our judgment (of course we are not in a position to speak for the companies) might not be wholly attractive to the companies, but we would think that they would not litigate to the extent that it would involve delay in the construction of the pipeline.

S Doc

MEMORANDUM

October 29, 1973

To: Members of the Senate Resources Committee

From: Arlon R. Tussing

PROPOSED AMENDMENTS TO AS 38.35

As requested yesterday I have drafted some amendments which retain the spirit and intent of the 1972 right-of-way leasing act, but which I believe remove its troublesome complexities. These amendments are based upon two elementary and uncontroversial propositions: (1) a right-of-way lease is a contract whose terms are binding upon the parties, and (2) everybody is expected to conform to the law.

The main problem with the 1972 act is that it asked the applicants to stipulate as a condition of getting a lease, to things they believed it was beyond the state's police power to require. By signing the lease contract, however, they might prejudice their right to challenge either a stipulation or a later order they deemed illegal. This is the reason they went to court immediately and spoke of not building a pipeline until the controversy was settled. These provisions attempt to meet the companies' legitimate concern in this regard, without however prejudicing the state's right to challenge what it believes is an improper federal invasion of state jurisdiction.

Unfortunately I did not have time to go through the entire act using this approach.

[A.T. AMENDMENT NO. 1 --- DRAFT OF 29 OCT., 1973]

Sec. 38.35.020 GRANT OF RIGHT OF WAY LEASE. (a) Rights-of-way on state [] land inculding rights-of-way on, over, under, along, across, or upon the right-of-way of a public road or highway or the right-of way of a railroad or other public utility, or on, across, upon, over or under a river or other body of water or land belonging to or administered by the state may be granted by noncompetitive lease by the commissioner for pipeline purposes for the transportation of oil, products or natural gas under those conditions prescribed by law and by administrative regulation. Except to the extent authorized by an oil and gas lease or unit agreement approved by the state, no person may engage in any construction or operation of any [] part of an oil, products or natural gas pipeline, which in whole or in part is or is proposed to be on state land, except in conformity with the terms of a right-of-way lease of that land, issued by the commissioner under this chapter [].

COMMENT: This language provides, as do both the 1972 act and the governor's bill, that the builder or operator of a pipeline in whole or in part on state land must have a right-of-way lease from the state. It also specifies, however, that all construction or operation of such a pipeline, by whomsoever, must be in conformity with the terms of the lease.

This provision clearly imposes the conditions of the lease (which include the information and plans in the lease application) on any successor to the original applicant.

[A.T. AMENDMENT NO. 2 --- DRAFT --- 29 OCTOBER, 1973]

Sec. 38.35.020 Add a new subsection, viz, (b) The commissioner may by regulation exempt the construction or operation of field gathering lines or any reasonable classification thereof from the requirement for a right-of-way lease under this chapter.

COMMENT: The proposed subsection recognizes that some so-called gathering lines may already be provided for in the terms of oil and gas leases, that others might best be exempt ftom the terms required for pipelines under this chapter (e.g., to be common carriers) in order to maximize wellhead prices, while others might best be brought under its terms. Under this reading, sec. 38.05.330 might be amended to allow the issuance of permits, etc. for "field gathering lines [] not subject to AS 38.35."

[A.T. AMENDMENT NO. 3 --- DRAFT --- 29 OCTOBER, 1973]

Sec. 38.35.030 ABANDONMENT, [] REDUCTION OR IMPAIRMENT OF SERVICE OF PIPELINE []. No lessee [] may abandon any portion of a pipeline that is [] subject to a [] lease granted under this chapter, or operation or transportation service or sale by it, or reduce or impair service, except in accordance with the terms of the lease [].

COMMENT: This language applies to abandonment, reduction or impairment of service the same standard applied in section 020 --- that any such action be carried out only in conformity with the terms of the right-of-way lease. Section 38.35.080 is not necessary if the new language is adopted.

[A.T. AMENDMENT NO. 4 --- DRAFT --- 29 OCTOBER, 1973]

AS 38.35.050 is repealed and re-enacted to read:

Sec. 38.35.050. APPLICATIONS FOR RIGHT OF WAY LEASES. (a) A person or persons desiring to engage in construction, acquisition or operation of a pipeline which is proposed to be located in whole or in part on state land, shall apply for a noncompetitive right-of-way lease of the state land under this chapter.

(b) Applications under (a) of this section shall be made in a form and manner prescribed by regulation, and shall include any and all data, information, plans and exhibits which the commissioner determines are necessary to prepare the analysis required by section 080 of this chapter and to make a decision under section 100 of this chapter.

(c) The application filed under this section shall be incorporated into any right-of-way lease issued thereupon, and shall become a part of the terms and conditions of the lease. Any amendment to an application filed under this section which constitutes a substantial change in the application is subject to all provisions of this chapter applying to an original application.

COMMENT: Subsection (a) is substantially the same as the governor's proposal. Subsection (b) requires the filing of relevant information demanded by the commissioner. Subsection (c) incorporates into the lease itself the lease application and any statement of intention therein (even where they concern actions to be taken off the state-issued right-of-way). These statements of intention then become contractual obligations of the lease and of continuing to hold it. Any substantial modification of conditions based upon the application must be processed like a new application.

[A.T. AMENDMENT NO. 5 --- DRAFT --- 29 OCTOBER, 1973]

AS 38.35.060 is repealed.

COMMENT: The intention of section 060 is carried out by the proposed language of section 030, which prohibits abandonment, etc., "except in accordance with the terms of the lease."

[A.T. AMENDMENT NO. 6 --- DRAFT --- 29 OCTOBER, 1973]

Sec. 38.35.120. COVENANTS REQUIRED TO BE INCLUDED IN LEASE. (a) A noncompetitive lease of state [] land for a right-of-way for an oil or natural gas pipeline valued at $1,000,000 or more may be granted only upon the condition that the lessee [] expressly covenants in the lease, in consideration of the rights acquired by it under the lease, that

(1) it will construct and/or operate the pipeline in accordance with applicable state laws and lawful regulations and orders of the Alaska Pipeline Commission. *Provided, however:* that the terms of a right-of-way lease issued under this chapter shall not be deemed to permit or require a lessee, the commissioner or the Alaska Pipeline Commission to take any action that is in conflict with federal law or with lawful regulations or orders of the Interstate Commerce Commission or the Federal Power Commission.

COMMENT: This proposed covenant incorporates as a condition of the lease itself submission to the state's regulatory jurisdiction ("police power" and/or "economic"), whatever the limits of that jurisdiction may be. The companies are not required as a condition of a lease to stipulate to some condition that may be prohibited by federal law, and thereby to waive the right to challenge that condition. At the same time, in contrast to the governor's bills, the state reserves the right to challenge federal actions that might invade the state's lawful regulatory jurisdiction.

The remaining covenants would be renumbered and amended to remove duplications or conflicts with this clause and proviso.

Sale by the State of Alaska of Rights to Receive Future Production of Royalty Oil and Gas

State of Alaska legislation in 1974 provides a procedure with respect to the sale of the State's royalty oil and gas. The Commissioner of Natural Resources of the State can sell royalty oil and gas received in kind at the time of its production. He can also sell the State's rights to receive future royalty oil and gas production and receive payment for all or part of it now in the form of an advance sale.

Such sales must be made with the prior written approval of the Alaskan Royalty Oil and Gas Development Advisory Board and with the prior approval of the Legislature. These sales are not sales of oil or gas in place. The Constitution of Alaska prohibits sales in place.

If the State made a sale of its rights to receive future production of royalty oil or gas, the following questions come up:

1. How would such a deal be structured?

2. Would the State lose any of the increased market value of oil sold in this way between the time of sale and the time of production?

3. What portion of the State's royalty from Prudhoe Bay would have to be committed to the repayment of, say, $100 million, over a 3½ year period, commencing with the startup of production?

Structure of the Transaction

A transaction of this type would involve at least three parties--seller, buyer and a financial institution. The State of Alaska, as the Seller, would contract to sell oil to a Buyer and deliver it as it is produced. The Buyer would contract to buy the oil and would pay for

it in advance. Since it is quite unlikely the Buyer would have money available for such an advance payment, he would very likely borrow it from a group of banks. The Seller and the banks can be readily identified. However, a Buyer cannot be so readily identified.

The Buyer could be an oil company who has use for the oil, however, it is doubtful that there are companies with the money available, or the willingness to incur the debt necessary for such an advance payment. Therefore, the Buyer would likely be a financial vehicle created for this purpose, perhaps a company owned by a charitable organization.

If the Buyer is owned by a charitable organization, the questions arise as to why it would be in such a transaction, and how it would use this oil. It would be in the transaction for the financial gain it would realize. It would probably enter into an agreement with another party, a fourth party in this transaction, to sell the oil as its agent. Such fourth party might well be the working interest owner of the properties from which the oil will be produced. This overall arrangement is outlined on the attached exhibit.

Market Value of Oil

The State should lose nothing in terms of market value by making such a sale. The terms of the agreement would be somewhat as follows: "Seller agrees to sell to the Buyer that quantity of crude oil representing __ percent of its royalty interest in leases _____, _____, and _____, until the market value of that oil at the time it is produced is equal to $_____." The quantity of oil to be delivered would include oil to cover interest for the use of the money which the Seller receives in advance and for any profits which the Buyer would make on the transaction. Such profits would be small in terms of the whole transaction.

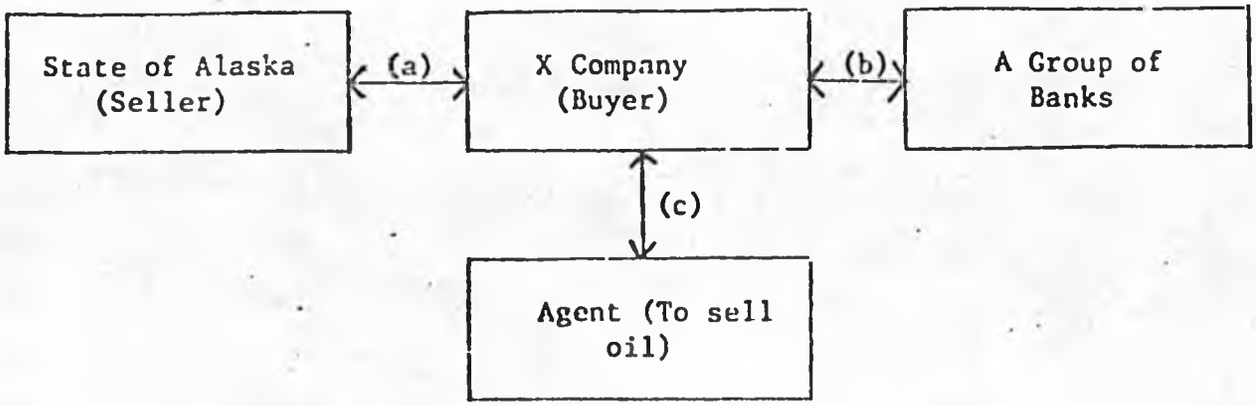
Portion of Royalty Dedicated to the Sale

If a sale of $100 million of Prudhoe Bay royalty oil were made on July 1, 1976, and if production commenced at Prudhoe Bay on July 1, 1977, the advance could be paid out of about ~~15~~ 17 percent of the State's royalties during the period July 1, 1977 to December 31, 1980--that is, a period of three and one-half years. The ~~15~~ 17 percent applies to the State's royalty after payment of 2 percent into the Native Claims Fund. A wellhead value of the oil of $5 per barrel and a production rate of 600,000 barrels per day for the first six months and 1.2 million barrels per day thereafter have been assumed. With an assumed interest rate of 8 percent, the State would deliver 25.1 million barrels--20 million to repay principal and 5.1 to pay interest. Thus, about 20 percent of the ~~15~~ 17 percent dedication (or 3 percent) would go to interest.

2/20/75

ADVANCE ROYALTY SALE BY
STATE OF ALASKA

1. Agreements



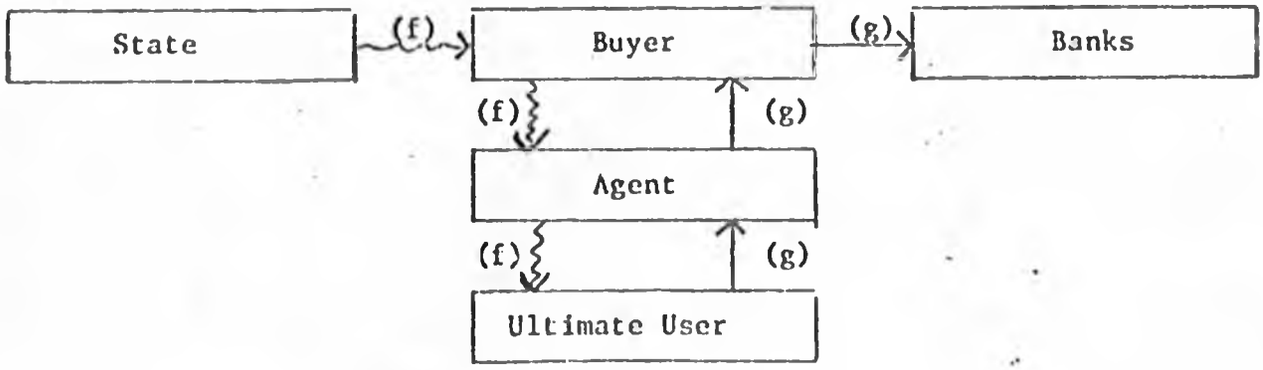
(a) State agrees to sell oil to Buyer.
(b) Buyer makes credit agreement with Banks.
(c) Buyer appoints agent to resell oil to ultimate user.

2. Flow of Money on 7/1/76 (e.g.)



(d) Banks lend money to Buyer.
(e) Buyer makes advance payment to State.

3. Delivery of Oil (~~~>) and Flow of Money (——→)--7/1/77 to 12/31/80



(f) State delivers oil to Buyer who resells and delivers it to the ultimate user, by using an agent to make the sale.
(g) User pays for the oil and Buyer repays the bank.

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PRUDHOE BAY ROYALTY AND SEVERANCE
PRODUCTION COMMENCING 7/1/77; 600 M B/D
AVERAGE FIRST SIX MONTHS, THEN 1.2 M B/D
(Millions)

		1976	1977	1978	1979	1980	1981
1.	Production (B/D)	0	0.6	1.2	1.2	1.2	1.2
2.	Wellhead Value Per Barrel (a)		$5	$5	$5	$5	$5
3.	State Income-- No Advance Sale						
	Royalty (b)	0	69	274	274	274	274
	Severance (8%)	0	38	153	153	153	153
	Total	0	107	427	427	427	427
4.	Effect of Advance Sale on State's Royalty Income	+100	-10	-39	-39	-38	0
5.	State Income-- With Advance Sale						
	Royalty (b)	100	59	235	235	236	274
	Severance (8%)	0	38	153	153	153	153
	Total	100	97	388	388	389	427

(a) Project Independence Blueprint of the Federal Energy Administration makes reference to "Minimum Acceptable Prices" of $5.16 to $6.15 per barrel at the wellhead to stimulate development in "special regions," (including the North Slope of Alaska). See Table B-1 in Part 2 of FEA publication dated November 1974 entitled "Task Force Report - Finance."

(b) Includes portion going to Native Claims.

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