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appoint at least five qualified persons to serve at his pleasure as the State Assessment Review Board.

Sec. 43.56.060. PER DIEM AND EXPENSES. Members of the State Assessment Review Board shall be compensated and are entitled to per diem and expenses authorized by law for boards and commissions.

Sec. 43.56.070. POWERS AND DUTIES. The State Assessment Review Board has the powers and duties with respect to assessment of property taxable under this chapter of an assembly or council sitting as a board of equalization.

Sec. 43.56.080. COLLECTION AND ENFORCEMENT. The tax levied under sec. 10(a) of this chapter is payable in full to the Department of Revenue on June 30 of the tax year, except that the Department of Revenue may by regulation provide for prepayment of taxes and payment by installments. A penalty of ten per cent shall be added to delinquent taxes and interest at the rate of eight per cent per annum, or four percentage points above the per annum rate charged member banks for advances by the 12th Federal Reserve District that prevailed on the first day of the month preceding the commencement of that calendar quarter, whichever is greater, shall accrue on all unpaid taxes, excluding penalties, from the due date until paid in full. Collection of the tax levied under this chapter shall be carried out by the Department of Revenue substantially in the manner provided in AS 29.53.200 - 29.53.390 except that the state is substituted for references to cities and boroughs.

Sec. 43.56.090. LIEN FOR TAX. Notwithstanding any other provision of law, the tax levied under this chapter and interest and penalty set out in sec. 80 of this chapter are liens upon the property subject to tax under this chapter. The liens provided by this section are prior and paramount to all other liens or encumbrances upon the same property.

Sec. 43.56.100. FAILURE TO FILE; FALSE STATEMENT. A person who

knowingly fails to file a return when due or makes a false statement in a return required under this chapter with intent to evade the taxation is guilty of a felony and upon conviction is punishable by a fine of not more than $5,000, or by imprisonment for not more than five years, or by both, together with the costs of prosecution.

Sec. 43.56.110. DEPOSIT IN GENERAL FUND. The revenue from the tax levied under sec. 10(a) of this chapter shall be deposited in the general fund.

Sec. 43.56.120. REGULATIONS. The state assessor and the Department of Revenue may adopt regulations as appropriate to carry out their respective duties under this chapter.

Sec. 43.56.130. DEFINITIONS. In this chapter "taxable real and tangible personal property" means machinery, appliances and equipment used in the operation of wells producing oil or gas and tank farms, tanker terminals, gathering and transmission lines, and related facilities associated with the production and transportation of crude oil and natural gas; the term includes otherwise taxable property exempted from taxation under home rule ordinance or charter, but does not include property exempt from taxation under the constitution and laws of the state or of the United States, or any subsurface estate, including oil in the ground, or property used in a consumer distribution system.

* Sec. 2. AS 38.35.140 is repealed and re-enacted to read:

Sec. 38.35.140. PAYMENT OF RENTAL. (a) The carrier shall agree in the lease, as a condition for obtaining the lease of state public land for pipeline right-of-way, that it will pay annually to the state as rent for the premises demised an amount determined in accordance with the provisions of AS 38.05.330 for the lease of state public land for easements and rights-of-way.

(b) Each lease of state public land for pipeline right-of-way

shall provide that all money and other sums which become due to the state by reason of any provision of the lease is and shall always be a valid and first lien but second in priority to a lien imposed under AS 43.56.090 upon the buildings and improvements on the demised property, and upon all of the interests of the lessee carrier in the lease and in the property of the carrier transported by the pipeline subject to the lease and paramount to any mortgage which the carrier may execute on them, or any lien caused by the carrier.

* Sec. 3. AS 38.35.190(c) is repealed.

* Sec. 4. This Act takes effect on the day after its passage and approval or on the day it becomes law without approval.

Alaska's Governor William Egan presented his case for ownership and regulation of the trans-Alaska pipeline by the State of Alaska in hearings before the Alaska legislature's House State Affairs and Senate Commerce committees in early March.

Extensive testimony by state administration officials and consultants laid out the problem of shrinking North Slope oil revenue projections caused by rapidly escalating pipeline costs; State ownership and regulation was presented as a solution. An oil industry task force led by the Standard Oil Company (Ohio) Chairman Charles Spahr, presented exhaustive counterpoint to the administration's testimony for a state owned pipeline. By the end of a solid week of hearings, feelings among most legislators were that public ownership of the pipeline would be a bad deal for the State of Alaska. But legislators also felt that the state's revenue situation thoroughly presented in overly negative terms by the administration, was critical enough to justify some local influence over tariffs on the trans-Alaska pipeline.

ALASKA'S REVENUE SITUATION

In simple terms, the State of Alaska's situation is this: Following the dramatic September, 1969 Arctic oil lease sale, which garnered $900 million into the state treasury, the state administration and legislature looked to a confident future in which $150 to $300 million annually in North Slope oil royalties and taxes would begin shortly after completion of the trans-Alaska pipeline in the early 1970's. The pipeline construction schedule appeared fairly certain, and likewise the projected pipeline cost (roughly one billion), a figure which would determine the pipeline tariff structure once in operation (which would in turn largely determine the wellhead field price of oil on the North Slope, on which state royalties and taxes were paid).

In an air of optimism, the state went into a heavy budget almost twice the budget of the year previous. Such innovative programs as local government revenue-sharing (which allowed a drastic cut of local property taxes), 90-10 state funding of school costs in school districts, and many other social services long in critical need in Alaska. Following the discovery of oil at Purdhoe Bay and the September, 1969 oil sale, Alaska public sentiment demanded an immediate showing of some benefit from the new arctic discoveries, and these benefits were delivered in the following year's expanded state budget. To accomplish this expansion, a part of the principal of the $900 million was used.

The State of Alaska has been criticized both within and without Alaska for spending parts of its oil wealth too quickly, thereby creating the financial situation the state now finds itself in. But in the spring of 1970, following the September lease sale, political realities in Alaska demanded that the public be given some demonstration of the benefits brought by Arctic oil discoveries.

One legislator put it this way, that year: "When you've been poverty stricken, starving and living on soup for many years and suddenly you inherit a million dollars, what's the first thing you're going to do? Go get another bowl of soup? No, you're going to walk into the finest restaurant in town and order the largest steak on the menu." The situation Alaska is in, though, is that of the man grown used to large steaks and suddenly faced with the prospect of living on soup again.

The rosy optimism of 1970 began to fade when unexpected delays hit the pipeline's construction timetable. Originally slated to begin construction in spring of 1970, federal right-of-way permits were withheld by court action brought by out-of-state conservation groups. At this writing, it appears extremely unlikely that any construction activity can begin before spring of 1973, and possible spring of 1974. A four year delay in receiving expected revenues from flowing North Slope oil has wrecked enough havoc on state budget projections, but an added twist lately is the unexpected sharp increase in pipeline construction cost estimates, which have a direct bearing on throughput tariffs and the determination of wellhead prices at Prudhoe, on which state revenues are based. As late as summer 1971, the State Department of Revenue had been informed that the pipeline costs were still hovering around $1 billion. Shortly following this, state officials read industry statements that projected line costs had escalated to around $2.5 billion. Industry statements also revealed that production would not increase as quickly as they had earlier expected, which meant that royalties and taxes, paid on a per-barrel rate, would not reach the income levels for given years that had been anticipated.

Faced with conflicting information and a growing "credibility gap" between state and industry, the state commissioned its own engineering consulting firm,

Tippetts-Abbett-McCarthy & Stratton, to develop a state estimate of construction cost. This is where the $3.5 billion state estimate came from. Factors in cost escalation, according to administration testimony were: Unrealistic original industry estimates, inflationary costs of delay, and increased costs due to engineering changes and adherance to strict federal environmental stipulations.

With these figures at hand, calculations in new budget projections showed that if industry would wish to levy high tariff charges on oil transport in the early years of pipeline operation to recoup an extremely heavy investment, the "wellhead" price of North Slope oil would be reduced to the point where little royalty and tax revenue would accrue to the state until the mid-1980's.

State officials were suspicious of the alleged common-carrier and ICC jurisdiction regulating tariffs and profits on the proposed pipeline. It would be simple for industry to "hide" high tariffs through accounting procedures allowed by the ICC which permitted pipeline companies (of which seven own the proposed trans-Alaska line) to lump tariffs on the Alaska line in with tariffs on other pipelines owned by that company.

To this complexity was added the legal problem of federal regulation preempting state regulation. For the state to simply own the pipeline was seen as a simple solution: The state could not only set tariffs which would determine North Slope wellhead prices, but would itself make profits from the pipeline.

HENRI'S GLOOMY OUTLOOK

State Commissioner of Administration Joe Henri, considered one of the prime "movers" behind state-ownership

concept, presented a dark and gloomy analysis of future budget projections at the Juneau hearings.

To fund a state budget of $311 million this year, he said, the state will again have to "raid" the lease sale bonus fund of roughly $100 million, further depleting it and reducing future interest income. The cycle will be repeated in following years, and "obviously, we will soon hit the bottom of the barrel. Only large and new revenues from the North Slope can allow us to continue our present growth rates," he said.

Growth rates this year, with program requests drastically slashed, were 3.5% for the general fund and 4.6% for the total budget. Increases in school foundation money,university budget, nursing home care and general medical relief, all desperately needed, will be foregone this year. In the next few years, Henri said, budget growth rates of 6% to 8% would allow "maintenance" state programs with no great increases, despite increases in population demand.

"Were Alaska to continue to increase its budget expenditures at the 6% and 8% rates...the first year of deficit would be 1978 (after the spending of all the bonus money), wherein we would experience a shortfall of over $156 million. This shortage would increase so that by Fiscal 1982 the deficit would be $1,135,000,000. Of course, deficits for operating expenditures are in fact impossible under our state constitution; instead of experiencing a billion dollar deficit ten years from now, we would in actuality have to reduce state expenditures radically," Henri said.

According to Henri's projections in the case of private pipeline ownership, the state could have $45 million in the treasury in 1982 only if state budget increases could be kept at 1% annually, which really meant, "a huge cut in all programs and the elimination of many," he said.

Henri paints a rosy picture for revenue projections under public ownership:. The state not only enjoys protection from "excessive" throughput tariffs and a reasonable wellhead price at Prudhoe, but also enjoys profits from the pipeline itself, which are bolstered by the fact that being publicly-owned, the pipeline pays no federal income tax. Under these terms, he says, money would be available to not only fund the "austerity" budgets of 6% to 8% increases, but also to fund additional increases.

"Were the oil line privately owned the state would have almost a billion less dollars to spend over the next ten years," he said.

Legislators were impressed by Henri's testimony and appreciated the budget predicament the state was in due to pipeline delays and cost escalation. However, they felt Henri had overstated his case and vastly oversimplified his projections.

In the end, Henri failed to convince legislators that there was any real difference between state royalty and tax rates under public ownership and private ownership. The only added benefit in the public ownership case was pipeline profits the state would theoretically enjoy, and that these would be the only "extra" funds available to bail the state out of a financial dilemma. This "extra" source of funds were questionable justification for the state to undertake the heavy burden of construction financing, many legislators felt.

Legislators also pointed out that Henri did not identify other potential revenue sources available from the pipeline and slope operations, no matter in what state of operation. These would be potential sources such as state property taxes aimed at pipeline, oil production and exploration facilities, possible revision of the severence tax or a switch to a cents-per-barrel severence (which would remove the need for a "wellhead price", thereby neatly solving one problem, though creating others).

Legislators also feel that Henri failed to accurately portray the budget considerations in the expanded post-lease sale budgets. The large budgets of 1970 onward could have been trimmed considerably without great harm to programs, and future budgets can be held in check without the great disasters in public services predicted by Commissioner Henri.

For instance, the local government revenue sharing and school-aid programs mentioned as marked for cutback would merely transfer tax responsibility back to the local governments and school districts. Implementation of state revenue sharing did not mean that local government or school budgets were drastically increased, but rather that local property taxes could be cut. If the state funds were eliminated higher local property taxes would have to be reinstated, but instances of real hardship caused by state cutbacks would be rare.

Legislators also felt that Henri dwelled on only the worst of possible circumstances for pipeline and slope revenue under private ownership of the line, and conversley presented public ownership in only the rosiest of terms. He failed to dwell on many obvious ominous risks inherent in public ownership which many legislators clearly saw.

Lawmakers not being pipeline experts, were still certain that there were huge and significant risks in the state "going out on a limb" by assuming ownership of the pipeline. They might have given Henri's presentation more weight had some of the risks been brought out and discussed.

Many felt that a picture was being painted for them and that they were being allowed to see only part of the picture.

HAVELOCK'S CASE AGAINST ICC PROTECTION

State Attorney General John Havelock does not believe that the federal Interstate Commerce Commission, with the constitutional authority to regulate pipelines, will adequately look after the interests of the State of Alaska in tariff regulation.

After state study of existing federal regulation systems under the ICC, Havelock said in his testimony at Juneau hearings, "our conclusion is that if existing federal regulation applied to the trans-Alaska pipeline and applies alone, no assurance is provided that tariffs will be reasonable from a state point of view."

"Nor, despite common carrier status, does it assure complete equal standing among all who might need access to it in later years for shipment of oil."

It is not clear that under all circumstances does the ICC have jurisdiction over pipelines, Havelock said, but the methods by which TAPS owners will organize the pipeline ownership (that of a joint interest pipeline owned by seven pipeline subsidiaries of producing companies), including the tanker portion of the trip, will involve ICC jurisdiction.

If the companies would "break down" the Alaska portion of their pipeline operations, instead of lumping in the Alaska ownership segment with pipelines elsewhere in the U. S., there might be a possibility of claiming state jurisdiction.

In later testimony, industry witnesses disagreed with Havelock's view that common carrier status of TAPS would offer no guarantee of "equal standing" among producers of oil on the North Slope. Also, at least one company with North Slope holdings and an interest in the pipeline has expressed its willingness to set up an Alaska subsidiary for the pipeline company managing its interest in the TAPS lines.

This would give the state a source for data on operating information of the Alaska line (where other companies would lump such information into their national systems before presenting it to the ICC), as well as make a case for state, rather than ICC, jurisdiction.

Havelock continues: "The ICC has some jurisdiction over all common carriers engaged in the transporation of oil from one state to another state, but jurisdiction over pipelines is far more limited both by law and in its exercise, than the ICC's sway in other areas, such as trucking and shipping."

"The Commission ostensibly determines what constitutes a "reasonable" tariff and whether any carrier is charging in excess of that standard. According to regulatory standards previously established by the ICC, that tariff includes a maximum profit of 8 percent of the valuation of a pipeline...the maximum dividend allowable is 7 percent."

"In its determination of whether any given carrier exceeds this rate the ICC reviews data sent to it by other companies regarding the valuation of a pipeline. The companies also publish their tariffs, which the ICC may challenge as unreasonable in the light of a given valuation."

Havelock cites these disadvantages to ICC regulation:

Regulation on dividends and profits as a percentage of valuation offers no control over costs. Cost increases can be added directly to the tariff per barrell so as to maintain the same percentage of profit.

ICC jurisdiction does not account for how financing is handled on a pipeline, and normally a large percentage of debt-financing reduced the amount of money the owner invests directly in the operation.

As a consequence, the actual profit owners may make on their money may be as much as 100 per cent per year.

On the basis of past performance, it may well take the ICC four years to establish a value for the trans-Alaska pipeline, and until the valuation is established the ICC cannot regulate in a meaningful way.

Because of ICC procedures, actual tariffs and profits may be far higher than the 7 to 8 percent limit mentioned earlier. The ICC would not consider the Alaska pipeline alone in considering valuation, Instead the ICC allows these figures to be lumped in with those of all other U. S. pipelines owned by the owners of TAPS, to see if the overal tariff is "reasonable." By such an averaging procedure, high tariffs might exist on the Alaska line since the overall figures may be brought down by lower rates elsewhere.

Havelock argues that under such a loose regulatory system, pipeline owners are essentially self-regulating.

"The owners of pipelines, who may also be producers, agree among themselves as to the fairness of particular tariffs. They operate under an unwritten rule not to wash their laundry in public. As long as the agreement is lived up to, no one complains and no one spurs a tariff investigation. The ICC has a right to complain on its own, but as a matter of practice in the years, it has never done so. With no complaints from any source, pipeline tariffs go unchallenged. Although the ICC has a section of personnel that review pipeline evaluations, no personnel are assigned to investigation or reate review otherwise."

Havelock concludes that the ICC does not, in effect, fully regulate the operations and tariffs of pipelines within its jurisdiction, and that federal law does not cover the whole area of pipeline regulation.

Under the pre-emption doctrine, the state may not regulate pipelines in matters where specific federal legislation applies. In this field, the ICC does not regulate all aspects of pipeline operation, even all aspects of economic regulation. The ICC, Havelock argues, has no effective regulation during the initial years when valuation is being set, nor over the construction of new pipelines, abandonment, security and no basis for regulation consolidations and acquisitions of control. In this void of regulation, state regulation may prevail, he says.

Certain parts of the jurisdiction question are unclear, and in making a decision the courts are required to balance the interests of the state and federal government in the specific regulatory program.

"Since the State of Alaska's interest in this case is so overwhelming," Havelock says, "Alaska has a much stronger argument than any other state for allowing it to impose effective regulations to protect the state's oil value...even if pre-emption were allowed, the findings of a state regulatory body would have a strong effect as an advisory opinion to the federal body on the reasonableness and the appropriateness of rates."

Havelock points out that while legislation package, with full state ownership of the pipeline these complexities of regulation vanish.

"With ownership," he says, "the state itself will be establishing tariffs, instead of being plunged into a maze of corporate accounting procedures from which it hopes to exit with knowledge of whether "tariffs are reasonable."

"Pipeline ownership is a most effective means of assuring that transportation costs stay low, and the wellhead value of our oil remains high. Ownership simply and directly works to assure Alaskans that they will receive what is due them for oil that is taken out of the state forever."

PETER TEMPLE: BENEFITS OF FULL OWNERSHIP

Peter Temple, of Temple, Barker and Sloane, economic consultants to the state, pointed out three reasons why state pipeline ownership would be beneficial to Alaska. First and most important, it would protect the state's interest in royalties and severance taxes by assuring a fair pipeline through-put tariff. Two, it would establish an ecomonic climate in Alaska condusive to further exploration, by companies not a part of the TAPS consortium who would then be able to use the pipeline as a public conduit when discoveries were made. Three, additional revenues would accrue to the state from full ownership.

"When we say these royalties and texes are based on wellhead value, what we mean is simply that they are based on the refinery sales price less cost of transportation to the refinery, and the transportation in this instance consists not only of the pipeline move but also the marine move to the refinery itself. This means the state has an urgent concern with the economics of both these transportation moves since the tariffs on both are deducted (to establish a "wellhead" price, on which oil royalties and taxes are paid)," Temple said.

He went on: "Some indication of the sensitivity of the royalties and severance taxes to transportation costs can be seen by the fact that with the pipeline at full capacity a difference of one cent, one cent per barrel, in the tariff, is estimated to result in a difference of one and a half million dollars per year to the state, in royalties and severance taxes."

"It might well be asked that the oil companies have a motivation and interest in maintaining rational costs and tariffs, especially in view of the fact that an appreciable allowance attaches to the wellhead value. This seems to argue that the companies have an interest exactly like that of the state in maximizing wellhead value.

And within limits, that is true. But the limits may be important. First we must recognize that the companies have heavy asset commitments in both the pipeline, if they own it, and in their shiping operations. And they have an understanding interest accordingly in recovering all possible costs and achieving maximum profit. Second, tax considerations may argue for allocation as large a proportion of earnings are possible to a company's pipeline operations. The pipeline operation for the most part held and managed through pipeline subsidiaries will accrue under private ownership conditions a substantial tax-loss carry-forward, which can be used to shelter their earnings. In some instances they can be used to shelter only pipeline earnings and they will, as I indicated, probably accrue and increase the amount of losses in the early years of any TAPS operations. This means that for some companies, sound business strategy may argue for maximizing the pipeline tariff and profits for a given period in order to make sure that certain tax laws are beneficial."

COMMISSIONER WOHLFORTH'S FIGURES

State Commissioner of Revenue Eric Wohlforth devloped a series of revenue scenarios under various conditions of private and public ownership of the pipeline.

In his testimony, he said: "The base case shown to you today in graphic form assumes the total pipeline cost of $3.5 billion financed 90% by debt at an interest rate of 8%. It conforms to the Alyeska throughput assumptions (production estimate by companies) of full production only in the seventh year of pipeline operation. It shows the ICC permitted rate of return described earlier. In the fourth year since the beginning of construction, and the first year of production, 1977, we now show a negative wellhead or no state oil revenues. This was the year comparable to that in earlier (state) projections it was shown that the state would capture at least $164 million in revenues.

"The fifth year, 1978, the assumed second year of operation, we earlier estimated $278 million in state revenues. In those two years alone the net revenue loss to the state over earlier estimates amounts to $442 million. By the sixth year or 1979, the new projection shows $84.6 million in oil severance and royalty revenues. Earlier we had estimated $282 million for that year. The net loss by that year over earlier estimates is $640 million. Not until the 15th year of the pipeline operation do royalties and severance taxes amount to near the amount shown to our previously calculated second year. In the 15th year we show severance and royalty revenues of $277 million.

The question may be asked whether this is most pessimistic of cases which can be produced. The answer is clearly no for three reasons. In the first place the revenue loss figure mentioned above gives no effect to our expectation now of first pipeline operation in the year 1977, wheras in July we estimated a full year of revenues starting on July 1, 1975.

In the second place we show state taxes in each year of operation of approximately $33 million. For the first three years of operation state income taxes are estimated to total approximately $100 million or $33 million a year. This assumes the full state income tax rate on pipeline profits. Experts have indicated that this may not be a realistic assumption. Even, however, with the most optimistic income tax estimate net revenue loss from earlier projections amounts to $540 million during the critical first three years of operation.

The 7% figure is not high also when it is remembered there are seven separate proposed pipeline owners, each of which may aggregate earnings of other pipelines when the 7% rate is considered. It is entirely possible that higher return rates may be permitted until the valuation of the line is complete and even thereafter when earnings of other pipeline companies are aggregated to arrive at a total rate of return.

The case showing the possible economic effect of state ownership of the pipeline. Financing is assumed in the amount of $1 billion in each of the first two years of construction at 8%, $900,000,000 in the third year of construction at 6-1/2%, $250,000,000 at 8% in the first year of operation and $310,000,000 in the second year of operation. This case also assumes the same ICC permitted rate of dividend payout as assumed for the private case, namely, 7% which is a cash dividend payout limitation in each year of the projection. In arriving at the State's net cash flow, operating expenses, amortization, and interest on bonds are deducted from the gross income. During the first year of operation net cash flow to the state through its tariff on the pipeline is $230 million and royalty and severance taxes of $15.7 million for a total of $245 million. Obviously, in state ownership no federal or state income taxes are calculated on pipeline income. In the fifth year from beginning of construction or the second year of operation net cash flow is $228 million which together with royalty and severances taxes of $17 million produce a total of $245 million. In the sixth year from beginning of construction and the third year of operation net cash flow amounts to $227 million through the tariff and total royalties and severance taxes amount to $123 for a total of $350 million. In the 15th year cash flow is reduced to $183 million by reason of the fact that the pipeline has depreciated but total royalties and severance taxes amount to $297 million for a total to the state treasury of $480 million.

It is emphasized that this case makes identical assumptions to that for the private case described above. It should be emphasized that the net income shown to the state is computed after debt service on state bonds. To avoid a speculative argument on the possible differential between interest rates on the state's debt which may be tax exempt versus taxable interest on the private borrowing we show all but $900,000,000 in state bonds at the same 8% rate.

The main differences, of course, lie in the fact that the state is not subject to federal income tax and will receive no state income tax from pipeline operations since it is the owner. The timing of the bond issues for both private and public ownership is the same although the term of the public bond issue is shorter indicating heavier debt service loads and the state of course is financing the pipeline 100% on a debt basis.

Numerous additional assumptions can be made on the question of the manner of public financing, the rate of return permitted either to the state or to private pipeline owners, interest rates payable by the state and private owners, the effective tax rate in private ownership, to mention only a few. We know that estimating the effect of economic projects based on events three to seven years away must rest on assumptions which are to a degree speculative. The point is that no one can say with positive certainty what our revenue picture will be with the pipeline in private ownership. We have, however, tested prior assumptions based on official information now before us. This effort has convinced the administration that it must do what it can now to remove the uncertainty of the revenue picture in the late 1970's and in the 1980's.

STATE FINANCING PROBLEMS

Speaking for the industry, bond consultant Raymond Gary of Morgan, Stanley & Company of New York, outlined problems facing the state in trying to sell a $3.5 billion bond issue.

"I think it might be useful if I talk briefly about how jointly-owned pipelines are customarily financed. Jointly owned common carrier pipelines have been conventionally organized and financed in one of two ways, either as so-called "project financing" of pipeline companies organized to own pipelines in corporate form, or, as in the case in Trans Alaska pipeline system, as undivided interest systems."

"In the first case, where project financing is done, the conventional practice is to form a pipeline company which constructs and operates the system and issues debt for virtually all of the cost of construction, the typical amount being 90% of final cost, The debt is secured by the pledge of completion agreements and throughput agreements undertaken by the several shipper-owners of the pipeline. The typical security arrangements include unconditional commitments of the shipper-owners to complete the facilities to operate them, and if operation is interrupted for any reason, to take necessary steps to restore the facilities to operation. As part of the throughput agreements, the "cash deficiency obligations" inevitably continue regardless of force majeure (any event interfering with operation of the line). In effect, they require the shipper-owners to maintain the pipeline's funds at a level which would enable it to meet all its obligations when they become due and payable. As such, they are firm applications of the full credit of the oil companies involved and, for the purposes of financing, are equivalent to guarantees of the pipeline company's indebtedness.

"In this type of financing, the project itself must be demonstrated to be economic and viable, and the quality of the obligations is measured by the composite credit of the several oil companies involved. In other words, the investors are concerned, first that the project stands on its own feet, but also they look through the project to the ultimate guarantors. This type of financing is standard and well understood by professional investors, and has been in common use since the time of the Elkins Act - Pipeline Consent Decree entered into in 1941.

"You might wonder why oil companies wish to raise and lenders readily provide indebtedness as high as 90% of total capitalization.

The first answer is that the Consent Decree has limited the return from pipeline operations to a specified percentage of pipeline valuation. This invariably dictates that oil companies maximize the use of debt, the objective being to match as closely as possible permitted ICC depreciation with repayment of debt. The reason that lenders accept high debt ratios on pipelines is that they recognize the throughput undertakings to be full application of the credit of the oil company or companies involved. Consequently, the lenders are not taking the risks of failure of the pipeline operation. These risks are borne by the oil companies in the form of their backstopping, as well as their equity interest. The end result is that the oil company has dedicated one of its valuable assets, namely its credit, to obtain use of a pipeline system and a regulated profit on its investment.

The second way of organizing and financing jointly owned pipelines is as undivided joint interestsystems, this is how Trans Alaska Pipeline System is organized. For Consent Decree reasons ownership is customarily invested in, and the indebtedness is usually raised by, a wholly-owned pipeline subsidiary of each owner, but the arrangement still amounts to a full use of the owners company's credit.

In a joint venture, each of the oil companies owns a share of the facilities, either directly or through its pipeline subsidiary. The pipeline is not financed as a project; each owner company completes its own share of the system and finances its share of the cost in the same way it does other items in its corporate budget. These are financed out of all corporate resources, including working capital, internal cash flow and issuance of securities - in effect reflecting its overall capital structure and debt/equity mix. The effect on the oil company is the same as in project financing - it has committed an important amount of its resources and credit to an undertaking that has associated with it significant risks.

This is as real a use of credit as any other, and pre-empts its use for other investments. Therefore, to compensate for these risks, an oil company must be able to control the operation of the facilities and must have prospects of earning a fair return on its investment comparable to the potential return available to it on alternative investments.

FINANCING OF TAPS

"Let me turn to the financing of TAPS and why we have considerable concern about the proposed legislation and its possible effect on the feasibility of financing TAPS.

"We are addressing ourselves to the financing over a period of years of expenditures which may amount to as much as $3 1/2 billion. I would like to emphasize again that we have a healthy respect for the amount of money involved here. The Churchill Falls project, to which I have already referred, is the largest privately financed project in history, and TAPS is 3 to 5 times as large depending upon how you measure it.

These expenditures are to be borne by seven oil companies, which differ in size and capability to support the commitments involved. We have studied each company and made an assessment of the financial capability of each to discharge these commitments within the limits of its individual financial strength. To put this in perspective, I might point out that the three companies that will own over 80% of the undivided joint interest are assuming an aggregate construction liability of 80% of $3.5 billion, or over $2.8 billion. If this amount were raised by debt, it would represent an increase of 170% over the aggregate indebtedness those three companies had outstanding on December 31, 1970.

"Despite our respect for the size of the TAPS project, we have come to the opinion that - absent the proposed legislation - the expenditures necessary to construct the pipeline can be successfully financed by the oil companies involved. However, the bills here under consideration represent a serious impediment to that financing, and I should like to share with you my concern about the effect this legislation would have upon the ability of the oil companies to conduct the necessary financing and build the pipeline. There are some major problems which arise out of these proposals; including the right-of-way lease provision:

1. THE LIMITATION OF THE LEASE TO FIVE YEARS DURATION: Normal practice would be for a pipeline to have undisputed right-of-way privileges for the expected economic and physical life of the system, but in no event less than the period of time required to recover the cost on reasonable terms. Lenders would regard the 5-year lease limitation as a major infirmity impairing the economic viability of the system. Oil companies could not prudently commit funds for what is in essence a long-term venture if there was a threat that the economic life could be terminated or modified at the end of the five-year period.

Regardless of the length of the lease, I think it is important to emphasize that where a portion of the right-of-way of a pipeline is government-owned, the general attitude of the host government toward the pipeline will enter importantly into the considerations of the lenders.

2. LOSS OF OWNERSHIP: The prospect that ownership might be taken away from shipper-owners at some indeterminate time in the future nullifies any economic justification for taking the risks involved in committing the substantial funds necessary to complete the project. As mentioned before, if an oil company has used its credit in this connection, it has foregone its use in other profitable investments. It must, therefore, have the expectation of making a return on its investment.

Furthermore, because the system is to be a common carrier available to all producers, owners will be sharing their space with other shippers. Therefore, it seems to us that those that have assumed the cost and risk of building the system must be in position to recover their investment in part through profits derived from use of the system by others. Otherwise, the companies building the pipeline would have used their credit for the benefit of others without compensation, which violates a cardinal rule of sound finance.

3. REGULATION: There has been in this country massive financing of crude oil and products pipelines subject to regulation of the ICC, and the effect of this regulation on the pipelines and their owners is well understood by institutional investors. We note that provisions of one of the bills appear to give the proposed Transportation Commission the authority to establish depreciation rates and tariffs independently of the ICC; further, the depreciation rules appear to be at variance with those prescribed by the ICC.

Unless these differences are ultimately resolved, we are not able to measure the impact they may have on financing feasibility, but the impact may be substantial if lenders cannot be convinced that the owners of the pipeline will be able to earn a fair return on their investments. As I shall mention later, uncertainty with regard to such question, or to the outcome of court tests determining jurisdiction, can cause delays and increased costs in financing.

4. REDEMPTION PENALTY: The contemplated legislation creates the possibility that the oil companies financing the pipeline will find themselves in the position, vis-a-vis the State of Alaska, of "heads you win, tails I lose." When they borrow to finance the line, they will pledge their full credit to repay regardless of whether the pipeline is built, operates profitably, or is shut down temporarily or permanently for any of a number of reasons. These are substantial risks. Under the proposed legislation, however, if the line is built and operates successfully and profitably, Alaska would be in position to take ownership away from them.

Not only would the companies lose the asset gained through the incurrence of risk, but they would be forced to pay a penalty to the lenders when they redeem the indebtedness incurred to build the line.

There is a reason lenders ask for redemption premiums. The types of lenders who normally furnish funds for the construction of major projects, such as TAPS, have long-term liabilities, and they wish to invest their funds at what they believe are satisfactory rates for long periods of time. If a loan is to be paid off prematurely they demand compensation, usually in the form of a redemption premium. This is to offset the possibility that the proceeds received from the early repayment of the loan may have to be invested at a lower rate than they may have been receiving. Because of the threat this legislation poses, I believe that the premium asked for redemption in the early years would be large. It might be as high as 10%. Against borrowings of the total pipeline costs, this would represent an additional $350 million. This might be more than the oil companies will be willing to contract to pay, and the alternative might have to be to agree to a higher interest rate than would otherwise be the case. In any event there would be substantial (and unnecessary) additional cost.

5. UNCERTAINTY: Any financing is difficult (and may be impossible) under conditions of uncertainty. The proposed legislation creates uncertainty. Neither potential borrowers not potential lenders know whether legislation similar to that in the proposed bills will be passed. Plans cannot be made. To the extent that this uncertainty has the effect of delaying the project, it possibly could lead to higher construction costs. A short delay could easily result in loss of a whole year because of the Alaskan climate. Uncertainty is already holding up financing by companies involved with the pipeline.

I am not going to attempt to forecast the outlook for interest rates, but I would like to mention parenthetically that current rates are well below what they were only a short time ago. In addition, funds are more readily available to investing institutions for lending purposes than has been the case for a number of years. This is likely to be a temporary situation. Many bankers and economists believe that as business recovers interest rates may rise and, therefore, any delay in arranging the financing could well result in the companies incurring higher interest costs. Because of the amounts involved, an interest rate change of 1% raises costs annually by $35 million.

Therefore, I would like to urge most strongly in the interest of all concerned that this situation of uncertainty be resolved as promptly as possible.

ABILITY OF THE STATE TO FINANCE CONSTRUCTION OF THE PIPELINE

Finally, we have given consideration to the ability of the State to finance the construction of the pipeline. This involves raising the staggering sum of $3.5 billion, and no state has ever sold an issue of this size. I am certainly not trying to be negative, but it is important that we be realistic and recognize the problems involved in raising this amount of money, even if it were to be attempted over the period of construction rather than all at once.

Although certainly the tax-exempt market is a large one, it is our opinion that in order for Alaska to have any hope of accomplishing such a financing operation, all of the country's large reservoirs of capital would need to be tapped. In our view, this would have to include those institutions which are not normally buyers of tax-exempt obligations because they get little or no benefits therefrom, namely, life insurance companies and pension funds.

These institutions are the normal suppliers of capital for pipeline projects, and they have required the unconditional backstopping by financially capable parties that I have already described. For TAPS the oil companies are able to provide this, but the State does not presently have the financial capacity to substitute for them.

We have heard the theory advanced that the State can dedicate to this project its anticipated revenues from oil royalties and severance taxes from the North Slope, but those revenues depend upon operation of the pipeline and are not "bankable" assets at the present time. In fact, they do not become valuable for adding substance to a financial undertaking until the pipeline is completed and in operation, because they are completely dependent on its success.

These considerations lead us to the opinion that the State of Alaska cannot raise the money to build the pipeline on the strength of its present credit resources. In our view, successful financing of the line depends, in the final analysis, on the backing of the oil companies' credit.

The question has also been raised of the State's ability to raise an appropriate amount of money to take over the pipeline in the future, after it has been operating successfully as a going concern. We do not feel that any expert can make an intelligent judgment at this juncture. The answer would depend upon a host of factors - economics of the system as finally constructed, economics of the crude at west coast ports, technical operating experience, the level of tariffs and debt service burdens, economics of alternative forms of transportation that may be available at the time, conditions of markets and levels of interest rates at the time. As a cautions, but experienced investment banker, I have to say there will be other factors none of us can think of now.

If all these factors turned out favorably - and that has to be a lot of ifs - then it is conceivable that the State might, over a period of time, raise substantial sums with less than the unconditioal credit of backing of the shippers.

To do so, however, would in all probability require that the State dedicate to the borrowing not just the pipeline earnings, but all of the State's potential oil income in order to effect successful sale of bonds in the amounts necessary to pay for the pipeline. Obviously, such a dedication would significantly reduce the State's potential ability to borrow for other purposes, such as schools, hospitals, roads and other worthwhile projects. It would also seem likely that, at that stage, the large increase in the amount of general obligations of the State which would be outstanding undoubtedly would raise the interest costs of any borrowings that might be undertaken for regular financing needs.

To sum up the proposed legislation puts a number of clouds over the financing of this pipeline.

If it is passed as it presently stands, there would be considerable doubt in the eyes of the investing public whether the oil companies could maintain control of the operation and earn an adequate return on their investment. When doubts of this kind exist, they are severe impediments to financing and would result in having to pay higher interest costs.

We are all painfully aware how the cost of TAPS has already escalated while its construction has been delayed in Washington. I would therefore urge in the interest of both Alaska and the producers that they avoid delay and an additional increase in cost by resolving their differences so that the project can go ahead.

REGULATION AND RIGHT-OF-WAY LEASING

Pipeline regulation by the State of Alaska, by itself or in conjunction with a program where the state leased right-of-way crossing state lands, was developed by the Governor as an alternate to full ownership of the trans-Alaska pipeline.

Earlier, a right-of-way leasing bill was developed by the legislature's Joint House/Senate Pipeline Impact Committee. The concept was originally suggested by Dr. Joseph Witherspoon, of the University of Texas Law School, acting as consultant to the pipeline impact committee. The Governor later borrowed the concept for his own right-of-way leasing bill.

Basically, state pipeline regulation is an exercise of the state's police powers. Under these provisions, the state can regulate construction activity, safety and economic factors (such as pipeline tariffs) which have a direct impact on the Alaska public (which pipeline tariffs would, since they affect state oil taxes and royalties).

The catch in this is that existing federal regulations under the Interstate Commerce Act and Natural Gas Act prempt state regulation in areas where interstate commerce might be involved.

Since transportation of oil from Prudhoe Bay to the U. S. West Coast is, under almost any definition, interstate commerce, the Interstate Commerce Commission's regulatory authority will prempt state authority over much of the oil moving from Prudhoe Bay to Valdez.

The legal argument is now whether the state can establish any regulatory rights on this transportation, and if so, how much jurisdiction. For oil to qualify as "intra-state" oil, in which state jurisdiction would clearly stand, it might be necessary to build a small topping plant in Valdez and refine a portion of the oil.

The limit to which state jurisdiction might apply is open to legal debate, and a state regulation bill, if and when passed, will almost surely be subjected to a court test. Walter Levy, legislative oil consultant, recommended passage of a regulation bill, suggesting that the state should try and assert some jurisdiction before the ICC. Failing in that, the state could move to class at least some of the Prudhoe oil as intra-state, thereby regulating an intra-state tariff and going to the ICC with that tariff determination compared to tariffs declared by industry on the interstate portion of the oil.

The right-of-way leasong bill is basicly seen as a companion to the state regulation bill, where the two supplement each other with right-of-way leasing giving the state certain rights that outright regulation, as a governmental action, cannot do.

The basic premise of right-of-way leasing is that the state, as a landowner of state lands (including all lake and stream bottoms) can negotiate a right-of-way lease crossing these lands. The state can then negotiate any covenants in the lease, granting it such things as the option to acquire a partial equity in the pipeline ownership.

Dr. Joseph P. Witherspoon, Professor of Law at the University of Texas School of Law and consultant to the legislature's Pipeline Impact Committee, describes the function of the leasing and regulatory measures in this manner:

"The Leasing Act is an exercise of the state's power to control and dispose of its property and to enter into contracts with third parties for subserving the state's interests and, as part of these powers, to require as partial consideration for its lease of state public land for pipeline right-of-way purposes that the other party to the transaction assume the statuses both of a common carrier and of a common purchaser of crude oil and natural gas produced in the fields served by its pipeline as well as agree to perform specified acts and observe specified conditions set out in a lease.

The pipeline regulatory act, "may be view as an exercise of two sets of state powers. Insofar as the agency designated to administer it, the Alaska Transportation Commission, is concerned with giving effect to the statuses and obligations assumed by a party to a lease with the state of state public land for pipeline right-of-way purposes, such as the common carrier duty or the obligation to construct a pipeline in accordance with a project description set out in the lease or a certificate issued under it, the Act is an extension of the Alaska Right-Of-Way Leasing Act and an exercise of the two powers upon which it is based. Insofar as the Commission is concerned with administering requirements imposed by the Act upon common carriers, or might be viewed as so doing, the Act is in part an exercise of the state's power to regulate activities of intrastate pipeline carriers and to regulate activities of interstate pipeline carriers in order to protect clear and important state interests insofar as those activities are not regulated by federal statute or are not regulated by such a statute on a basis excluding concurrent state regulation and state regulation is otherwise appropriate in light of federal statutory and constitutional limitations.

Important covenents in the leasing bill include:

(1) a provision relating to the term or duration of the lease and to its renewal;

(2) a covenant to construct, operate and maintain the pipeline described in the pipeline project description set forth in the lease or in certificates issued under it;

(3) a covenant to assume the status of a common carrier and of a common purchaser of crude oil produced in fields served by natural gas pipelines;

(4) a covenant to transfer to the state, at its election, an undivided interest in the pipeline equal to the interest of the state and of the United States in fields served by the pipeline;

(5) a covenant to pay a minimum percentage rental based upon the higher of two formula computations, one of which utilizes a specified percentage of the total pipeline facility cost and the other of which utilizes a specified percentage of the pipeline's annual net earnings;

(6) a covenant not to transfer the right-of-way lease, certificates issued thereunder, or the pipeline facility without first securing the consent of the Board;

(7) a covenant to submit to the jurisdiction of the Alaska Transportation Commission and the state courts for the purpose of adjudication of complaints concerning violation of the Act or a lease or certificate issued under it or resolution of any question of interpretation of the lease or any dispute concerning the lease or certificate thereunder between the parties;

(8) and a covenant to maintain the leasehold and pipeline in good repair, to use the highest degree of care to prevent a pipeline incident causing injury, sickness, disease, or death or loss of or damage to property or damage to the natural environment, and to promptly repair or replace any damage to or destruction resulting from the former.

At the time of this writing, substantial parts of the regulation and state right-of-way leasing bill have been revised. The basic covenents remain, generally, as Prof. Witherspoon described them above. These may change before the end of the legislative session in 1972, however.

There are three parts of the right-of-way leasing bill particularly bothersome to some petroleum companies: The formula used in determining lease rental will result in high revenues to the state, and is really just another form of taxation; the "common purchaser" provision places the pipeline company in the position of having to buy any oil or gas from any field found along its route, thus providing a marketing service (this differs from common carrier status where the pipeline owners only provide transportation to market, with the owners of the oil having to find their own market); and the lease term of 10 to 25 years, where the companies say that the possibility that the lease might be cancelled could create financing problems.

THE POLITICS OF PIPELINE OWNERSHIP

The compromise regulation and right-of-way leasing bills emerging out of the legislative session will accomplish many of the goals set out for full state ownership, without placing the heavy burden of financing pipeline bond issues on the state.

But the Governor's seeking of state ownership has wider political ramifications in Alaska. Some are apparent and others are not.

The central issue at stake in regulation, leasing and partial or full ownership is how effectively the state will be able to protect and manage its revenue source on the North Slope. This question will determine the amount of money the state will have to spend for years to come and it is a question loaded with political dynamite. Governor Egan's concern appears to be a sincere and genuine conviction that, with the discovery of oil at Prudhoe Bay, an "economic state" will form in Alaska which will be more powerful than the political state theoretically containing it (Egan used these same words in his statement at the March 6 pipeline hearings). If the state has no adequate "handle" on the oil industry, the thinking goes, decisions made in corporate board rooms in Dallas, Houston and New York will have far greater influence (indirectly) on state policy decisions than decisions made in Juneau.

This question, to the man on the street in Alaska, is the self-automony and statehood issue all over again: who will "run" Alaska? The people? Or the oil companies? In their attitudes toward state ownership, the "people"? Or the oil industry, but they also have a built-on distrust of government bureaucracy. The feeling is evident that if the state can't adequately maintain roads, how can it build and run a profitable pipeline? But while state ownership per se may not have wide public support in Alaska, the question of the state "getting a handle" of control on the oil industry does have wide support.

These are the direct, and apparent, political ramifications. There are deeper remifications that are not so apparent.

The nature of Alaska's population has always been mobile and shifting. Attitudes can change more in a decade than other states can ever experience in a century. But the legacy of territorial status still hangs over Alaskans.

Many Alaskans feel as if they haven't yet attained full statehood and self-autonomy. Decisions made in faraway Washington D.C. still affect Alaska heavily, and Alaskans still feel that sense of helpless frustration when seemingly unilateral federal actions are made with apparently no local consideration.

The pipeline promised to change that. The pipeline meant that for the first time, Alaska would have true economic as well as political statehood. The state would have the money to "fight" federal intereference, or so the feeling ran.

When conservationists came along it seemed to Alaskans that they were in "cahoots" with the federal bureaucrats. The National Environmental Act was a "conspiracy" to negate the state hood act, keeping Alaska forever in economic territorial status, people said. Reacting to what they felt was more interference in Alaskan affairs by 'Outsiders", Alaskans grouped protectively around the idea of the trans-Alaska pipeline as the symbol of Alaska self-autonomy. Many in industry have confused this whole-hearted endorsement of the pipeline by Alaskans as a sign that Alaskans in general felt their goals were the same as those of the industry. There has been confusion on overlapping goals since the discovery of Prudhoe Bay in 1968, and the pipeline proposal.

It must be remembered that before Prudhoe Bay, when the only industry activity was in exploration and the only production was in Cook Inlet, local attitudes toward industry were decidedly cool. Oil companies then represented "big Outside corporations", and the "robber baron" image was very popular.

It was only when Prudhoe Bay and the pipeline brought promise of huge state revenues, and when an "adversary" appeared in the form of a environmentalist-federal government "conspiracy to hold back Alaska", that Alaskans warmed to the idea of oil development. Many in industry confused Alaskans' endorsement of the pipeline as endorsement of the industry itself.

Many Alaskans were even confused on this point. But this wasn't necessarily the case, as Egan's state ownership question has pointed out.

When Governor Egan first asked the question about pipeline tariff regulation, protection of the state's financial interest at Prudhoe and state ownership of the pipeline, it was the first time that any highly placed state official had called the industry on the "carpet". Egan, who has wide popular support in Alaska, forcefully identified the goals of Alaska as different from those of the industry.

With their initial strong negative reactions to the state ownership proposal, two companies (Standard Oil of Ohio and Humble Oil & Refining) made the situation worse for industry by hotly arguing Egan's assertion and, in the minds of Alaskans, confirming what Egan had originally said.

The Alaska image of the industry began to change again, to assume once more the "robber baron" coloration. As the Governor's pipeline ownership legislative program advanced, and as hearings were held with resulting heavy press coverage in Alaska, the image of the oil industry holding hard against any state regulation measures to protect its interest (regardless of the legality or merit of the measures) was firmly planted in the minds of the Alaska public.

The companies may not have realized it, but the Governor's campaign for state regulation and control of the pipeline was as much wages as a public relations effort through the press and aimed at "grass-roots" emotional support among the Alaska public, as it was waged as a legislative and legal issue through the legislature.

The industry, attempting to deal with the Governor's plan on a purely legal and legislative basis, had lost the war before the first battle had even been fought. No matter how adamantly industry representatives and witnesses may argue legal precedents, when the populace has been aroused (and the legislature is a reflection of that arousal) a way will be found, by one method or another, to put a "handle" on the oil industry.

As of this writing, public attitudes in Alaska now show a clear distinction in goals between "what is good" for Alaska and "what is good" for industry. Although Alaskans clearly support speedy expedition of the questions delaying the trans-Alaska pipeline, they also regard oil companies themselves with a cool attitude.

One other increasingly active and strong public group in Alaska was the Native groups, who were a strong potential ally of the industry. Unfortunately, the industry's action in bringing suit over the proposal to create a North Slope borough has alienated the Native groups to a point where they, too, regard oil companies with cool disdain. In taking the formation of a North Slope borough, the industry again addressed itself to only the legal parameters of an issue, while ignoring the larger political aspects which will, in time, become legal aspects.

CONCLUSION

The present Alaska Legislature will undoubtedly adopt some form of right-of-way leasing legislation, and further may possibly enact a strong state pipeline regulatory measure. For the present state pipeline ownership will fall by the wayside. However,,,,,,,, regardless of what is --or is not-- enacted, the issues exposed by currently pending pipeline legislation are likely to remain "alive" in the Alaska public policy making forum for years to come.

The basic issues revolving around state land leasing, pipeline economic regulation, and pipeline ownership will undoubtedly be pressed forward by Alaskans time and time again as development continues within the state. The issues will be posed by the legislature, by state regulatory bodies, and in the Courts as state and industry clash over what is the proper division of resource wealth to each. At the core of the state's position is its unique status as "landowner," and therefore industry can consistantly expect the state to exert its "proprietary" rights and to utilize those rights to maximize its alternative rights as a state government. Quite in contrast to the other states, the relationship of industry and state government in Alaska must stand apart because of this essential role of the state as the No. 2 landholder.

Nor should the issues that surround state pipeline ownership be disregarded. The ownership issue is not dead. Instead the issue will be refocused on future smaller pipelines, and in particular on the Alaska portion of the proposed Alaska/Trans-Canada Natural Gas pipeline.

Because of some of the inherent difference in Alaska, such as its position as a major landholder, its super-centralized and very strong executive form of government, its politically insulated judicial system, extreme grass-roots political sensitivity, and the existance of semi-governmental landowning units in the form of the native corporations, it is fair warning that industry would be ill-advised to view dealing with government in Alaska as being anywhere near similar to their experiences elsewhere.

The issues discussed in this report will be with Alaska for a long time, and they will be the subject of "Alaska Series" reports next year. It is likely that the issue of the state's proprietary rights reflects a "trend" --a theme-- that will weave itself into the state's development fabric for the next quarter century. And, it is likely that "industry" that identifies and can cope with this trend will likewise weave itself through Alaska's development for the next 25 years.

IN THE SUPERIOR COURT FOR THE STATE OF ALASKA

THIRD JUDICIAL DISTRICT

AMERADA HESS CORPORATION, AMOCO PRODUCTION COMPANY, GULF OIL CORPORATION, HUMBLE OIL & REFINING COMPANY, HUMBLE PIPELINE COMPANY, PHILLIPS PETROLEUM COMPANY, SKELLY OIL COMPANY, SOHIO PIPELINE COMPANY, UNION OIL COMPANY OF CALIFORNIA, Plaintiffs, vs. STATE OF ALASKA, DEPARTMENT OF NATURAL RESOURCES and THE DIVISION OF LANDS, DEPARTMENT OF REVENUE, Defendants.	)

NO. 72-_____

COMPLAINT
(Declaratory and Injunctive Relief Sought)

1. This action arises under the Constitution of the United States, Article I, Sections 8 and 10, Article VI and the Fifth and Fourteenth Amendments, and under the Constitution of the State of Alaska, Article I, Sections 1, 7, 15, and 18, and Article VIII, Sections 17 and 18, and AS 09.50.250 and AS 22.10.020.

2. Plaintiffs Amerada Hess Corporation, Amoco Production Company, BP Oil Corporation, Gulf Oil Corporation, Humble Oil and Refining Company, Phillips Petroleum Company, Skelly Oil Company and Union Oil Company of California (hereinafter sometimes referred to as the plaintiff producers) are in the business of producing and marketing petroleum products. Plaintiffs Humble Pipeline Company and Sohio Pipeline Company (hereinafter sometimes referred to as the plaintiff pipeline companies) are in the business of

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building, owning and operating pipelines for the transportation of crude oil and other petroleum products, as is plaintiff Union Oil Company of California. Each of the plaintiffs is authorized to do business in Alaska, has filed its last annual report with the State and has paid all taxes due the State.

3. This is a suit for a declaration that the following acts of the Seventh Legislature of the State of Alaska, duly approved by the Governor of said State, are unconstitutional, invalid and of no effect:

(1) "An Act relating to oil and gas revenues; and providing for an effective date" (hereinafter sometimes Minimum Price Act), approved by the Governor June 2, 1972, and

(2) "An Act relating to lease of rights-of-way over state land for the transportation of oil and gas within the state; and providing for an effective date" (hereinafter sometimes Right-of-Way Act), approved by the Governor May 19, 1972;

and to enjoin the enforcement of the Alaska Right-of-Way Leasing Act of 1972, which is Section 1 of the Right-of-Way Act. Each of said acts was separately enacted and approved, but each was enacted as a part of a single plan to change unilaterally the terms of certain oil and gas leases purchased from the state by the plaintiff producers and others similarly situated, these changes being designed to subject the lessees to more onerous conditions than those contemplated under the lease contracts and to exact for the State of Alaska a higher price than the contracting parties had agreed to for the right to explore for, develop, produce, process and market petroleum products in and from the North Slope of Alaska. This action seeks also a declaration that "An Act relating to oil and gas pipelines and to the creation of the Alaska Pipeline Commission; and providing for an effective date" (hereinafter sometimes Pipeline Commission Act), approved by the Governor June 20, 1972, is not applicable to the proposed Trans

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Alaska Pipeline hereinafter described.

4. For many years the United States and, after its creation and admission to the Union, the State of Alaska have granted for a valuable consideration to individuals and corporations applying therefor, in accordance with the Constitution of Alaska and the laws and regulations enacted and established for the purpose, the exclusive right, on specifically described land owned by the United States or by the State of Alaska, as the case may be, to explore for, develop, produce, save, store, treat, process, transport, take care of and market oil, gas and associated substances, and to install pipelines and structures on said land in connection therewith.

5. Approximately 98.8% of the land surface of Alaska is owned either by the United States or by the State of Alaska. The state, in making the initial selection of lands to be conveyed to it by the United States under the Statehood Act (P.L. 85-508; 72 Stat. 339), tended to designate land already in oil or gas production or believed to have potential for oil production and the transport thereof to market in preference to land not thought to have such potential. As a consequence, much of the exploration for oil and gas in the state has been conducted on lands owned by or selected by the state for ownership. Because of the location of such lands owned and selected by the state, no oil or gas produced on such lands has been or can now or in the foreseeable future be marketed or used by the producer in commercial quantities without the utilization in some degree of land owned by the defendant State of Alaska, in addition to the land upon which such production takes place.

6. Exploration for oil and gas has been carried out in the southern portion of Alaska for at least 60 years, but commercial quantities were first discovered in 1957 on the Kenai Peninsula. Additional discoveries have been made from time to

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time in the Cook Inlet area, and annual production from that area now totals about 200,000 barrels per day. This oil, after supplying the comparatively negligible demand within the state for crude oil, moves entirely in interstate commerce. Any additional oil produced in Alaska during the foreseeable future will and can only be marketed almost exclusively in interstate commerce.

7. Exploration for oil and gas has been carried out on the North Slope of Alaska for many years, primarily since the establishment of Naval Petroleum Reserve No. 4 (hereinafter sometimes Pet 4) by Executive Order 3797A, 27 February 1923. Pet 4 consists of 23,680,000 acres in northwest Alaska bordering on the Arctic Sea. The United States carried out active exploration in Pet 4 from 1944 to 1952, and in addition to the discovery of gas fields at Gubik and Barrow, this exploration resulted in the discovery of an oil field at Umiat, in the southeast portion of Pet 4, about 75 miles south of the Arctic Sea and about the same distance west of the probable route of the proposed oil pipeline hereinafter described. The oil field proved at Umiat did not give assurance of production sufficient to pay the high cost of transport to market or to any point of feasible use in the United States although preliminary studies of such costs were made.

8. Following the discovery of oil at Umiat the United States opened substantial amounts of land on the North Slope to exploration for oil, and extensive exploration was carried out by private interests for more than 10 years. Although many millions of dollars were expended by certain of the plaintiffs and by others, no commercial discoveries of oil were made until 1967.

9. Under the provisions of the Alaska Statehood Act (P.L. 85-508; 72 Stat. 339, (1958)), the State of Alaska is entitled to select approximately 103,350,000 acres of Federal

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land, subject to the approval of the United States and subject to certain withdrawals by the United States. Pursuant to this act the state has selected various tracts of land known or believed to have potential for oil production, including the lands containing the producing oil fields in the Cook Inlet area.

10. In 1964 the State of Alaska selected approximately 1,600,000 acres on the North Slope of Alaska between Pet 4 on the west, the Arctic National Wildlife Range on the east, and the Arctic Sea on the north. Such selection has been tentatively approved by the United States. Immediately to the south of the tentatively approved selection, the State of Alaska has selected in excess of 2,800,000 acres upon which oil and gas leases sold by the United States to sundry persons are now outstanding. The latter selection has not been approved by the United States, tentatively or otherwise.

11. The State of Alaska has received an aggregate cash consideration of almost one billion dollars for the oil and gas leases it has sold in the lands selected under the Statehood Act and patented to the state or tentatively approved for patent, exclusive of the rentals and royalties reserved in the leases. The state's income from oil and gas rentals and royalties is currently about $35,500,000 per year, and the state also receives severance taxes and income taxes attributable to the production on the leases.

12. There are in the state of Alaska commercial pipelines for the transportation of crude oil, gas or other petroleum products as follows:

A. Alaska Pipeline Company, a subsidiary of Alaska Interstate Company of Houston, Texas. This company operates a 90-mile natural gas pipeline from the Kenai Peninsula to Anchorage, built in 1960-1961.

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B. Cook Inlet Pipeline Company. This company is owned by Marathon Oil Company, Atlantic Pipeline Company, Mobil Pipeline Company, and plaintiff Union Oil Company. It operates a 42-mile crude oil common carrier 20-inch pipeline and a marine tanker terminal. It was built in 1966.

C. Kenai-Nikiski Pipeline. This pipeline, owned and operated by the plaintiff Union Oil Company and by Marathon Oil Company, is a 20-inch, 17-mile gas line from Kenai Gas field to a point near the Collier Carbon and Chemical Ammonia and Urea Plant.

D. Kenai Pipeline Company. This company, owned by Atlantic Richfield Company and by Standard Oil Company of California, operates an 18.5-mile, 8-inch common carrier crude oil pipeline that was built in 1960 and that extends from the Swanson River Field to the Nikiski terminal. Kenai Pipeline Company also operates a 3.5-mile, 12-inch crude oil pipeline built in 1965 from an on-shore facility north of Nikiski to Kenai Pipeline's terminal.

Each such pipeline occupies state land, at no cost to the operator or owner thereof, by virtue of permits granted under the provisions of the Alaska Land Law (AS 38.05) and the regulations issued thereunder. No rental has ever been charged for any rights-of-way granted under these permits.

13. Oil of commercial significance was first discovered on the North Slope of Alaska in 1967, near the shore of Prudhoe Bay by Atlantic Richfield Company and plaintiff Humble Oil & Refining Company. Subsequent drillings by the plaintiff producers

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and by others have proved the existence of an oil pool of major proportions (Prudhoe Oil Pool - Alaskan Oil & Gas Conservation Committee Order No. 98-B, March 12, 1971), and two lesser pools (Prudhoe Bay Kupurak River Pool - Order No. 98-A, March 12, 1971, and Prudhoe Bay Lisburne Pool - Order No. 83-C, January 12, 1970), as well as two still undesignated pools known as Ugnu and Simpson Lagoon. All of these pools are within a range of about 40 miles of the Prudhoe discovery well, and all are located on the 1,600,000-acre selection described in paragraph 10.

14. Each of the leases purchased by the plaintiff producers from the State of Alaska provides, among other things, for the payment to the State of Alaska of royalties of 12-1/2% in amount or value of the oil produced and saved, and removed or sold from said land, and 12-1/2% in amount or value of the gas produced and saved and sold or used off said land or used for the extraction of natural gasoline or other products therefrom. Thus, the contractual arrangement between the state and the plaintiff producers contemplates that the benefit of increases in the wellhead value of the oil and the burden of decreases in such value will be shared by the parties on a pro rata basis in accordance with their respective interests. Leases sold by the State of Alaska prior to 1969 provide for a reduction in the royalty rate to 5% for a period of ten years if the lessee shall have drilled on the land and made the first discovery of oil or gas in commercial quantities in any geological structure; and the state has recognized the right of Atlantic Richfield Company and plaintiff Humble Oil & Refining Company to a 5% discovery royalty with respect to one North Slope lease. A specimen copy of the basic form of lease contract entered into between the State of Alaska and the plaintiff producers is attached hereto, marked Exhibit A, and made a part hereof. The leases were drafted by the defendant State of Alaska, which was solely respon-

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sible for establishing their terms, and none of the leases provided for the payment to the state of any rental or other consideration in addition to the payments described above other than nominal rentals prior to completion of a well capable of producing oil or gas in paying quantities and nominal minimum royalties thereafter. All of the North Slope leases granted by the State of Alaska were sold under a public competitive bidding procedure pursuant to a notice which stated that bids would be accepted subject to the provisions of the Alaska Land Act (AS 38.05) and the oil and gas leasing regulations currently in effect. No right unilaterally to change any of the terms of the leases or of said Act or regulations in effect at the time of the state's award of the leases to the plaintiff producers is reserved in any of the leases or in said Act or regulations. At such time the Alaska Land Act provided for the issuance of permits or easements on state land for pipelines, and provision was made (AS 38.05.330) for the establishment of a reasonable rate or fee schedule to be charged for these uses. In addition, provision was made in AS 09.55.240 for the exercise of the right of eminent domain to take land for pipelines, including land owned by the State of Alaska and not already devoted to a public use inconsistent therewith, which right of eminent domain was granted pursuant to the requirements of the Alaska Constitution, Article VIII, Section 18. These statutory and constitutional provisions were received into and incorporated in the lease contract.

15. The leasehold interests of the plaintiff producers in state lands on the North Slope, the bonuses they have paid for such leasehold interests, and the amount they have expended there in oil exploration and development are as follows:

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Producer	Total North Slope Acreage Under Lease From State And Percent of All State Land Leased on the North Slope	Portion of Such Acreage in Production Pools On North Slope Designated by the State and Percent of all in Pools	Bonuses Paid to the State For North Slope Leases	Amount Expended on Exploration and Development for Oil on the North Slope
Amerada Hess	13,799 (1.05%)	4,818 (1.54%)	$83,728,891	$ 1,187,800
Amoco Prod.	35,591 (2.71%)	11,968 (3.82%)	$97,216,615	$ 8,726,053
BP Oil Corp.	135,556 (10.31%)	96,716 (30.87%)	$ 5,509,000	$168,686,000*
Gulf Oil Corp.	26,891 (2.05%)	0	$93,534,822	$ 2,957,090
Humble Oil & Ref.	145,240 (11.05%)	86,014 (27.45%)	$18,092,875*	$ 91,097,000
Phillips Pet.	78,675 (5.99%)	18,987 (6.06%)	$49,327,961	$ 23,219,618
Union Oil	80,945 (6.16%)	11,968 (3.82%)	$76,279,965	$ 2,952,374

Inclusive of the bonuses listed above, the state has received in excess of $910,000,000 in bonuses for leases on the North Slope. Out of the 1,600,000 acres referred to in paragraph 10 hereof, the state has granted the right to explore for, develop, produce, save, store, treat, process, transport, take care of and market oil, gas and associated substances on approximately 1,314,500 acres. Such leases are held by more than 70 different persons. Of these acres, approximately 313,301 are in production pools designated by the state. What, if any, additional oil or gas

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*Includes expenditures by others with respect to leases now owned by this producer.

underlies the remaining North Slope acreage (comprising approximately 1,000,000 acres) under lease from the state cannot be known with certainty unless or until additional exploration is carried out. In addition to their interests in the 1,600,000-acre tract selected by the State of Alaska with the tentative approval of the United States, plaintiff producers own the right received from the United States to explore for, find, produce and market oil and gas with respect to substantial acreage on the North Slope in the areas to the south of the 1,600,000-acre tract. Exploration for oil and gas is now in progress in this area.

16. The market for oil produced in Alaska is primarily the lower 48 states, and the nearest markets therein are on the west coast of the states of Washington and California. As a consequence, the value of oil in Alaska approximates the market price of such oil delivered to the west coast of the lower 48 states less the cost of delivery. The cost of delivery of oil produced in southern Alaska is comparatively modest. The cost of delivery of oil produced from the North Slope of Alaska will be very large.

17. The oil field at Prudhoe Bay, based on reserves now proven, will, it is estimated, produce oil at a rate in excess of 1,000,000 barrels per day for a substantial number of years. Such production would be sufficient in amount to justify the investment in facilities necessary to market said oil under the terms of the contracts between the state and the plaintiff producers--at least under the conditions existing prior to the enactment of the legislation herein complained of. All but a relatively insignificant proportion of the oil in question will be produced, transported and marketed in interstate commerce, and the energy needs of the United States are such that any unwarranted burden upon or impediment to such commerce would be

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detrimental not only to plaintiffs' interests, but to the national interest as well.

18. In order to make it possible to market the oil produced from the North Slope leases, and in reliance on the contracts between the oil and gas lessees and the State of Alaska, certain of the plaintiffs entered into a series of contracts, the first of which was dated October 28, 1968, in which they agreed to design, construct, maintain and operate a crude oil pipeline that would extend from the vicinity of the Prudhoe Bay Field to Valdez, Alaska, and that would permit the North Slope oil to be transported in interstate commerce, via the pipeline and ocean-going vessels, to markets in the lower 48 states. Applications were submitted to the state and to the United States for permits to cross state and federal land, and it was proposed that construction of this pipeline be initiated in the summer of 1969. The state was fully informed as to the route of the proposed pipeline and was furnished detailed descriptions of the interests in state lands that would be required in connection with the construction and operation of the pipeline. The route selected represents a logical and economical choice and will offer a reasonable and proper means of transporting the oil to market with minimal inconvenience to the state. The location and mode of construction of the proposed pipeline were given written tentative approval by the state in April of 1971, and the state has never questioned the reasonableness of the route. $347,000,000 has been spent to date in preparing to construct and operate the pipeline so as to permit the North Slope oil to be marketed in interstate commerce. These funds, which were advanced by the companies named in paragraph 19 hereof, in the proportions there set out, were advanced and spent in reliance on the contractual undertaking of the state to permit the North Slope oil to be

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marketed, and in reliance upon statutory and constitutional provisions (imported into the lease contracts) authorizing creation of the necessary rights-of-way on state land. With the consent of the defendant state and the United States, the route of the pipeline has been explored, surveyed and engineered, and an agreement has been made with the state under which Alyeska Pipeline Service Company, as agent for the pipeline owners, is to construct a state road along the route of the proposed pipeline at the expense of the pipeline owners. More than 50 miles of roadway, costing the pipeline owners some $20,600,000, have been completed along the route of the proposed pipeline between Livengood and a point near the Yukon River, and this road has been accepted by the state. In consonance with the rights granted under the North Slope leases and the constitutional and statutory provisions with reference to which the leases were entered into, the state has contractually obligated itself, in these agreements, to permit the pipeline to cross the roads in question, and has also contracted to permit the pipeline to cross the Yukon River on supports for a bridge that is to be constructed by the state.

19. Said pipeline will be owned in common by the companies identified below, and will be constructed and operated for them by Alyeska Pipeline Service Company, acting as their agent. The ownership interests in the pipeline are presently as follows:

(Owner)	(% Ownership in Pipeline)
* Amerada Hess Corporation	3.00%
Atlantic Pipeline Company	28.08%
* Humble Pipeline Company	25.52%
Mobil Pipeline Company	8.08%
* Phillips Petroleum Company	3.32%
* Sohio Pipeline Company	28.08%
* Union Oil Company of California	3.32%

*Plaintiffs

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The pipeline agreement provides that each of the pipeline owners will independently operate as a common carrier and will be entitled to a percent of the capacity of the pipeline equivalent to its ownership therein. The pipeline is designed in such a way as to permit ultimate expansion of its capacity to approximately 2,000,000 barrels per day.

20. Said pipeline (hereinafter sometimes referred to as the Trans Alaska Pipeline System, or TAPS) will be approximately 789 miles in length, of which approximately 653 miles will be on land owned by the United States, 98 miles on lands owned by the State of Alaska or tentatively approved for patent to the state, and 38 miles on lands owned by private citizens. Plaintiffs are advised that the necessary permits will be granted by the United States, subject to pending judicial review.

21. There is no feasible way to market the oil produced at Prudhoe Bay other than in interstate commerce through a pipeline of large diameter and pumping capacity. There is no way to market said oil without traverse of the land and highways owned by the state.

22. Due to causes beyond the control of, and despite the best efforts of plaintiffs and of the State of Alaska, the initiation of the construction of TAPS has been delayed from 1969, as planned, to at least 1973. As a consequence of such delay and of requirements attending such construction not originally contemplated, the original estimated cost of said line ($1,500,000,000) has more than doubled, thus increasing the risk of the parties undertaking it and reducing the expected value of the oil at the Prudhoe Bay wellhead.

FIRST COUNT

23. When it became evident that the cost of marketing the oil from Prudhoe Bay would be increased substantially over

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earlier estimates, with a consequent reduction in the expected wellhead value of such oil and a corresponding reduction in the estimates of revenue to be derived by the State of Alaska from the marketing of North Slope oil, the state devised and carried out a plan to use its legislative power to change unilaterally the terms on which it had sold the right to find, produce and market the North Slope oil, so that the state would bear no part of the risk of increases in the cost of marketing North Slope oil and the concomitant risk of decreases in the value of such oil at the wellhead. The contracts between the plaintiff producers and the defendant state, however, require that the parties shall bear ratably, according to their respective interests, the risk of increased marketing costs and the risk (and benefit) of fluctuation in the market price. Said plan was carried out as follows:

A. The provisions of the Alaska statutes authorizing use of eminent domain for pipeline purposes and authorizing the issuance of permits to cross state lands for pipelines at a reasonable charge were so amended as to make them unavailable for the TAPS project.

B. The state passed the Right-of-Way Act to make any grant of its permission for TAPS to cross state rivers, highways and lands (without which crossing the oil cannot be marketed) conditional upon the applicant's agreeing to pay the state rentals calculated under an arbitrary formula that bears no rational relationship to the rental value of the right-of-way and that lends itself to the production of sums of money for the state which

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are grossly excessive in relationship to the value of the right-of-way to which they purport to relate. To the extent that the rentals calculated under this arbitrary formula are unjustifiably high in relation to the actual value of the right-of-way, they will result in an unjustifiable reduction in the value of the plaintiff producers' oil at the wellhead.

C. Knowing full well that the increasing pipeline construction costs and excessive right-of-way rentals threaten to drive North Slope wellhead values below $2.65 per barrel, the state passed the Minimum Price Act, the effect of which is to provide that if the wellhead price of the oil is less than $2.65 per barrel, then with respect to each barrel of oil produced the producer must make a payment to the state in lieu of severance taxes (which taxes are fixed by law at a percentage of wellhead value) in an amount which, when added to a 12-1/2% royalty, will yield the state an amount equal to the sum of the royalties and severance taxes that would have been payable if the wellhead price were $2.65 per barrel. (Thus, under the Minimum Price Act, the percentage of wellhead values paid to the state in lieu of severance taxes varies inversely with the amount of royalty paid to the state, thereby taking the property of the plaintiff producers without due process of law.) The usual wellhead value of oil produced in the southern part of the state is and can be expected to remain higher than $2.65. The Minimum Price Act will have no

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appreciable effect upon production in the southern part of the state and its burden will fall almost entirely on North Slope production, thereby denying the plaintiff producers the equal protection of the law.

D. The state included provisions in the Right-of-Way Act requiring that: (i) the state must be granted an option to purchase an interest of up to 20% in the entire pipeline, at a price to be fixed by an "agreement" exacted long before the actual cost of such line could be known; (ii) the pipeline owners must "agree" in advance to convey to the state their entire right-of-way, including that portion received from the United States by permit under federal law, nothwithstanding that such right-of-way will include federal lands withdrawn by the Secretary of the Interior for a utility and transportation corridor and barred from state selection under §17(C) of the Alaska Native Claims Act, P.L. 92-203; (iii) the pipeline owners must "agree" to grant to the state their constitutional right of eminent domain and their right to acquire right-of-way across federal land; (iv) a certificate of public convenience and necessity must be obtained from the state to transport the oil in interstate commerce upon further conditions yet unknown; and (v) the pipeline owners must "agree" to purchase from third parties at the wellhead all oil offered to them thus putting them in a new business and increasing their risk and expense.

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Under the requirements of federal law the pipeline owners will be common carriers.

24. By the aforesaid Acts, the state has impaired the obligation of the contracts it entered into in selling the North Slope leases, contrary to Article I, Section 10, of the Constitution of the United States, and Article I, Section 15, of the Alaska Constitution, and for this reason and for the reasons stated below the Right-of-Way Act and the Minimum Price Act are void and of no effect. Additionally, the state has by such Acts unreasonably burdened and placed unlawful conditions on the grants to plaintiffs by the United States of the right to explore for, find and market oil from lands owned by the United States on the North Slope.

SECOND COUNT

25. Section 2 of the Right-of-Way Act makes the provisions of law granting the right of eminent domain for pipeline rights-of-way unavailable to the owners of a pipeline any part of which is on or is intended to be located on state land or across the right-of-way of any public road or highway, but other pipeline owners not so using or intending to use state land are not deprived of this right. Similarly, Section 4 of the Right-of-Way Act withdraws authority for the granting of permits across state lands for such pipelines, but not for corresponding uses. These provisions violate the equal protection clause of the Fourteenth Amendment to the Constitution of the United States and Article I, Section 15, of the Alaska Constitution.

26. It is essential that a pipeline right-of-way across state lands not now devoted to an inconsistent public purpose be granted to or for the use of the plaintiff producers if they are to have access to their producing leases for the extraction and utilization of the resources thereof, and insofar

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as it negates the right to institute proceedings in eminent domain for the acquisition of such rights-of-way, the Right-of-Way Act violates Article VIII, Section 18, of the Alaska Constitution.

27. A right-of-way across state lands is necessary for the enjoyment of the right to explore for, develop, produce, process and market oil, which right was expressly granted to the plaintiff producers by the defendant state for a valuable consideration. The plaintiff producers therefore have the right to acquire or obtain the benefit of such right-of-way on reasonable terms, and the denial of such right is an impairment of the contractual provisions contained in the plaintiff producers' leases and an unlawful and unconstitutional destruction of the right to find and market petroleum products.

THIRD COUNT

28. With respect to any pipeline for the transportation of crude oil, natural gas or related products costing more than $1,000,000 as to which a right-of-way permit has not already been issued, the Right-of-Way Leasing Act of 1972 contains among others the following provisions, in addition to (or amplification of) those previously described:

A. No one may own or operate a pipeline any part of which is to be on state land unless it is a common carrier, has obtained a right-of-way lease of the land, and unless the Commissioner of the Department of Natural Resources of the State of Alaska finds that said pipeline is or will be required by the present or future public interest and necessity.

B. Any person obtaining a right-of-way lease for a crude oil pipeline across state public land is required as a condition thereof expressly to covenant, among other things: (1) that it will

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be a common purchaser of crude oil; (2) that it will grant to the State of Alaska the right to purchase an undivided interest of up to 20% in the entire length of said pipeline, at a price to be fixed in the right-of-way lease itself; (3) that it will provide for intrastate deliveries of oil, under certain conditions; (4) that it will not transfer its interest in the pipeline or right-of-way lease except as authorized by the Commissioner of the Department of Natural Resources of the State of Alaska; (5) that upon demand of the Commissioner it will convey to the state any and all rights-of-way, permits, or easements acquired or to be acquired, "at a just price"; (6) that it grants to the state its right to acquire rights-of-way on lands of the United States.

C. Said Right-of-Way Leasing Act further provides that as a condition for obtaining permission to cross said lands the applicant must expressly agree to make annual rental payments designed to yield the state over the life of the pipeline a minimum of approximately 2% of the cost of construction of said pipeline on state land plus an amount equal to interest at five percent on the aggregate of such payments for a number of years equal to the estimated life of the line, or, if the annual earnings of the pipeline are such that a larger rental payment would be produced thereby, an amount equal to 2% of the pipeline's entire net earnings (before income taxes) up to 4% of the value of the pipeline's

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total assets, plus 25% of that portion of such annual net earnings between 4% and 6% of total asset value, plus 50% of that portion of such annual net earnings greater than 6% of total asset value. Neither "rental" formula has a rational relationship to the value of the property interests to be acquired from the state.

29. Although the provisions of the Right-of-Way Leasing Act purport to be consensual in nature, they are in fact a requirement imposed by law, because the alternative to non-acceptance would be abandonment of private property for which the state has been paid millions of dollars and in the development of which millions of additional dollars have been spent upon the faith of the state's grant. These "consensual" provisions, exacted as they are by the exercise of the monopoly power of the state and operating solely to promote its commercial interest, are unlawful and void for the following reasons:

A. They condition the right to transport and market property in interstate commerce on the consent of the state and subject said interstate commerce to arbitrary, unfair and oppressive burdens;

B. They regulate interstate transportation although the right to regulate such transportation has been pre-empted by Congressional action, and otherwise burden interstate commerce;

C. They are confiscatory because they unreasonably impair the ability of a pipeline owner to sell his interest in the pipeline and thus to obtain financing on the security of such interest;

D. They take the property of the plaintiff pipeline

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companies without due process because they require them to purchase oil although they are not in the business of purchasing oil.

E. They impair the obligation of the state's contracts.

The rental requirement bears no rational relationship whatever to the value of land or right-of-way conveyed, nor do the other conditions bear any rational relationship to the privileges purported to be conveyed thereby; they represent, rather, a unilateral revision by the state of its contracts with the plaintiff producers, and an attempt to exact additional compensation for the enjoyment of rights already granted and paid for.

FOURTH COUNT

30. Prior to enactment of the Minimum Price Act, the tax laws of the State of Alaska had provided for a severance tax that yielded an amount equal to approximately 7-1/2% of the well-head value of all oil produced in the state of Alaska. (AS 43.55.010.) The Minimum Price Act amended the tax laws to provide that such tax should not be payable if the charge, denominated a "tax", imposed by the newly enacted provisions of AS 43.55.015 were applicable. Said AS 43.55.015 provides for a "tax" designed to yield approximately 55 cents per barrel of oil produced, but provides that there shall be credited against said 55 cents the amount paid in royalties up to one-eighth (or 12-1/2%) of the value of the oil produced. In the case of producers such as Atlantic and plaintiff Humble, who have a state lease the royalty on which is less than one-eighth, the royalty credit shall be computed as if it were one-eighth.

31. Said Minimum Price Act is illegal and void because though purporting to be a tax, it is not in fact a tax but a device to insure that the state of Alaska will receive a greater percentage of the value of oil produced on the North Slope than

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that to which it is entitled by contract, thus impairing contractual obligations and taking private property without just compensation and without due process of law. If the law be regarded as a tax, it taxes the producer of oil on the North Slope at a substantially greater proportion of wellhead value than the producer in the southern part of the state, thus denying the equal protection of the laws to the North Slope producers. The latter producers are also required by operation of said Act to assume a greater risk of loss from increases in the cost of transportation or decreases in the market price of oil than producers in the southern part of the state, the North Slope producers thereby being denied the equal protection of the laws and being subjected to a deprivation of property without due process of law. The Act also results in the denial of the equal protection of the laws in that it imposes a higher tax per barrel upon the production of wells to which a reduced "discovery royalty" is applicable than upon the production of other wells and guarantees to the state $2.65 per barrel for its royalty oil at the wellhead whereas no other oil owner has such guarantee. The Minimum Price Act thus violates the Fifth and Fourteenth Amendments to the Constitution of the United States, Article I, Section 10, of the United States Constitution, and Article I, Sections 1, 7, 15 and 18 of the Alaska Constitution.

32. Section 9 of P.L.92-203, the Alaska Native Claims Act, requires the State of Alaska to pay $500,000,000 into the Alaska Native Fund from royalties, rentals and bonuses received by the state. The Native Claims Act provides that such payment shall be made by the state's paying into the fund a royalty of 2% of the gross value of the minerals produced or removed from lands received by the state from the United States under the Statehood Act, and 2% of the rentals and bonuses received by the state under leases and sales of such lands. Contrary to this

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requirement, the Minimum Price Act provides that when the purported tax imposed by AS 43.55.015 is payable (i.e. when the wellhead price is below $2.65 per barrel), 5 cents per barrel shall be paid into the Alaska Native Fund until all amounts paid into said fund shall equal $500,000,000. This provision imposes solely upon the North Slope oil producers the obligation imposed by federal law on the state to make said payment and to do so at an accelerated rate, thereby enabling the state to avoid sharing its mineral royalty income with the natives of Alaska contrary to the express intention of Congress set forth in P.L. 92-203, and contrary to the supremacy clause in Article VI of the Constitution of the United States.

FIFTH COUNT

33. The Alaska Pipeline Commission Act (AS 42.06) expressly exempts from certain of its regulatory requirements pipeline carriers that are subject to regulation by the United States Interstate Commerce Commission, to the extent that the United States has pre-empted the field by enactment of the Interstate Commerce Act as amended, 34 Stat. 584. The Trans Alaska Pipeline System will be engaged in interstate commerce and subject to the jurisdiction of the United States Interstate Commerce Commission.

34. Under the provisions of AS 42. 06.240 a certificate of public convenience and necessity is required before any pipeline carrier may undertake construction of any pipeline facility. TAPS is exempt from said statute under its express terms and under Article I, Section 8 of the United States Constitution, but the state nevertheless claims the right to require such a certificate. The Commission charged with the enforcement of said act has not yet been appointed, and the commencement of construction of TAPS would carry an unreasonable risk without a determination whether the aforesaid certificate is required.

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35. The owners of TAPS are ready and willing to proceed with construction, and added delays will further increase construction costs and thus diminish the value of North Slope oil by amounts which cannot be calculated with precision but which are very large. The owners of TAPS are not prepared voluntarily to submit to the unlawful and unconstitutional conditions and requirements of the laws of the state herein complained of.

WHEREFORE, PLAINTIFFS PRAY:

A. That the Court find and declare the Minimum Price Act and the Right-of-Way Act to be void and of no effect, and permanently enjoin their enforcement;

B. That the Court find and declare that the transportation of oil by pipeline from Prudhoe Bay to Valdez and thence to the west coast of the lower 48 states is interstate transportation and that the plaintiff owners of TAPS may not constitutionally be subjected to the provisions of Chapter 35 of Title 38 of the Alaska Statutes and are excluded from the provisions of said Chapter under AS 38.25.230(19);

C. That the Court find and declare that the proposed pipeline from Prudhoe Bay to Valdez is subject to regulation by the United States Interstate Commerce Commission and that the power to require a certificate of public convenience and necessity with respect to such line, or the transportation of oil thereby, is pre-empted by the Interstate Commerce Act as amended (34 Stat. 584), and is denied to the state of Alaska and that said pipeline is not subject to the requirements of AS 42.06.240;

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D. That the Court find and declare that the plaintiff producers are entitled to a right-of-way over lands owned by the State of Alaska essential to enable them to market petroleum products produced from leases acquired by them from the state.

E. That the Court, by mandatory injunction, require the defendants to grant the pending application for a pipeline right-of-way permit for the location and configuration heretofore tentatively approved and permanently enjoin the defendants from interfering with the exercise by plaintiffs, or any of them, of the right of eminent domain granted by Article VIII, Section 18 of the Alaska Constitution; and

F. That plaintiffs may have their costs and such other and further relief as to the Court may seem just.

DATED: September 12, 1972.

BURR, PEASE & KURTZ, INC.

By: D. A. Burr
D. A. BURR

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FORM NO. DL-1
REVISED OCT., 1963

STATE OF ALASKA
DEPARTMENT OF NATURAL RESOURCES
Division of Lands

LEASE NO. ADL. _____

Competitive Oil and Gas Lease

THIS LEASE is made by and between the State of Alaska, acting by and through the Director of the Division of Lands, Department of Natural Resources or his authorized agent, hereinafter called "Lessor", and

_____

_____

hereinafter called "Lessee", whether one or more.

1. GRANT. For and in consideration of a cash bonus and the first year's rental, the receipt of which is hereby acknowledged, and of the rents, royalties, covenants, and conditions herein contained on the part of the Lessee to be paid, kept and performed, and subject to the conditions and reservations herein contained, Lessor does hereby grant and lease unto Lessee, exclusively, without warranty, for the sole and only purposes of exploration, development, production, processing and marketing of oil, gas, and associated substances produced therewith, and of installing pipe lines and structures thereon to find, produce save, store, treat, process, transport, take care of and market all such substances, and for drilling water wells and taking underground and surface water for use in its operations thereon, and for housing and boarding employees in its operation thereon, the following described tract of land in Alaska:

containing.....acres, more or less, hereinafter called "said land".

For the purposes of this lease, said land contains the legal subdivisions, as shown on the plat of said land attached hereto, marked Exhibit A and by this reference made a part of this lease.

If said land is described above by protracted legal subdivision and Lessor hereafter causes said land to be surveyed under the public land rectangular system, the boundaries of said land shall be those established by such survey, when approved, subject, however, to the provisions of the regulations relating to such surveys.

2. "OIL AND GAS". "Oil" means crude petroleum oil and other hydrocarbons regardless of gravity which are produced and saved in liquid form at the well by ordinary production methods. "Gas" means all natural gas and all hydrocarbons produced at the well not defined herein as oil; "Associated substances" mean all substances produced in association with oil or gas and not defined herein as oil or gas.

3. TERM. This lease is issued for an initial primary term of _____ years from date hereof, subject to extension as provided in Paragraph 4 hereof, and shall continue so long thereafter as oil and gas or either or any of them are produced in paying quantities from said land; provided,that this lease may be extended beyond its primary term as provided in Paragraph 5 hereof and shall not expire under the conditions set forth in Paragraphs 6, 7, and 8 hereof.

4. EXTENSION BY SUSPENSION OF OPERATIONS. If, prior to the expiration of the primary term, Lessor, in the interest of conservation, directs or assents to the suspension of all operations and production, if any, hereunder, the primary term will be extended by adding the period of suspension thereto.

5. EXTENSION BY UNIT PRODUCTION. (a) This lease shall without application be extended beyond its primary term if upon or prior to the expiration date of such term the lease is committed to a unit agreement approved or prescribed by Lessor as provided in the regulations, production of oil or gas is had in paying quantities under the agreement, and a portion of such production is allocated to said land under the agreement. In such event this lease shall continue in effect so long as it remains subject to such agreement and actual production under said agreement is allocated to said land; (b) The Commissioner may, in his discretion provide for the extension of the term of this lease, if such lease is on the expiration date thereof included in an approved unit plan or if it is included in a program of secondary recovery operation designed to bring about or restore production, provided, however, that if any lease or portion thereof is eliminated from such unit plan or recovery program, or if such unit plan or recovery program is terminated, then any such lease or portion thereof shall continue in full force and effect for ninety (90) days from the date of such elimination or termination and so long thereafter as drilling or redrilling operations are being conducted thereon and so long thereafter as oil or gas is produced in paying quantities.

6. EXTENSION BY DRILLING. (a) If production shall have been obtained in paying quantities during the primary term, and if, at the end of the primary term, or at any time prior to the end of the primary term, such production shall have ceased from any cause, or in the event production shall at any time or times after the expiration of the primary term cease from any cause, then this lease shall not terminate if the Lessee commences drilling or reworking operations (either in a well from which such production has ceased or in a new well) within sixty days after the cessation of production, and the lease shall remain in full force and effect so long as such operations are prosecuted with reasonable diligence or are suspended under Paragraph 27 hereof; and, if such drilling or reworking operations result in the production of oil or gas, the lease shall remain in full force and effect so long as oil or gas is produced therefrom in paying quantities; (b) if actual drilling has commenced on the expiration date of the primary term of the lease and is continued with reasonable diligence, such operations to include redrilling, sidetracking or other means necessary to reach the originally proposed bottom hole location, the lease shall continue in full force and effect sixty (60) days after such drilling has ceased and for so long thereafter as oil or gas is produced in paying quantities; (c) if all or part of the lands covered by the lease are lands that have been selected by Alaska under the laws of the United States granting lands to Alaska and the conveyance of lease was issued thereon, the term of the lease shall be extended for a period equal to the period during which the lease was conditional.

Exhibit A

7. EXTENSION BY DRILLING PRODUCTION. If, upon the expiration of the primary term or at any time or times thereafter, there is on said land a well capable of producing oil or gas in paying quantities, this lease shall not expire because lessee fails to produce the same unless lessor gives notice to lessee allowing a reasonable time, which shall not be less than sixty days, after such notice to place the well on a producing status, and lessee fails to do so; provided, that after such status is established such production shall continue on the said land unless and until suspension of production is allowed by lessor.

8. EXTENSION BY SUSPENSION OF PRODUCTION. This lease shall not expire because of any suspension of operations in or upon or production from said land if such suspension is made under any order or with the consent of lessor.

9. RENTAL. This lease shall terminate on any anniversary date hereof prior to the completion on said land of a well capable of producing oil or gas in paying quantities, unless on or before said anniversary date lessee shall pay or tender to lessor as annual rental a sum equal to $1.00 per acre or fraction thereof, then included in this lease, or unless such annual rental has been waived or suspended as provided in Paragraph 13 of this lease. If lessor's office is not open for business on the anniversary date, the time for payment is extended to include the next day on which said office is open for business.

10. MINIMUM ROYALTY. Commencing with the lease year beginning on or after completion on said land of a well capable of producing oil or gas in paying quantities, lessee shall pay lessor, at the expiration of each lease year, in lieu of rental a minimum royalty equal to $1.00 per acre, or fraction thereof, then included in this lease, or the difference between the actual royalty paid on production during the year if less than $1.00 per acre and the prescribed minimum royalty.

11. ROYALTY ON PRODUCTION. Except for oil and gas used on said land for development and production or unavoidably lost, lessee shall pay lessor as royalty the following:

(a) On oil ..... per cent in amount or value of the oil produced and saved and removed or sold from said land.

(b) On gas ..... per cent in amount or value of the gas produced and saved and sold or used off said land or used for the extraction of natural gasoline or other products therefrom.

(c) On associated substances ..... per cent in amount or value of such substances produced and saved and removed or sold from said lands.

12. REDUCTION OF ROYALTY RATES FOR DISCOVERY. If lessee shall drill on said land and make the first discovery of oil or gas in commercial quantities in any geological structure, the royalty rate under this lease shall, instead of the rates prescribed in Paragraph 11, be five per cent for a period of ten years following the date of such discovery, and thereafter the royalty rates shall be those prescribed in Paragraph 11. If this lease is committed to a unit agreement approved or prescribed by lessor as provided in the regulations, the five per cent royalty rate shall not apply to all, but only, the production allocated to this lease under such agreement.

13. REDUCTION OF RENTAL AND ROYALTY. Rental or minimum royalty may be waived, suspended, or reduced, or royalty may be reduced on all of said land or any tract or portion thereof segregated for royalty purposes if lessor finds that such relief is necessary for the purpose of encouraging the greatest ultimate recovery of oil or gas and is in the interest of conservation of natural resources and either that such relief is necessary in order to promote development or that the lease cannot be successfully operated under the terms provided herein.

14. ROYALTY IN KIND. Whenever, at the option of lessor, which may be exercised from time to time upon not less than six months notice to lessee, lessor elects to take its royalty in kind, lessee shall deliver free of charge (on said land or at such place as lessor and lessee mutually agree upon) to lessor or to such individual, firm, or corporation as lessor may designate all royalty oil and/or gas produced and saved from said land. Such oil and/or gas shall be in good and merchantable condition. Lessee shall, if necessary, furnish storage for royalty oil free of charge for thirty days after the end of the calendar month in which the oil is produced from said land; provided, that lessee shall not be held liable for loss or destruction of royalty oil and/or gas from causes beyond lessee's reasonable control. Should lessee dehydrate or clean the oil or gas produced from said land, lessee shall be entitled to an allowance of the actual cost of dehydrating or cleaning said royalty oil or gas.

15. ROYALTY IN VALUE. At the option of lessor, which may be exercised from time to time upon not less than six months notice to lessee, and in lieu of royalty in kind, lessee shall pay to lessor the field market price or value at the well of all royalty oil and/or gas. All royalty that may become payable in money to lessor shall be paid on or before the last day of the calendar month following the month in which the oil or gas is produced. The payments shall be accompanied by copies of run tickets or other satisfactory evidence of sales, shipments, and amounts of gross production.

16. PRICE. The field market price or value of royalty oil or gas shall not be less than the highest of: (1) The price actually paid or agreed to be paid to lessee at the well by the purchaser thereof, if any; or (2) The posted price of lessee in the field for such oil or gas at the well, if any; or, (3) The prevailing price received by other producers in the field at the well for oil of like grade and gravity or gas of like kind and quality at the time such oil or gas is removed from said land or run into storage, or such gas is delivered to an extraction plant.

17. PAYMENTS. All payments to lessor under this lease shall be made payable to the Department of Revenue of the State of Alaska and shall be tendered to lessor at the place designated under Paragraph 44 for giving notices to lessor.

18. OFFSET WELLS. Lessee shall drill such wells as a reasonably prudent operator would drill to protect lessor adequately from loss by reason of drainage resulting from production on other land. Without limiting the generality of the foregoing sentence, if oil or gas should be produced in a well on other land not owned by lessor or on which lessor receives a lower rate of royalty than the royalty under this lease, which well is within 500 feet in the case of an oil well or 1,500 feet in the case of a gas well of lands then subject to this lease, and such well shall produce oil or gas in paying quantities for a period of thirty consecutive days, and if, after notice to lessee and an opportunity to be heard, lessor finds that production from such well is draining lands then subject to this lease, lessee shall within 120 days after written demand by lessor begin in good faith and prosecute diligently drilling operations for an offset well on said land. In lieu of drilling any well required by this paragraph, lessee may with lessor's consent compensate lessor in full each month for the estimated loss of royalty through drainage in the amount determined by lessor.

19. OTHER WELLS. This lease contemplates the reasonable development of said land for oil and gas as the facts may justify. Upon discovery of oil or gas in paying quantities on said land, lessee shall drill such wells as a reasonably prudent operator would drill having due regard for the interests of lessor as well as the interests of lessee.

20. DILIGENCE; PREVENTION OF WASTE. Lessee shall exercise reasonable diligence in drilling, producing, and operating wells on said land unless consent to suspend operations temporarily is granted by lessor; shall carry on all operations hereunder in a good and workmanlike manner in accordance with approved methods and practices, having due regard for the prevention of waste of oil and gas and the entrance of water to the oil and gas bearing sands or strata to the destruction or injury of such deposits and the preservation and conservation of the property for the future productive operations; shall use reasonable care and all proper safeguards to prevent the pollution of water; shall plug securely in an approved manner any well before abandoning it; shall allow lessor to inspect all operations at any time; shall carry out at lessee's expense all reasonable orders and requirements of lessor relative to the prevention of waste and the preservation of said land, and on failure of lessee so to do, lessor shall have the right together with any other recourse available to it to enter on said land to repair damage or prevent waste at lessee's expense; and shall, abide by and conform to valid and applicable rules and regulations of the Alaska Oil and Gas Conservation Commission and the regulations of lessor relating to the matters covered by this paragraph in effect on the effective date hereof or hereafter in effect if not inconsistent with any specific provisions of this lease.

21. WELL LOCATIONS. Lessee shall within five days after spudding in a well advise lessor in writing of the location and date of spudding of said well.

22. APPROVAL OF PLANS. Lessee shall not place into actual operation any plan or method for the purpose of stimulating or increasing production on said land other than plans and methods in common use without first having obtained the written approval of lessor.

23. LOGS AND RECORDS. An electric log or radioactive log, if taken, and a descriptive geologic sample log, if taken, and a record of all tests run for each well drilled on said land, together with a plat showing the exact location of each such well, shall be filed with lessor within thirty (30) days after such well has been completed, suspended, or abandoned. Any and all information filed by lessee with lessor in connection with this lease shall be available at all times for the confidential use of lessor for the purpose of enforcing compliance with the terms, covenants, and conditions of this lease and the regulations of the lessor but shall not be open for inspection by any person other than officers, or employees of lessor and persons performing any function or work assigned to them by lessor for a period of twenty-four (24) months after the thirty (30) day filing period, except upon written consent of lessor. Notwithstanding any other provision hereof, said information may be disclosed to any person where such disclosure is reasonably necessary for the administration of the functions, responsibilities, and duties vested by law in the Commissioner of the Department of Natural Resources or in the Division of Lands or the Director thereof, including but not limited to functions, responsibilities, and duties arising in connection with any litigation or administrative adjudication relating to that lease or to the rights, duties, and obligations arising hereunder.

24. RECORDS. Lessee shall keep and have in its possession books and records showing the production and disposition of all oil and gas produced from said land and shall permit lessor or its agents at all reasonable hours to examine the same. Such records and reports of production shall be kept upon such methods and techniques as shall ensure the most accurate reports reasonably available without requiring the lessee to provide separate tankage for each well.

25. [illegible] As [illegible] provides in part that no rights under reservations contained in certain leases or grants of Alaska land shall be exercised

28. DAMAGES. AS 38.05.130 provides in part that no rights under reservations contained in certain leases or grants of Alaska land shall be exercised by Lessor or its lessee until provision has been made to pay the owner of the land upon which the reserved rights are sought to be exercised for payment for all damages sustained by said owner by reason of entering on said land; provided, that if said owner for any cause whatever refuses or neglects to settle said damages, Lessor or its lessee shall have the right to institute such legal proceeding in a court of competent jurisdiction where the land is situated as may be necessary to determine the damage which the owner of such land may suffer. Lessee hereby agrees to pay any damages that may become payable under said statutory provisions and to indemnify Lessor and hold it harmless from and against any claims, demands, liabilities and expenses arising from or in connection with such damage. The furnishing of a bond in compliance with this lease will be regarded by Lessor as a sufficient provision for the payment of all damage that may become payable under said statutory provisions.

29. BONDS.

(a) If required by Lessor, Lessee shall furnish a bond prior to the issuance of this lease in an amount equal to at least $2.00 per acre or fraction thereof contained in said land but not less than $1,000.00 and shall maintain said bond as long as required by Lessor.

(b) Before beginning drilling operations on said land Lessee must have furnished and shall maintain a bond in an amount of at least $5,000.00

(c) Lessee may, in lieu of the foregoing, furnish and maintain a statewide bond in the amount of $100,000.00

(d) Lessor may, after notice to Lessee and an opportunity to be heard, require a bond in a reasonable amount greater than the amount specified above in this paragraph where such greater amount is justified by the nature of the surface and its uses and improvements in the vicinity of said land and the degree of the risks involved in the type of operations being or to be carried out under this lease. A statewide bond will not satisfy any requirement of a bond imposed under this subparagraph but will be considered by Lessor in determining the need for and the amount of any additional bond under this subparagraph.

(e) If said land is committed in whole or in part to a cooperative or unit agreement approved or prescribed by Lessor pursuant to law and the regulations and a unit bond is furnished in accordance with the regulations, Lessee need not thereafter maintain any bond with respect to the portion of said land so committed to such agreement.

27. ACTS OF GOD. Should Lessee be prevented from complying with any expressed or implied covenant of this lease, from conducting drilling operations thereon, or from producing or marketing oil or gas from said land after efforts made in good faith, by reason of war, riots, acts of God, severe weather in the area of said land, acts of governmental authorities, failure or lack of adequate transportation facilities, or any other cause beyond Lessee's reasonable control whether similar to those enumerated or not, then while so prevented and for a reasonable time thereafter within which to resume operations, Lessee's obligation to comply with such covenant shall be suspended and Lessee shall not be liable for damages for failure to comply therewith. If drilling or reworking operations are suspended by virtue of this paragraph and the prosecution of such operations would have had the effect of preventing the expiration or termination of this lease, then this lease shall not terminate during the period which the obligation to perform such operations is suspended under this paragraph; provided, however, that nothing in this paragraph shall be construed to suspend the payment of rentals or of minimum royalties.

28. SUSPENSION. Lessor may from time to time direct or assent to the suspension of production or other operations or both under this lease if such action is necessary or justified in the interest of conservation.

29. RESERVATIONS. Lessor reserves the right to dispose of the surface of said land to others subject to this lease, and the right to authorize others by grant, lease, or permit subject to this lease and under such conditions as will prevent unnecessary or unreasonable interference with the rights of Lessee and operations under this lease, to enter upon and use said land:

(a) To explore for oil or gas by geological or geophysical means including the drilling of shallow core holes or stratigraphic tests to a depth of not more than 1,000 feet.

(b) To explore for, develop and remove natural resources other than oil, gas, and associated substances on or from said land.

(c) For nonexclusive easements and rights of way for any lawful purpose including shafts and tunnels necessary or appropriate for the working of said land or other lands for natural resources other than oil, gas or associated substances.

(d) For well sites and well bores of wells drilled from or through said land to explore for or produce oil, gas, and associated substances in and from other lands.

(e) For any other purpose now or hereafter authorized by law and not inconsistent with the rights of Lessee under this lease.

30. UNDERGROUND STORAGE. This lease does not authorize the subsurface storage of oil or gas except as a necessary incident to recycling, pressure maintenance, repressuring, or other similar operation designed to increase the ultimate recovery of oil or gas or prevent the waste of oil or gas produced from said land or from any unit area of which the said land is a part. Lessor reserves the right to authorize the subsurface storage of oil or gas in said land by Lessee or by others in order to avoid waste or to promote conservation of natural resources and upon such conditions as will prevent unnecessary or unreasonable interference with the rights and operations of Lessee under this lease, including conditions prohibiting the storage of oil or gas without the consent of Lessee in any reservoir covered by this lease capable of producing oil or gas in paying quantities.

31. ASSIGNMENTS. This lease or any undivided interest herein may with the approval of Lessor be assigned or subleased as to said land or any one or more legal subdivisions included therein, or any separate and distinct zone or geological horizon underlying said land or such one or more legal subdivisions, to any person or persons qualified to hold a lease. No transfer of any interest in this lease including assignments of working or royalty interests and operating agreements and subleases shall be binding upon Lessor unless approved by Lessor. Lessee shall remain liable for all obligations under this lease accruing prior to the approval of such transfer. Approval of transfer of this lease or an interest therein will not be denied except (1) for failure to comply with the regulations, (2) in the discretion of Lessor, where the transfer covers an distinct zone or geological horizon, or (3) where Lessor determines that the best interests of Lessor justify such action. Applications for approval of a transfer under this paragraph must comply with the regulations and must be filed within ninety days after the date of final execution of the instrument of transfer. Where a transfer is made of all or a part of Lessee's interest in and to a portion of the acreage in said land the assigned acreage shall, at the option of Lessor, or may upon request of the transferee and with the approval of Lessor be segregated into a separate and distinct lease having the same effective date as this lease.

32. UNITIZATION. Whenever determined and certified by Lessor to be necessary or advisable in the public interest for the purpose of promoting conserving the natural resources of any oil or gas pool, field or like area or any part thereof, which includes or underlies said land or any part thereof, Lessee may unite with other lessees of Lessor or with others owning or operating lands not belonging to Lessor including lands belonging to the United States and with others, jointly or separately, in collectively adopting and operating under a cooperative or unit agreement for the development or operation of the pool or field or like area or part thereof. Lessee shall within thirty days after demand by Lessor subscribe to such a cooperative or unit agreement, which agreement shall be reasonable and shall adequately protect all parties in interest including Lessor. Lessor may with the consent of Lessee establish, alter, change, or revoke drilling, producing, rental, minimum royalty, and royalty requirements of this lease if committed to any such cooperative or unit agreement and may make such regulations with reference to this lease with the like consent of Lessee in connection with the constitution and operation of any such cooperative or unit agreement as Lessor may determine to be necessary or proper to secure the proper protection of the public interest. If a portion of said land is committed to an approved or prescribed unit agreement, the committed acreage shall at the option of Lessor and may upon the request of Lessee and with the approval of Lessor be segregated into a separate and distinct lease having the same effective date as this lease.

33. SURRENDER. Lessee may at any time make and file with Lessor a written surrender of all rights under this lease or any portion thereof comprising one or more legal subdivisions or, with the consent of Lessor, of any separate and distinct zone or geological horizon underlying said lands or such one or more legal subdivisions thereof. Such a surrender shall be effective as of the date of filing subject to the continued obligations of Lessee and his surety to make payment of all royalties theretofore accrued and to place all wells on the surrendered land or in the surrendered zones or horizons in condition satisfactory to Lessor for suspension or abandonment; thereupon, Lessee shall be released from all other obligations accrued or to accrue under this lease with respect to the surrendered lands, zones, or horizons.

34. DEFAULT; TERMINATION. Whenever Lessee fails to comply with any of the provisions of this lease other than the payment of rental and Lessee fails within sixty days after written notice of such default to commence to remedy and thereafter prosecute diligently operations to remedy such default, Lessor may cancel this lease if at that time there is no well on said land capable of producing oil or gas in paying quantities. If at such time there is on said land a well capable of producing oil or gas in paying quantities, this lease may be canceled only by judicial proceedings. In the event of any cancellation under this paragraph, Lessee shall have the right to retain under this lease any and all drilling or producing wells as to which no default exists together with a parcel of land surrounding each such well or wells and such rights of way through said land as may be reasonably necessary to enable Lessee to drill and operate such retained well or wells.

35. EXCESS AREA. If for any reason said land includes more acreage than the maximum permitted under applicable laws and/or regulations, this lease shall not be void but the acreage included in said land shall be reduced to the permitted maximums. Whenever Lessor determines that this lease so exceeds the permitted acreage and notifies Lessee stating the amount of acreage that must be eliminated, Lessee may within sixty days after such notice surrender one or more legal subdivisions included in said lands comprising at least the amount of acreage that must be eliminated. If such a surrender is not filed within such sixty days Lessor may terminate this lease as to the acreage that must be eliminated by mailing notice of such termination to Lessee describing the parcel or parcels eliminated. Such a notice shall have the effect of terminating this lease as to the parcel or parcels described in such notice.

36. RIGHTS ON TERMINATION. Upon the expiration or earlier termination of this lease as to all or any portion of said lands, Lessee shall have the privilege at any time within a period of six months thereafter, or such extension thereof as may be granted Lessor, of removing from said land or portion thereof all machinery, equipment, tools, and materials other than improvements needed for producing wells. Any materials, tools, appliances, machinery, structures, and equipment subject to removal as above provided which are allowed to remain on said land or portion thereof shall become the property of Lessor upon expiration of such period; provided, that Lessee shall remove any and all of such property when so directed by Lessor. Subject to the foregoing, Lessee shall deliver up said lands or such portion or portions thereof in good order and condition.

37. INTEREST IN LAND. It is the intention of the parties that the rights vested in Lessee by this lease shall constitute an interest in real property in said land.

38. LESSEE INTEREST. If Lessor owns a lesser interest in the oil and gas deposits in said land than the entire and undivided fee simple estate, then the royalties and rentals herein provided shall be paid Lessor only in the proportion which its interest bears to the whole and undivided fee.

39. CONDITIONAL LEASE. If all or a part of said land is land that has been selected by the Lessor under laws of the United States granting lands to Lessor, but such land has not been patented to Lessor by the United States, then this lease is a conditional lease as provided by law until such patent becomes effective. If for any reason such a selection is not finally approved or such a patent does not become effective, any rental, royalty or minimum royalty payments made to Lessor under this lease will not be refunded.

40. DRILLING OPERATIONS. As used, in this lease "drilling operations" mean any work or actual operations undertaken or commenced in good faith for the purpose of carrying out any of the rights, privileges or duties of Lessee under this lease, followed diligently and in due course by the construction of a road or derrick and/or other necessary structures for the drilling of an oil or gas well, and by the actual operation of drilling in the ground. Any such work or operations preliminary to drilling in the ground may be undertaken either on said land or in the vicinity of said land in any order Lessee shall see fit.

41. ACTUAL DRILLING. As used in this lease, "actual drilling" means any and all operations necessary or convenient to the drilling of a well in the ground after the first drilling or spudding with equipment of sufficient size and capacity to drill to the total depth proposed for the well.

42. RULES AND REGULATIONS. As used in this lease "regulations" mean the applicable and valid oil and gas leasing regulations of the Commissioner of the Department of Natural Resources in effect on the effective date of this lease unless otherwise specified.

43. INTERPRETATION. As used in this lease words which are defined in the regulations have the meaning assigned by such definition except where the context clearly requires a different meaning. The paragraph headings are not a part of this lease and are inserted only for convenience.

44. NOTICES. Any notice required or permitted under this lease shall be in writing and shall be given by registered or certified mail, return receipt requested, addressed as follows:

To Lessor:

Director, Division of Lands
State of Alaska
344 Sixth Avenue
Anchorage, Alaska 99501

To Lessee:

.....

.....

.....

Any such notice shall be deemed given when delivered to the foregoing address. Either party may change the address to which such notices are to be sent, by a notice given in accordance with this paragraph.

45. HEIRS AND ASSIGNS. Subject to the other provisions of this lease, the covenants, conditions, and agreements contained in this lease shall extend to and be binding upon the heirs, executors, administrators, successors, or assigns of Lessor and Lessee.

46. WILDLIFE STIPULATIONS. This lease is subject to such stipulations as are attached.

IN WITNESS WHEREOF the parties have executed this lease effective as of the ..... day of ..... 19.....

.....

.....

.....

.....

.....

LESSEE

STATE OF ALASKA

By.....

Title.....LESSOR

THE UNITED STATES OF AMERICA }
STATE OF ALASKA } ss

This certifies that on the.....day of.....19....., before me, a notary public in and for the State of Alaska, duly commissioned and sworn, personally appeared ....., to me known and known to me to be the person described in and who executed the foregoing lease on behalf of the State of Alaska as Director of the Division of Lands, Department of Natural Resources, or his authorized agent. The said ..... executed said lease in my presence and, after being duly sworn according to law, stated to me under oath that he is the Director of the Division of Lands, Department of Natural Resources, or his authorized agent, and has authority pursuant to law to execute the foregoing lease as such Director, or authorized agent, on behalf of the State of Alaska, acting through the Division of Lands, Department of Natural Resources and that he executed the same freely and voluntarily as the free and voluntary act and deed of the said State of Alaska and for the Division of Lands, Department of Natural Resources.

WITNESS my hand and official seal of the day and year in this certificate above written.

..... Notary Public in and for Alaska. My Commission expires .....

AGO 760587

SENATE BILLS NOS. 294 AND 313

RIGHT-OF-WAY LEASING

Joseph R. Cortese
Squire, Sanders & Dempsey
Cleveland, Ohio

Senate Bills 294 and 313 present a number of serious problems and, in our opinion, they conflict with federal regulatory authority and the United States Constitution.

I. THE BASIC PREMISE OF THE BILLS IS WRONG, FOR THE STATE CANNOT USE ITS LAND CONTROL TO FORCE UNCONSTITUTIONAL RESULTS.

The basic premise of these bills is that the State, in its capacity as a landowner having control over land necessary for the pipeline, can impose terms and conditions on the pipeline proprietors that it concededly could not impose in its governmental capacity. We should state at the outset that this premise is wrong. It directly conflicts with the decisions of the United States Supreme Court. For example, in Frost v. Railroad Commission of California, 271 U.S. 583, 594 (1926), the U. S. Supreme Court held that a California statute, which sought concessions from a motor carrier as to methods of operating its business as a condition of the use of state highways, was in violation of the United States Constitution because such a requirement would constitute a taking of the carrier's property without due process. The Court said:

> "If the state may compel the surrender of one constitutional right as a condition of its favor, it may, in like manner, compel a surrender of all. It is inconceivable that guaranties embedded in the Constitution of the United States may thus be manipulated out of existence."

Likewise, the attempt of a state to regulate how an interstate telegraph company may select its customers is void even where posed as a condition to use of the streets, for the state may not use its constitutional powers to achieve the unconstitutional result of interfering with interstate commerce.

> "It is suggested that the State gets the power from its power over the streets which it is necessary for the telegraph to cross. But if we assume that the plaintiffs in error under their present charters could be excluded from the streets, the consequence would not follow. Acts generally lawful may become unlawful when done to accomplish an unlawful end, United States v. Reading Co., 226 U.S. 324, 357, and a constitutional power cannot be used by way of condition to attain an unconstitutional result." Western Union Telegraph Co. v. Foster, 247 U.S. 105 (1918).

As the following will further show, a state may not use its control of land to prohibit, attempt to regulate, interfere with, or unduly burden interstate commerce, nor to exact waivers of constitutional rights. If the use of state lands is necessary for interstate transportation, the state cannot withhold the right-of-way, it cannot exact more than reasonable compensation for such right-of-way, and it cannot invade the field of federal regulation or unduly burden interstate commerce as a condition of making available the use of its land.

II. THE STATE OF ALASKA MAY NOT WITHHOLD THE NECESSARY RIGHT-OF-WAY FOR IT MAY NOT WITHHOLD THE MEANS OF TRANSPORTING THE OIL AND GAS IN INTERSTATE COMMERCE.

The State of Alaska through its oil and gas leases has granted to the lessees the right to develop, produce, process and market oil and gas. That oil and gas can only be marketed feasibly by means which utilize state-owned lands. Under these circumstances, the State may not withhold its lands from the lessees.

This principle follows from the commerce clause of the United States Constitution. In Oklahoma v. Kansas Natural Gas Company, 221 U.S. 229 (1911), the State of Oklahoma by statute prohibited companies, which were engaged in transporting gas out of the State of Oklahoma, from laying, constructing and operating gas pipe lines in, on, under, across or along the highways of the State. The gas company merely sought rights to cross the highways for purposes of a pipeline to get natural gas out of the state. Oklahoma argued that while the gas company had the right to engage in interstate commerce, it did not have a right to obtain right-of-way in the state for that purpose, and that the state could withhold from such foreign corporation the power of eminent domain and the right to cross highways. The Supreme Court held that the state could not withhold the right to use highway crossings to construct the pipeline, and rejected the state's contentions, saying:

"At this late day it is not necessary to cite cases to show that the right to engage in interstate commerce is not the gift of a State, and that it cannot be regulated or restrained by a State, or that a State cannot exclude from its limits a corporation engaged in such commerce. To attain these unauthorized ends is the purpose of the Oklahoma statute. The State through the statute seeks in every way to accomplish these ends, and all the powers that a State is conceived to possess are exerted and all the limitations upon such powers are attempted to be circumvented. * * * The use of the highways is forbidden to them [interstate pipeline companies] and the right of eminent domain is withheld from them, and the prohibitive strength which these provisions are supposed to carry is exhibited in the fact that the boundary of the State is a highway. If it cannot be passed without the consent of the State, commerce to and from the State is impossible. The situation is not underestimated by appellant [Oklahoma Attorney General], and he says: 'If the appellees had the right of way they might engage in interstate commerce, but their desire to engage in interstate commerce is a different thing from the means open to them to procure a right of way.' And it is further said, that 'the confusion of the right to engage in interstate commerce with the power to forcibly secure a right of way is the basis of appellees' case.'

"There is here and there a suggestion that the State not having granted such right the alternative is a grant of it by Congress. But this overlooks the affirmative force of the interstate commerce clause of the Constitution. The inaction of Congress is a declaration of freedom from state interference with the transportation of articles of legitimate interstate commerce, and this has been the answer of the courts to contentions like those made in the case at bar.

"* * * No State can by action or inaction prevent, unreasonably burden, discriminate against or directly regulate interstate commerce or the right to carry it on. And in all of these inhibited particulars the statute of Oklahoma offends."

Thus, it was held that the interstate pipeline could cross state highways notwithstanding the prohibition in the Oklahoma statute.

The same Oklahoma statute was also considered, and was held to be unconstitutional in the case of Haskell v. Cowham, 187 F. 403 (8th Cir. 1911). There, the court stated as follows:

"No state may by means of its police power, or its proprietary power, over highways or by means of any of its other powers, erect and maintain impassable barriers against interstate commerce along its borders or through its body in the face of the grant to the nation of the power to regulate that commerce; for all the powers of the state are subordinate to this power of the nation and to its will that such commerce shall be free."

Not only would the withholding by the State of a right-of-way to the lessees constitute an undue burden on interstate commerce, but it would also constitute a deprivation of the lessees' property without due process of law. A succinct statement of this principle is found in the Haskell case cited above:

"But an owner who by virtue of his ownership of land or of mining leases thereof has the vested right to draw by means of wells or pumps natural gas from beneath the surface is the owner of valuable property which the state cannot take from him without just compensation and state laws and acts of the officers of a state which prevent him from taking it from the land and selling it and conveying it out of the state in interstate commerce, while they permit the withdrawal and sale of such gas in intrastate commerce, necessarily violate the national Constitution (1) because they take his property without just compensation and (2) because they substantially discriminate against and directly regulate interstate commerce."

The right of the lessees of the North Slope oil and gas to transport it in interstate commerce without obstacles or burdensome conditions imposed by the State is

expressly apparent in view of the fact that the State invited them to bid competitively for and purchase such oil and gas rights from the State, including, as stated in the leases, the right to "market" such oil and gas.

The point to be emphasized in our consideration of House Bills 294 and 313 is that their factual premise is inconsistent with their legal premise. Factually, they assume that the only practical way of getting the oil out of Alaska is by a pipeline and that pipeline must run across State controlled lands. If that were not the fact there would be no point to the bills for the price and conditions they exact would be avoided by using other lands. Thus, the premise is that the pipeline owners must contract with the State for right-of-ways. On the other hand, the legal premise is that the State, through its proprietary capacity, can achieve by right-of-way contracts what it could not achieve in its governmental capacity because the contracts will be entered into, it is claimed, by voluntary bargaining. It has been claimed that a state as proprietor can legally obtain unusual contract terms because others may contract with it on its terms or forego contracts with the state. That legal theory is plainly irrelevant where interstate commerce would be thwarted and property rights lost if the private parties declined the state's terms.

Instances of the federal government asserting conditions and requirements in the exercise of its contract functions are beside the point. Those are in fact instances where private parties may forego contracts with the federal government without loss of property rights, and it can hardly be claimed that the federal government is unconstitutionally restraining or burdening interstate commerce since the Constitution places the power over such commerce in the federal government.

The very factual premise of House Bills 294 and 313 that the pipeline owners must get right-of-way from the State, makes it apparent under U.S. Supreme Court cases, that such right-of-way cannot be withheld and cannot be used by the State to achieve results which are otherwise prohibited.

III. THE STATE OF ALASKA MAY CHARGE A RENTAL FOR THE USE OF ITS LAND, BUT SUCH RENTAL MUST BE REASONABLE AND CONSTITUTE NO MORE THAN JUST COMPENSATION TO THE STATE.

The State may properly charge rents for the right-of-way, even when there is no other practical way to conduct the interstate commerce involved. But, the Constitution requires that such rents be reasonable and not discriminatory and bear a true relation to the actual value of the land. The leading case in this regard is St. Louis v. Western Union Telegraph Company, 148 U.S. 92 (1893), rehearing denied, 149 U.S. 465 (1893). There, the City of St. Louis imposed an annual rental of $5.00 per pole for the use of so much of its lands as were occupied by the telegraph poles of the Western Union Telegraph Company, and the Company claimed such charge could not be made at all and, in any event, was excessive. The court held that a rental charge could be imposed, but that it must be reasonable in relation to the value of the land used. The Court said:

> "Indeed, it may be observed, in the line of the thoughts heretofore expressed, that this charge is one in the nature of rental; that the occupation by this interstate commerce company of the streets cannot be denied by the city; that all that it can insist upon is, in this respect, reasonable compensation for the space in the streets thus exclusively appropriated; and it follows in the nature of things that it does not lie exclusively in its power to determine what is reasonable rental. The inquiry must be open in the courts, and it is an inquiry which must depend largely upon matters not apparent upon the face of the ordinance, but existing only in the actual state of affairs in the city."

The Court did not have sufficient evidence before it to determine whether the rental was reasonable. But, upon remanding the case, it gave clear guidance that the rental had to bear a proper relationship to the value of the land occupied.

> "The court cannot assume that such a charge is excessive, and so excessive as to make the ordinance unreasonable and void; for, as applied in certain cases, a like charge for so much appropriation of the streets may be reasonable. If within a few blocks of Wall Street, New York, the telegraph company should place on the public streets 1500 of its large telegraph poles, it would seem as though no court could declare that five dollars a pole was an excessive annual rental for the ground so exclusively appropriated; while, on the other hand, a charge for a like number of poles in a small village, where space is abundant and land of little value, would be manifestly unreasonable, and might be so excessive as to be void."

Thus, the rental must bear a proper relationship to the value of the land occupied.

Land value is most frequently determined in eminent domain cases where just compensation is based upon the value of the land taken. It is held that land value is determined by what the owner gives up, not by what the taker gains. In United States v. Miller, 317 U.S. 369 (1943), the party whose land was being condemned argued that the land should be valued in relation to the specific purpose for which it was to be used, a railroad right-of-way. The United States Supreme Court rejected this contention, and stated:

> "Since the owner is to receive no more than indemnity for his loss, his award cannot be enhanced by any gain to the taker. Thus, although the market value of the property is to be fixed with due consideration of all its available uses, its special value to the condemnor as distinguished from others who may or may not possess the power to condemn, must be excluded as an element of market value." (p. 375).

The defect of the rental formulas of Senate Bills 294 and 313 is that they bear no relationship to the value of the particular land involved, and are not limited to the value of the land itself but seek to use some measure of gross revenues or the profitability of a pipeline built with private capital. This clearly goes beyond what the Supreme Court has said could be reasonably charged, and would constitute a prohibited burden on interstate commerce. Furthermore, since these unusual charges are wholly out of keeping with the general practice in other states and in Alaska, and are largely addressed to this pipeline project, they might also be viewed as violative of the prohibitions against discrimination against interstate commerce and as constituting discriminatory taxes upon interstate commerce.

IV. OTHER PROVISIONS OF THESE BILLS ARE UNCONSTITUTIONAL.

A. Court Jurisdiction.

The Bills provide that the lessee shall agree to the jurisdiction of state courts with regard to the interpretation of the lease or resolution of disputes concerning the lease provisions. (Section .020(1) of S.B. 313 and .410 of S.B. 294.)

We are not certain of the intent of this provision. If it is only designed to insure that state courts may readily obtain personal jurisdiction over the lessee, then a provision similar to that of Section .531 (designation of service agents) in S.B. 315 would be appropriate and avoid confusion.

Similarly, if the provision is only intended to mean that the law of Alaska governs interpretation of the lease, the provision appears unnecessary, but in any event should be more clearly worded to reflect that intention.

However, if this provision is intended to require the lessee to seek relief only in state courts and to prohibit it from invoking, in appropriate circumstances, the aid of federal courts, including the removal of cases to federal court where appropriate, it is clearly unlawful. As stated by the United States Supreme Court in the case of Terral v. Burke Construction Co., 257 U.S. 529 (1922):

> "The principle established by the more recent decisions of this court is that a State may not, in imposing conditions upon the privilege upon a foreign corporation's doing business in a State, exact from it a waiver of the exercise of its constitutional right to resort to the Federal courts, or thereafter withdraw the privilege of doing business because of its exercise of such right, whether waived in advance or not."

Such a requirement, if imposed by the state police power, would be unconstitutional. Even a voluntary agreement having this result would be void. Roberts v. Lexington Insurance Co., 305 F.Supp. 47 (D.C. N.C. 1969).

B. Penalty Provision.

Section .020(4) of S.B. 313 would require the lessee to agree to penalties "that the Commissioner may determine to be appropriate." It provides no standard to guide the Commissioner in the exercise of this delegated authority and would place the lessee at the mercy of the Commissioner. Such a provision is contrary to the due process requirements of the Fourteenth Amendment of the Federal Constitution.

C. Regulatory Jurisdiction.

Section .350(2) of S.B. 294 requires acceptance of the jurisdiction of the Alaska Transportation Commission (oil pipeline) or the Alaska Public Utility Commission (natural gas pipeline), and Section .020(4) of S.B. 313 requires acceptance of the jurisdiction of the Alaska Oil and Gas Transportation Board. This presents a problem similar to that raised by the court jurisdiction provision of the Bills. If it is an attempt to impose exclusive jurisdiction over the lessee, or to give the State any jurisdiction in matters which are pre-empted by federal law, it patently conflicts with the Interstate Commerce and Natural Gas Acts; and it is equally obvious that the lessee cannot give the State jurisdiction or deprive federal agencies of jurisdiction merely by agreeing with the State to do so.

A private party's agreement to jurisdiction cannot create jurisdiction that does not otherwise exist by law. An attempt by the State to gain regulatory jurisdiction by consent of the party to be regulated and thus place the State in a position to regulate that which is pre-empted by the superior law of the United States, would be ineffective. As we have seen, a state may not boot-strap itself into regulation of interstate commerce by obtaining consent to such regulation as a conditions of use of its streets, for it may not use its constitutional powers to obtain unconstitutional results. Western Union Telegraph Co. v. Foster, 247 U.S. 105 (1918). Thus, in all those areas from which the state is excluded, as previously testified by others, the state can obtain no greater participation by contract than it can by its police power.

It is equally apparent that the State cannot avoid this result in the rate-making area by forcing the pipeline owners to agree to rates before submitting them to the I.C.C. Any forced agreement to come to terms with the State on rates has implicit within it a veto power of the State over rates, and would clearly be an invasion of an area pre-empted by the federal government. State cases where municipal corporations have a function in rate-making as part of their franchising power are not applicable, for there the state law permits that function. The federal law does not permit any such primary function in the states with regard to rate-making for oil and gas pipelines engaged in interstate commerce. The federal law provides only for proper state participation as a party in the proceedings of the federal regulatory agencies, but not as a prior regulator.

D. Forfeiture.

Section .020(3) of S.B. 313 provides for forfeiture for failure to comply with any lease provision and Section .040 for failure to comply with any of the provisions of the statute or regulations of the Commissioner. Section 400 of S.B. 294 gives the Leasing Board discretion to insert such a provision in each lease. Any forfeiture because of noncompliance with unconstitutional conditions of the lease, such as those already described, would itself be a direct burden on interstate commerce.

E. The Option To Purchase.

Section 370 of S.B. 294 and Section .020(11) of S.B. 313 require the lessee to agree to grant the state an option to purchase an ownership interest in the entire facility and Section 500 of S.B. 294 and Section .069(9) of S.B. 313 so define a "pipeline facility" as to make it clear that this relates to the entire pipeline, even though most of it would not cross state lands.

One rather apparent effect of this provision would be to force agreement on a price for an interest in the pipeline and thus require the lessee to forego what would otherwise be its rights to due process and just compensation under the Alaska and United States Constitutions. There is a serious question as to whether the State could lawfully proceed to acquire the pipeline or any part thereof under its eminent domain power. It is apparent, however, that if it attempted to do so, the lessee would be entitled to require that it receive just compensation, lawfully determined and, perhaps more important, require the State to show a public necessity for the taking.

Furthermore, the forced option provision, dealing as it does with the pipeline and not the state lands, obviously and directly injects the state into the business of the pipeline contrary to federal pre-emption, and unduly burdens interstate commerce.

The apparent reason for the option requirement is the fear that the wellhead price and royalties of the state may be reduced by the imposition of excessive pipeline charges. This fear is unfounded. The pipeline's rates will be regulated by federal regulatory agencies in whose deliberations the State may fully participate.

F. The Savings Clause.

S.B. 313 purports to escape constitutional infirmities by specifying that the lease conditions be imposed only "to the extent not pre-empted by federal law." Also, the bill defines "transporation" to include activities only "to the extent that such transportation may constitutionally be subject to the provisions of this chapter." As indicated above, the application of such exceptions would leave little, if anything, of consequence in the bill. The unconstitutional matter in S.B. 313 is so pervasive that we believe it would be held unconstitutional in its entirety. The problem is that the basic premise of the bill, that the State can exact any conditions it desires by virtue of its landowner position, is constitutionally unsound.

V. CONCLUSION.

We have not attempted to deal with every provision of Senate Bills 294 and 313, and do not mean to imply that provisions not discussed would be valid. Rather, we have shown that the basic legal premise of these bills is wrong and would produce unconstitutional results in vital respects. We do not doubt the authority of the state to provide for leasing rights-of-way over the public domain for this pipeline project and others, to obtain reasonable rentals therefore, and to provide for reasonable conditions and terms relating to the protection of the State's lands and properties to the extent not inconsistent with or pre-empted by the federal authority. However, Senate Bills 294 and 313 are not proper vehicles for such purpose for they are permeated with unconstitutional provisions developed from an unsound legal premise.

Original sponsor: Fink, Banfield,
Fischer and McVeigh

IN THE HOUSE BY THE FINANCE COMMITTEE

CS FOR HOUSE BILL NO. 245

IN THE LEGISLATURE OF THE STATE OF ALASKA

EIGHTH LEGISLATURE - FIRST SESSION

A BILL

For an Act entitled: "An Act relating to oil and gas revenue; and providing for an effective date."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. AS 43 is amended by adding a new chapter to read:

CHAPTER 56. OIL AND GAS TRANSPORTATION AND PRODUCTION FACILITIES PROPERTY TAX.

Sec. 43.56.010. LEVY OF TAX. (a) Subject to the provisions of (b) of this section, an annual tax of 20 mills is levied each tax year beginning January 1, 1974, on the full and true value of taxable real and tangible personal property actually used or designed as intended for use in the production and transportation of unrefined oil and gas. With respect to a facility employed for part of a tax year in a manner as to render it taxable under this chapter or partly so employed for a full tax year, the value of the facility taxable under this chapter shall be proportionate to the employment. Property taxable under this chapter does not include property employed in the construction of facilities as distinguished from the facilities themselves; however, with respect to pipelines and other facilities taxable under this chapter which may be under construction or awaiting construction, full and true value for each tax year shall be measured by the costs incurred or accrued with respect to the facility as of the assessment date in accordance with the percentage of completion method. The tax imposed by this subsection shall not be applied on production facilities until these facilities are actually employed in the production of oil and gas.

(b) Local governmental units may levy and collect a tax not to exceed 20 mills on not more than 35 per cent, or 7 mills on not more than 100 per cent or the equivalent, of the full and true value as determined in accordance with secs. 40 - 70 of this chapter of taxable real and tangible personal property employed in the production and transportation of unrefined oil and gas. Payment of the tax levied under this subsection is in lieu of the appropriate portion of the tax levied by the state under (a) of this section.

Sec. 43.56.020. EXEMPTIONS. In addition to property excluded under sec. 120(2) of this chapter, the following property is exempt from the tax levied under this chapter:

(1) property rights attached to or inherent in the right to producing oil or gas;

(2) producing oil or gas leases;

(3) oil and gas produced in the state upon which gross production taxes are paid under AS 43.55;

(4) an investment in property described in this section.

Sec. 43.56.030. IN PLACE OF OTHER TAXES. Payment of the tax levied or authorized to be levied under this chapter is in place of all other ad valorem taxes on property subject to tax under this chapter now or hereafter imposed by the state, or by a city or a borough.

Sec. 43.56.040. ASSESSMENT. Assessment of property subject to the tax levied under this chapter shall be carried out by the state assessor substantially in the manner provided in AS 29.53.060 - 29.53.-160 for municipalities, except that the state assessor shall function in place of the local assessor, and the State Assessment Review Board shall function in the place of the assembly or council sitting as a board of equalization.

Sec. 43.56.050. STATE ASSESSMENT REVIEW BOARD. The governor shall

appoint at least five qualified persons to serve at his pleasure as the State Assessment Review Board.

Sec. 43.56.060. PER DIEM AND EXPENSES. Members of the State Assessment Review Board shall be compensated and are entitled to per diem and expenses authorized by law for boards and commissions.

Sec. 43.56.070. POWERS AND DUTIES. The State Assessment Review Board has the powers and duties with respect to assessment of property taxable under this chapter of an assembly or council sitting as a board of equalization.

Sec. 43.56.080. COLLECTION AND ENFORCEMENT. The tax levied under sec. 10(a) of this chapter is payable in full to the Department of Revenue on June 30 of the tax year, except that the Department of Revenue may by regulation provide for prepayment of taxes and payment by installments. A penalty of ten per cent shall be added to delinquent taxes and interest at the rate of eight per cent per annum, or four percentage points above the per annum rate charged member banks for advances by the 12th Federal Reserve District that prevailed on the first day of the month preceding the commencement of that calendar quarter, whichever is greater, shall accrue on all unpaid taxes, excluding penalties, from the due date until paid in full. Collection of the tax levied under this chapter shall be carried out by the Department of Revenue substantially in the manner provided in AS 29.53.200 - 29.53.390 except that the state is substituted for references to cities and boroughs.

Sec. 43.56.090. LIEN FOR TAX. Notwithstanding any other provision of law, the tax levied under this chapter and interest and penalty set out in sec. 80 of this chapter are liens upon the property subject to tax under this chapter. The liens provided by this section are prior and paramount to all other liens or encumbrances upon the same property.

Sec. 43.56.100. FAILURE TO FILE; FALSE STATEMENT. A person who

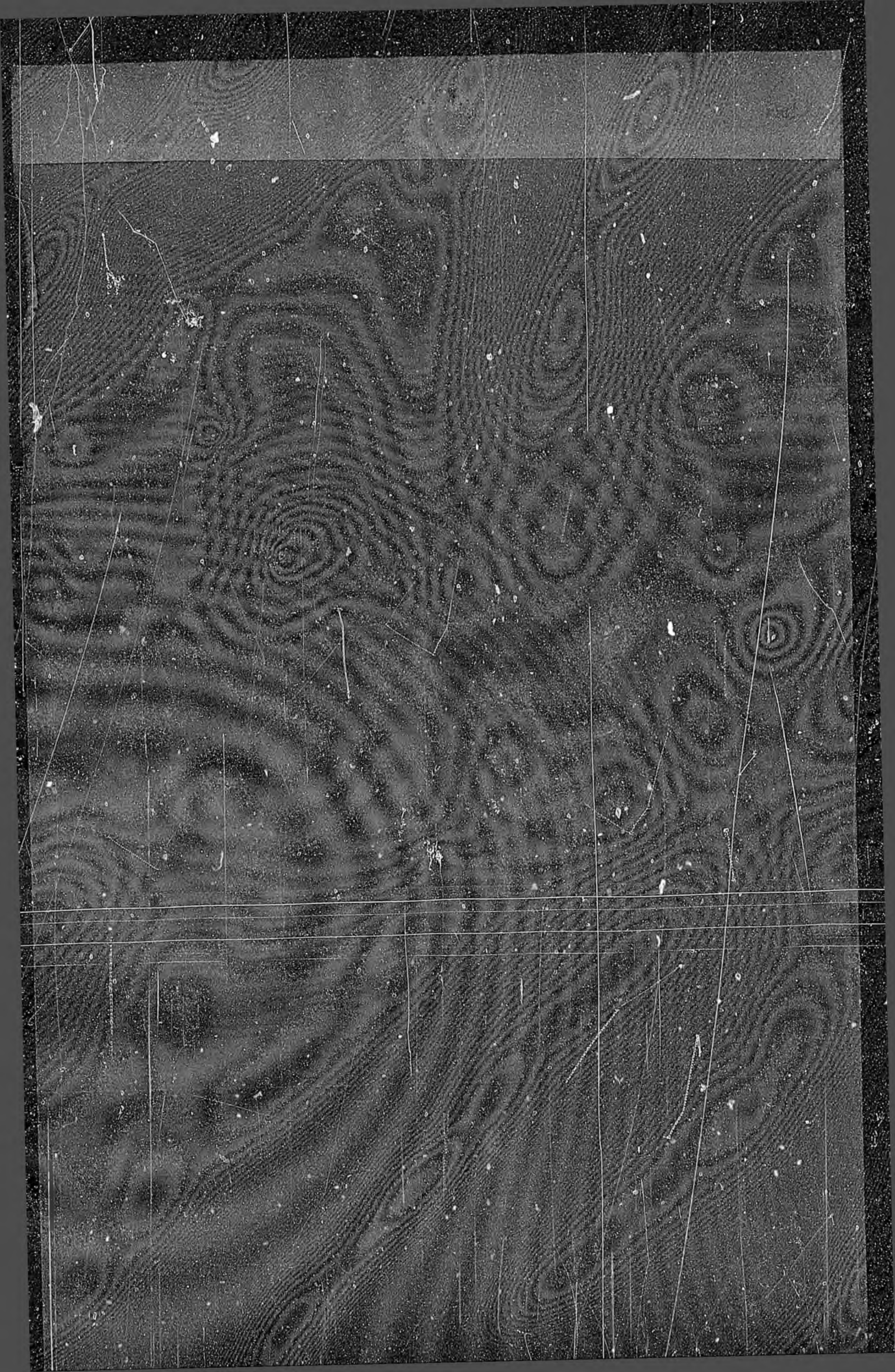
knowingly fails to file a return when due or makes a false statement in a return required under this chapter with intent to evade the taxation is guilty of a felony and upon conviction is punishable by a fine of not more than $5,000, or by imprisonment for not more than five years, or by both, together with the costs of prosecution.

Sec. 43.56.110. DEPOSIT IN GENERAL FUND. The revenue from the tax levied under sec. 10(a) of this chapter shall be deposited in the general fund.

Sec. 43.56.120. REGULATIONS. The state assessor and the Department of Revenue may adopt regulations as appropriate to carry out their respective duties under this chapter.

Sec. 43.56.130. DEFINITIONS. In this chapter "taxable real and tangible personal property" means machinery, appliances and equipment used in the operation of wells producing oil or gas and tank farms, tanker terminals, gathering and transmission lines, and related facilities associated with the production and transportation of crude oil and natural gas; the term includes otherwise taxable property exempted from taxation under home rule ordinance or charter, but does not include property exempt from taxation under the constitution and laws of the state or of the United States, or any subsurface estate, including oil in the ground, or property used in a consumer distribution system.

* Sec. 2. This Act takes effect on the day after its passage and approval or on the day it becomes law without approval.



Original sponsor: Fink, Banfield,
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IN THE HOUSE BY THE FINANCE COMMITTEE

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EIGHTH LEGISLATURE - FIRST SESSION

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(b) Local governmental units may levy and collect a tax not to exceed 20 mills on not more than 35 per cent, or 7 mills on not more than 100 per cent or the equivalent, of the full and true value as determined in accordance with secs. 40 - 70 of this chapter of taxable real and tangible personal property employed in the production and transportation of unrefined oil and gas. Payment of the tax levied under this subsection is in lieu of the appropriate portion of the tax levied by the state under (a) of this section.

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(2) producing oil or gas leases;

(3) oil and gas produced in the state upon which gross production taxes are paid under AS 43.55;

(4) an investment in property described in this section.

Sec. 43.56.030. IN PLACE OF OTHER TAXES. Payment of the tax levied or authorized to be levied under this chapter is in place of all other ad valorem taxes on property subject to tax under this chapter now or hereafter imposed by the state, or by a city or a borough.

Sec. 43.56.040. ASSESSMENT. Assessment of property subject to the tax levied under this chapter shall be carried out by the state assessor substantially in the manner provided in AS 29.53.060 - 29.53.-160 for municipalities, except that the state assessor shall function in place of the local assessor, and the State Assessment Review Board shall function in the place of the assembly or council sitting as a board of equalization.

Sec. 43.56.050. STATE ASSESSMENT REVIEW BOARD. The governor shall

appoint at least five qualified persons to serve at his pleasure as the State Assessment Review Board.

Sec. 43.56.060. PER DIEM AND EXPENSES. Members of the State Assessment Review Board shall be compensated and are entitled to per diem and expenses authorized by law for boards and commissions.

Sec. 43.56.070. POWERS AND DUTIES. The State Assessment Review Board has the powers and duties with respect to assessment of property taxable under this chapter of an assembly or council sitting as a board of equalization.

Sec. 43.56.080. COLLECTION AND ENFORCEMENT. The tax levied under sec. 10(a) of this chapter is payable in full to the Department of Revenue on June 30 of the tax year, except that the Department of Revenue may by regulation provide for prepayment of taxes and payment by installments. A penalty of ten per cent shall be added to delinquent taxes and interest at the rate of eight per cent per annum, or four percentage points above the per annum rate charged member banks for advances by the 12th Federal Reserve District that prevailed on the first day of the month preceding the commencement of that calendar quarter, whichever is greater, shall accrue on all unpaid taxes, excluding penalties, from the due date until paid in full. Collection of the tax levied under this chapter shall be carried out by the Department of Revenue substantially in the manner provided in AS 29.53.200 - 29.53.390 except that the state is substituted for references to cities and boroughs.

Sec. 43.56.090. LIEN FOR TAX. Notwithstanding any other provision of law, the tax levied under this chapter and interest and penalty set out in sec. 80 of this chapter are liens upon the property subject to tax under this chapter. The liens provided by this section are prior and paramount to all other liens or encumbrances upon the same property.

Sec. 43.56.100. FAILURE TO FILE; FALSE STATEMENT. A person who