

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 86/2

437 SCOMM12: OIL & GAS TAXATION & PIPELINE 1972-77

TESTIMONY OF STATE OF ALASKA
Trans-Alaska Pipeline Cost Estimates
March 6, 1972

My name is Bruce A. Campbell. I am Commissioner of Highways for the State of Alaska.

The single most important economic factor in any analysis concerning the ultimate impact of a trans-Alaska pipeline upon the State of Alaska is the initial capital cost of the line and its appurtenances. This factor is the prime variable in determining the yearly amortization cost and in determining the dividend which the owners may receive by virtue of the line's operation.

As many of you recall, the initial publicity concerning the pipeline estimated the cost of the project at approximately one billion dollars. In the ensuing three years there has been a variety of every-increasing estimates by owner companies and by Alyeska Pipeline Service Company ranging upward to the \$3.0 billion cost estimated by Alyeska in December of 1971. In looking for the true return to the citizens of the State of Alaska, it became immediately apparent that a reasonably accurate initial cost figure must be determined before any meaningful analysis could be performed.

In addition to State in-house capabilities, we engaged the consultant engineering firm of Tippetts-Abbett-McCarthy & Stratton to aid us in the determination of the probable cost. We also met with Alyeska Pipeline Service Company in December 1971 and learned something of their cost analysis. We were not, however, allowed access to the basic cost data so that a comprehensive analysis could be made.

Before making our cost estimates, we reviewed the basic designs of all the components of the pipeline. We especially reviewed such crucial items as total throughput capacity of the line, handling and dock facilities at Valdez, and proposed construction techniques in highly unstable permafrost areas. We are convinced that this line is now probably one of the most thoroughly engineered projects of its type ever proposed.

The line is proposed to be constructed in basically three phases. The first would be for a 600,000 barrel per day capacity, the second a 1,200,000 barrel per day capacity, and the last a 2,000,000 barrel per day capacity. The second two phases will require primarily the addition of pumping horsepower and tankage.

If you will review the handout given to you, you will find a breakdown of the costs of construction of the various major features of the project as we have estimated them.

Our total estimated cost of the project, based on 1972 dollar value, is 3.5 billion dollars, of which 2.9 billion dollars will be required for the initial phase, 249 million dollars for the second phase, and 314 million dollars for the third phase.

These costs are based on 1972 construction costs and do not contain any estimate for inflation. The costs that we have determined have been compared to the total cost of initial construction as prepared by Alyeska and compare reasonably well with their December 1971 projected cost of 3.0 billion dollars. Any inflation

which may take place and any increase in construction costs may modify these costs in future years. Concurrent with these cost studies we estimated what the operation and maintenance costs of the line would be and have shown these in the hand-out. These range from \$22 million in the first year to \$65 million at full throughput.

In order to evaluate the probable well-head price of the North Slope oil we, thru our engineers, investigated the probable refinery gate price of crude oil in the Los Angeles area. We have forecast the price variation of crude during the study period. Our estimated price ranges from \$3.45 to \$4.85 in the year 2000.

Tanker transportation costs were likewise studied and evaluated for the future years so that their eventual effect upon well-head price could be determined. The tanker costs were estimated at \$.45 in 1977 and range to \$.67 in 1988.

We believe that the cost items used in our analysis are as accurate as can be determined at this time and give us a firm basis for projecting economic impact on the State of Alaska.

Commissioner Eric Wohlforth will now discuss the revenue aspects of the proposals before you.

Testimony of Eric E. Wohlforth
Commissioner of Revenue

March 6, 1972

I am Eric Wohlforth, Commissioner of Revenue. I will summarize past projections of North Slope revenues and those presented today based on private ownership, and contrast the revenue effect of private ownership case with the case of a pipeline owned by the State.

The most recent public North Slope oil revenue projections, before those referred to the Governor last week, were made by the Division of Oil and Gas in cooperation with the Department of Revenue as part of the State's contribution to the federal pipeline Impact Statement released by Governor Egan on July 30, 1971. These projections were developed from a computer model which was based on the information then available to the State and showed numerous economic cases on differing assumptions again based on facts then assumed to be ascertainable.

The July 30 report states on page 166 that, "the originally estimated \$900 million cost of the pipeline has already increased considerably. Present cost estimates range from about \$1.0 to \$2.3 billion." The revenue projections used the assumption of \$1 billion as the lowest installed cost and \$2.5 billion

as the highest estimate. The footnote to this statement gives the backup for the State's cost estimates. It notes that as late as June 19, 1971 Alyeska furnished the State Department of Revenue an estimate of \$969 million as the cost of the entire contract and concludes with reference to a statement from Interior Secretary Rogers C. B. Morton in late spring of 1971 that environmental precautions are contributing to a higher price tag of around \$2.3 billion. This figure of \$2.3 billion total cost was used in the State's "most likely" estimate of North Slope revenues. The revenue estimates included in the State's Report developed from this estimate of total cost, assumed refinery values in fiscal year 1976, the then estimated start up year, of \$3.37, marine transportation costs of 44 cents, a pipeline tariff initially of 80 cents per barrel, giving a wellhead value of \$2.12. From these figures it was estimated that total royalties and taxes would amount to \$164 million a year in fiscal year 1976, the first year of pipeline operation. In the second year of operation, fiscal 1977, total revenue was estimated at \$278 million, the third year \$282 million, and the fourth year \$311 million. In the then estimated fifth year of production, fiscal 1980, the pipeline tariff was calculated at 47 cents a barrel with the marine transportation costing 52 cents leaving a wellhead value of \$2.56. In that year we showed a total of \$348 million in total royalties and severance taxes from the pipeline.

Other estimates were also run with different assumptions. For example, one set the pipeline cost at \$1 billion with again the initial production year assumed in fiscal 1976. A wellhead value of \$2.75, with lower marine transportation and tariffs produced \$212 million in revenues in the first year of production and the fifth year of production on this optimistic projection the State was assumed to capture \$412 million in oil pipeline revenues. A pessimistic case which assumed a pipeline cost of \$2.5 billion shows a wellhead value of \$1.76 in the initial year of 1976 and royalties and taxes of \$136 million in that year. In 1980, however, at a wellhead value of \$2.20 per barrel, royalties and severance taxes reached a figure of \$297 million. Incidentally, in all of these cases, one of the main reasons wellhead value increases over the years is that transportation costs go down as the volume of oil shipped increases.

Several important events have now come to light which have required the State to revise downwards drastically its revenue estimates. The first indication of the fact that the State was incorrect in assuming as it did in the Impact Statement that a production flow starting at 600,000 barrels per day would reach 1.7 million barrels per day in the second year of production was disclosed in the summary project description of the trans-Alaska pipeline system received by the State this fall. On page 55 of that document it is stated that

the pipeline system will be brought to its full capacity in stages. In the initial phase of operation the system will have the ability to transport 600,000 barrels per day. The report goes on to state that the second phase is tentatively scheduled to be completed approximately two years after initial start up. In this phase the system will have a design capacity of 1,200,000 barrels per day. The final phase is expected to be completed approximately seven years after initial start up at which time the pipeline will reach its ultimate capacity of 2,000,000 barrels per day according to the project description. In other words, there will be at least 500,000 barrels per day less production in the second year of operation and every year thereafter for the initial seven years.

The next shock to the State was disclosed by the SEC Registration Statement filed by British Petroleum Co., Ltd., on October 12, 1971. In the offering circular accompanying the registration statement the following statement is made at page 24:

... "The initial construction phase of the pipeline is expected to provide a minimum aggregate throughput capacity upon completion of 600,000 barrels per day. This capacity is designed to be expanded in two stages, the first stage resulting in a total capacity of 1,200,000 barrels per day, and the second in a total capacity of 2,000,000 barrels

per day. It is presently estimated that the cost of the pipeline upon completion to the 600,000 barrels per day capacity would be approximately \$2.3 billion, and that increasing the capacity to 2,000,000 barrels per day would increase the cost by approximately \$400 million." (Emphasis added.)

On November 10, 1971, Atlantic Richfield filed a Registration Statement with the SEC stating that:

... "The cost of the system upon completion to the 600,000 barrel per day capacity is presently estimated to be approximately \$2.4 billion, of which the Company will be responsible for approximately \$675 million. The additional cost to all participants of increasing the capacity to 2,000,000 barrels per day is estimated to be at least \$400 million." (Emphasis added.)

Thus, by mid November, the total pipeline cost had escalated to \$2.8 billion or \$500 million over the average case assumed in July when the State made its revenue estimates. In fact it increased \$100 million in less than one month

between SEC filings. This dramatic increase in pipeline costs revealed in official documents at the time of Governor Egan's first announcement on State ownership made it urgently necessary that the State finally determine the likely magnitude of pipeline costs. Commissioner Campbell has already indicated the independent study which the State has made through its consulting engineers, Tibbets, Abbott, McCarthy and Stratton, and the foundation for the present estimate of \$3.5 billion. These figures have just recently been developed along with an independent evaluation of operating costs so that for the first time the State can make a reasonable projection of the probable amount it can expect to capture from North Slope oil revenues.

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 of full production only in the seventh year of pipeline operation. It shows the same ICC permitted rate of return as shown in the State's projection in July. In the fourth year from the beginning of construction and the first year of production, or 1977, we now show a negative wellhead or no State oil revenues. This was the year comparable to that in which it was earlier shown that the State would capture at least \$164 million in revenues. The fifth year, 1978 the second assumed 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 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, whereas 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.

Thirdly, calculation of the 7% permitted rate of return on valuation may err on the low side. The leading text on the subject "Petroleum Pipelines and Public Policy" by Arthur Johnson cites numerous instances of the slowness of the ICC to actually evaluate pipeline costs and its heavy reliance on industry figures. The Cook Inlet pipeline valuation itself took three years to complete.

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 next case presented shows 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 severance taxes of \$17 million produce a total of \$245 million. In the sixth year from the 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 almost 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. You will hear testimony that our assumptions are incorrect. 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. Mr. Eppenbach will explain how our projections were made and some of the detail on the charts before you.

Testimony of Lawrence Eppenbach
State Investment Officer

March 6, 1972

Mr. Chairman, Committee Members. In testimony already presented you have heard a great deal about revenues, costs of pipelines, calculations of royalties and severance taxes and permitted dividends. Rather than to add more numbers, more formulas, more calculations, I think it would be prudent now to pause and develop perspective on the numbers already given to you and about the many charts. To do this, I should like to talk first about how the State brought all of its pipeline information together to calculate what is really the most important piece of information thus far and that is an estimate of total revenue from the North Slope.

We employed a computer model which simulated each year, economic operation of the pipeline under varying conditions regarding ownership, financing, taxes, and earnings limitations. In a sense, an income statement was prepared each year for the owner of the line. This income statement does not appear so very different, at least in terms of its expressions, from that of any other income statement. Gross revenues to the pipeline are derived from its tariff charge on barrels of oil transported through the line. That gross revenue less the cost of operating and maintaining the line, less depreciation, and less interest costs for financing

the line, will produce a net income figure. From that we deducted any federal or state income taxes paid to yield a net after taxes income.

Similarly, the cash flow to a pipeline company is much like that of any other business. The net after tax income plus any additional cash flows which may be generated because the depreciation charge that is provided for in the income statement happens to be greater than the bond retirement actually made by the company. The only place that pipeline operation appears different, economically, to that of the ordinary company, is in the dividend payout allowed each year by the pipeline company to its owners.

That dividend is not some percentage of equity or some rate of return of capital investment, it is a percentage dividend allowed on the valuation of the pipeline as determined by the ICC. The ICC valuation approach takes into account many issues: original cost of the line, depreciation, percentage increases for going concern value, and additional percentage increases for inflation. Our computer model had to also simulate this ICC valuation. In general terms, during the first year of operation ICC valuation was about \$3-1/4 billion. In the following years it increases slightly as additional phases of operation were under way providing for higher throughput and then decreased in value as the line began to depreciate.

The dividend limitation on ICC valuation is a critical variable in the

economics of pipeline ownership. Our model, given a dividend rate calculated back up the income statement to find out what kind of tariff would have to be placed upon the pipeline in any year to provide gross revenue required to generate the appropriate cash flow for the dividend. During the first year of operation of the trans-Alaska pipeline, the 7% dividend limitation provides for a dividend to the parent company of over \$230 million, a legal dividend provided only to the owner of the pipeline.

If I may turn your attention now to the large chart: it is that very dividend that accounts for the vast difference between estimated income to the State of Alaska under conditions of public ownership on the top line, versus conditions of private ownership, the bottom line. You will note that both lines slope upward as the throughput of oil through the line increases, clearly shown as a step increase between operation of the line in phase one, a capacity of 600,000 barrels a day up to phase 2, a design capacity of 1,200,000 barrels per day. But the graph does not display all of the information which is in the tables alongside of it.

First, in public ownership, the major part of revenue during the early years is derived from dividends with positive and growing amounts of revenue coming from wellhead value royalty and production taxation. You will note that there are no state income taxes included here as a revenue source to the State

under conditions of public ownership.

Under conditions of private ownership, a very different case develops. Here in the initial year a total of about \$37 million should accrue to the State. Where does it come from? \$3.2 million of it only comes from the North Slope in the form of gas royalty and production tax payments. This is gas that is assumed to be shipped in a trans-Canadian gas pipeline. The remaining \$34 million comes from state income taxes. In the 7% dividend case displayed here there is no positive wellhead value for oil during the first two years of operation under private ownership. In this case, for there to begin to be some positive wellhead for oil during the first two years, the dividend payments must be no greater than 4.75% and even if the dividend were lowered to zero the State's income from royalty and severance tax of approximately \$53 million would be less than one third of that estimated as recently as last year.

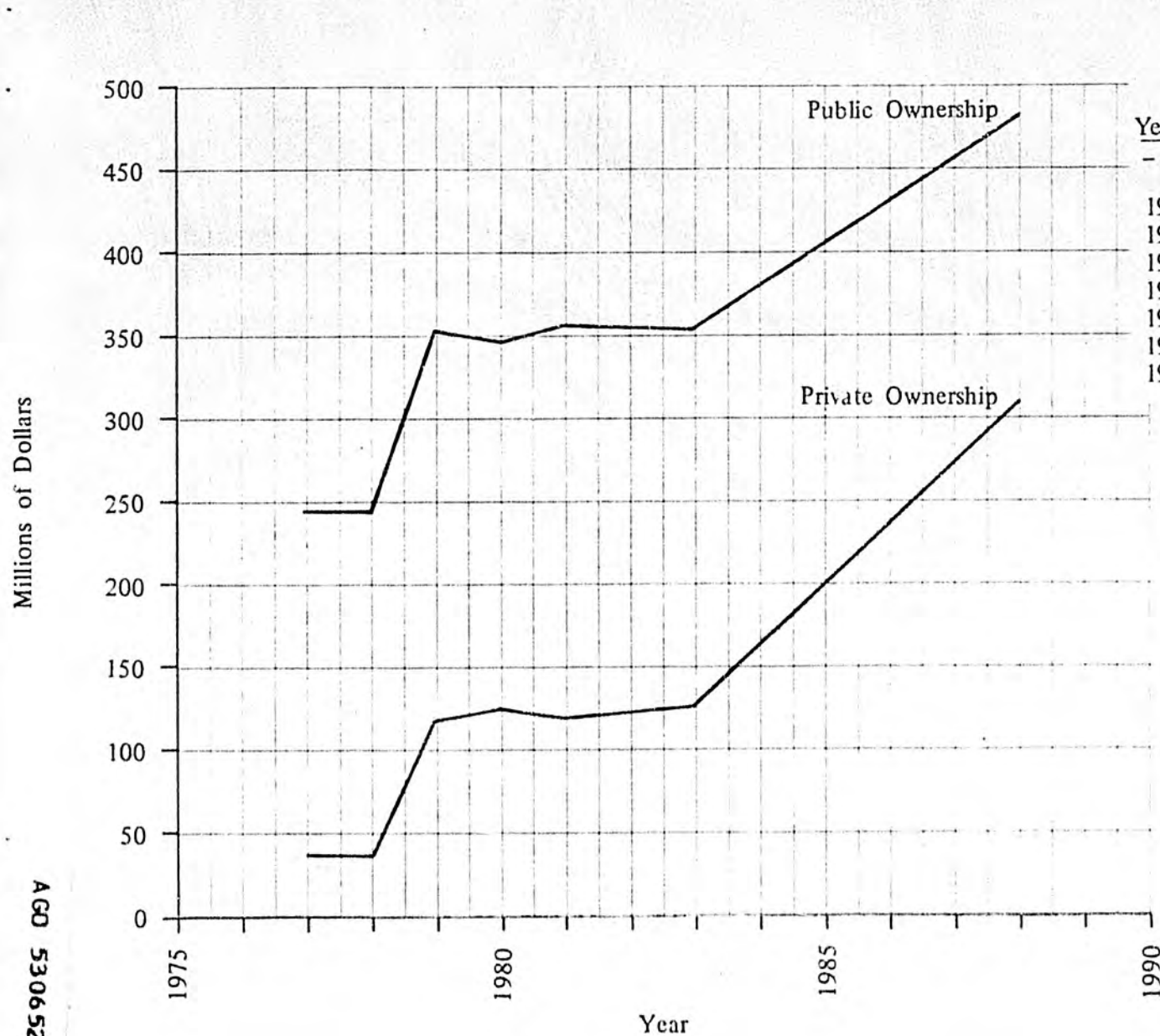
I shall present at the close of the testimony this afternoon a series of cases for the committee to study that explore this question of taxation and dividend limitation. For the present, however, let us return to these two cases that we have displayed before you. Again, they provide a legal 7% ICC dividend. In the private case even though a negative wellhead value is indicated for the first two years it is quite possible that the oil companies would still pump oil

as their true cost of shipping their own oil through their own pipeline may be different than their calculated cost of shipping the State's oil through their own pipeline. Not only is the dividend permitted legal, but together with the costs and throughput capacity limitations as stated in the Impact Statement, this case of private ownership of the line appears quite possible. So are the revenues it generates. Speaking next to the very important question of what these revenues will mean to the State will be the Commissioner of Administration, Joseph Henri.

STATE OF ALASKA
EXHIBITS TO
SUPPORT TESTIMONY
GIVEN BEFORE
SENATE COMMERCE COMMITTEE
AND
HOUSE STATE AFFAIRS COMMITTEE
CONCERNING REGULATION AND
OWNERSHIP OF THE TRANS-ALASKA PIPELINE
MARCH 6, 1972

AGO 530651

ESTIMATED INCOME TO STATE



Assuming Public Ownership

Year	Pipeline Income	Royalty & Production Payments	Total
(Millions of Dollars)			
1977	\$230.86	\$ 15.70	\$246.56
1978	228.00	17.28	245.28
1979	227.47	123.47	350.94
1980	224.60	122.26	346.86
1981	243.56	123.35	355.91
1983	234.69	117.53	352.22
1988	183.00	297.92	480.92

Assuming Private Ownership

Year	State Taxes	Royalty & Production Payments	Total
(Millions of Dollars)			
1977	\$33.73	\$ 3.22	\$ 36.95
1978	33.62	3.22	36.84
1979	34.01	84.66	118.67
1980	91.82	33.97	125.79
1981	82.91	37.05	119.96
1983	36.67	89.48	126.15
1988	30.98	277.15	308.11

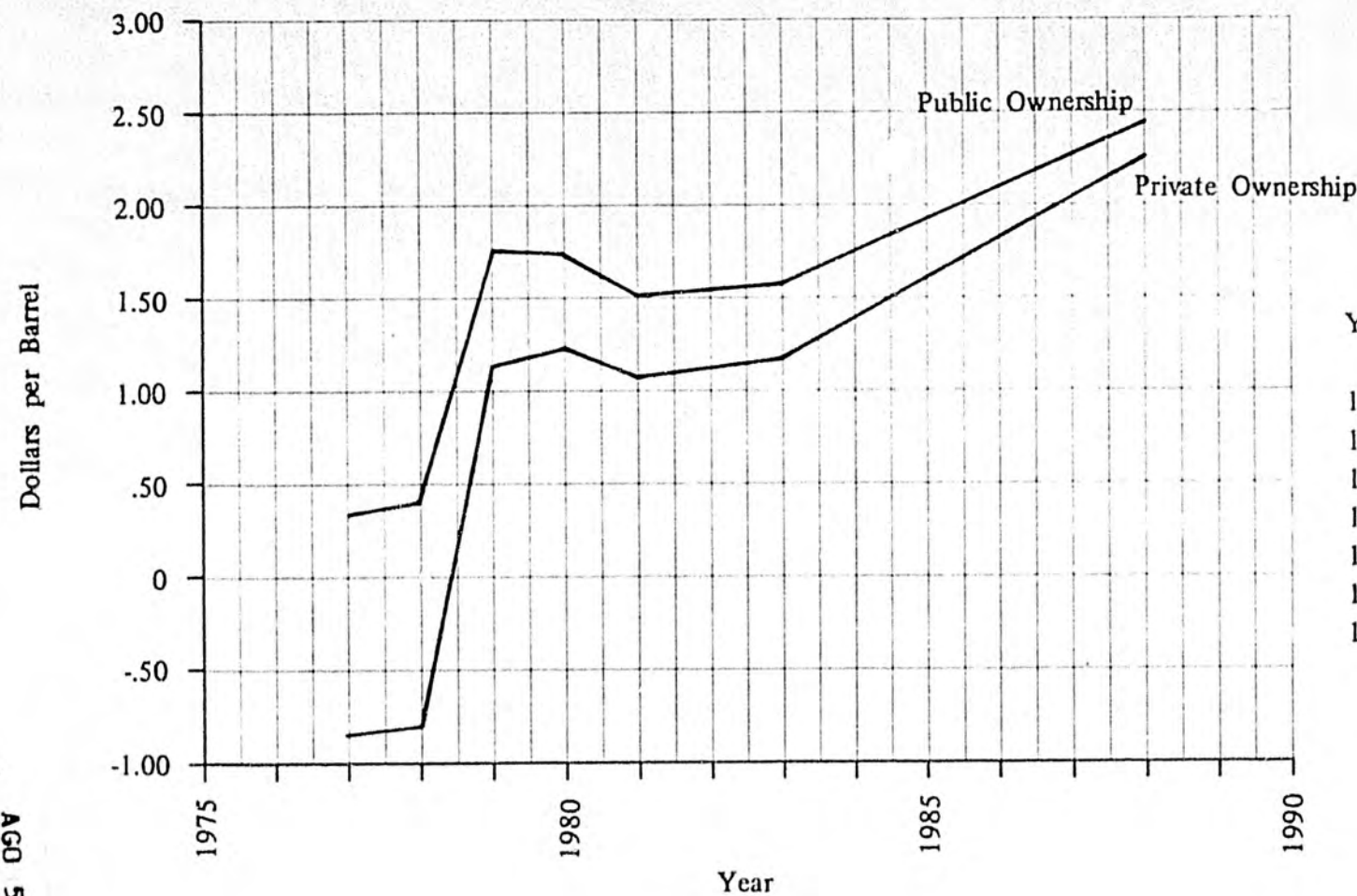
ESTIMATED CAPITOL INVESTMENTS

January 1972 prices

(Million of Dollars)

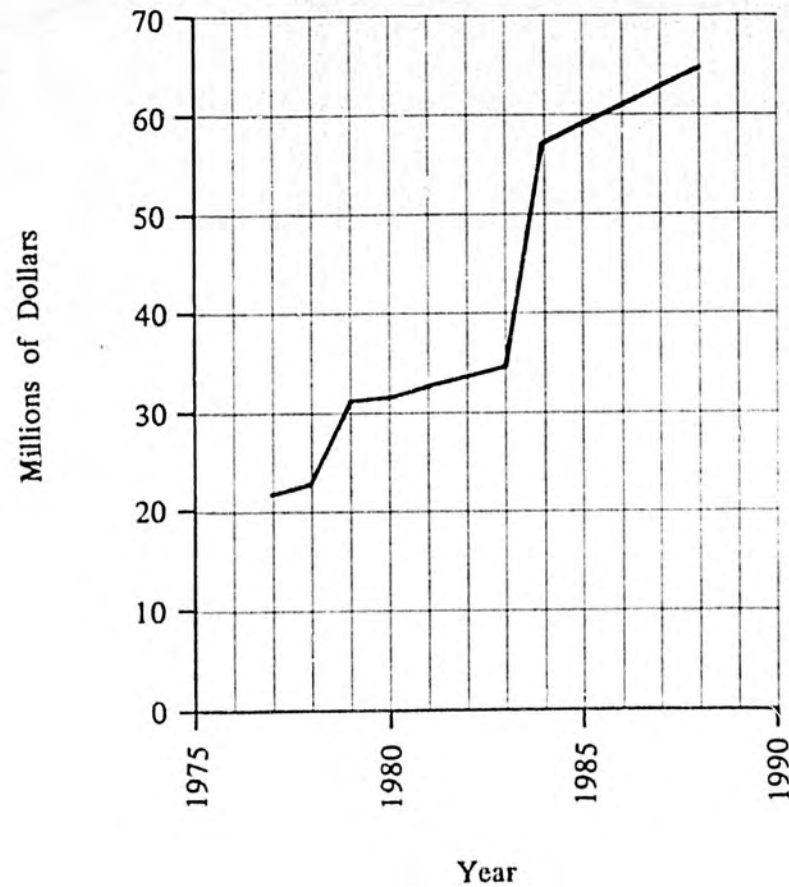
	P H A S E I			P H A S E II		P H A S E III		Totals
	Before start of Construc- tion	Construc- tion	Super- vision & Admin.	Construc- tion	Super- vision & Admin.	Construc- tion	Super- vision & Admin.	
Pipeline and stations	144.50	1,935.22	130.12	106.35	6.85	197.57	9.97	2,530.58
Valdez		219.04	13.57	130.75	5.00	101.84	5.00	475.20
Communications		<u>25.08</u>						<u>25.08</u>
Sub-total	144.50	2,179.34	143.69	237.10	11.85	299.41	14.97	3,030.86
Design Engineering	<u>273.70</u>							<u>273.70</u>
Sub-total	418.20	2,179.34	143.69	237.10	11.85	299.41	14.97	3,304.56
Roads and Airfields		133.00	6.15					139.15
Yukon Bridge		<u>8.50</u>	<u>.41</u>					<u>8.91</u>
Total	418.20	2,320.84	150.25	237.10	11.85	299.41	14.97	3,452.62
			2,320.84		237.10		299.97	3,452.62
			418.20					
GRAND TOTAL			<u>2,880.29</u>		<u>248.95</u>		<u>314.38</u>	<u>3,452.62</u>

Estimated Wellhead Price



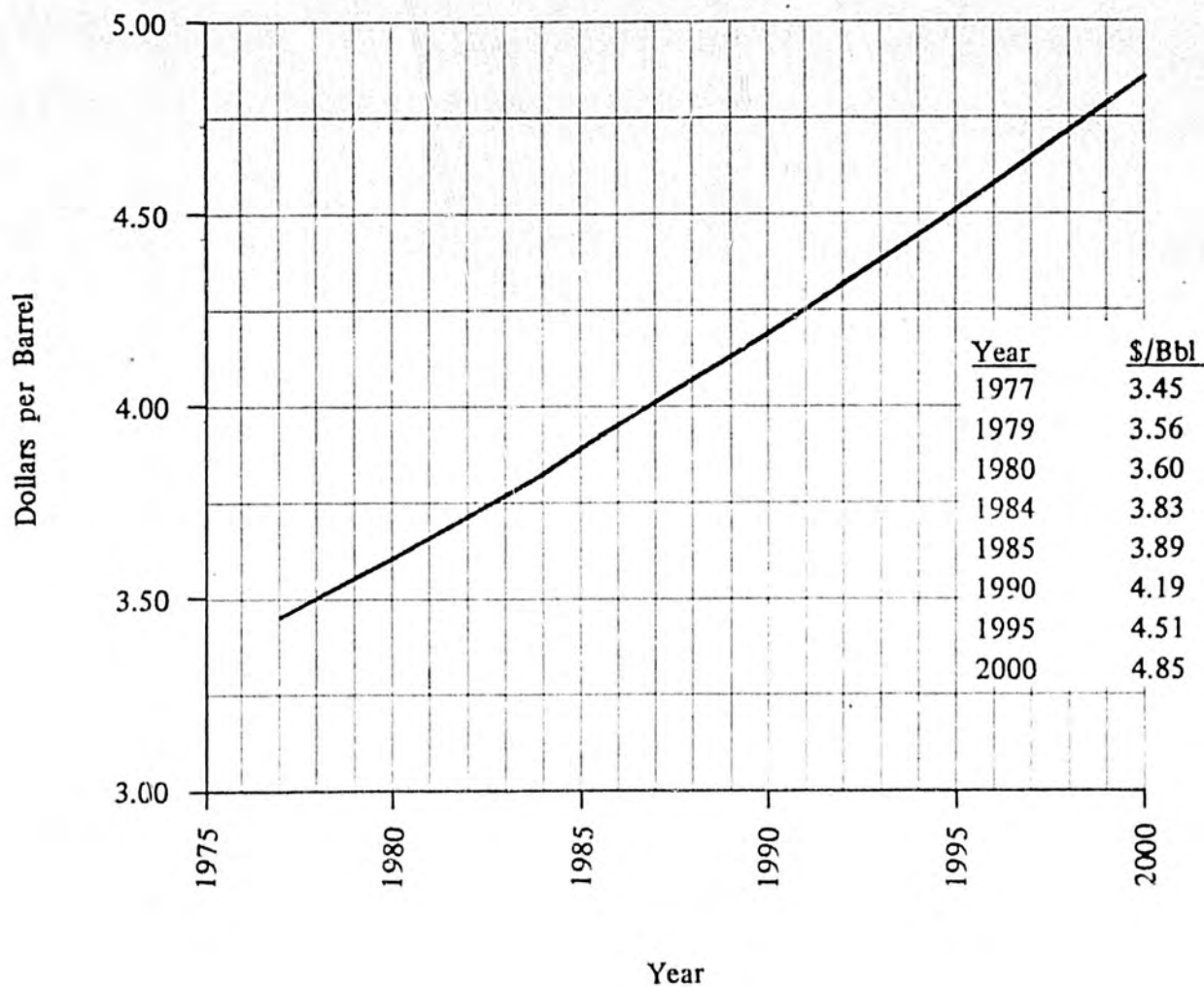
Year	Public Ownership	Private Ownership
1977	\$0.36	\$-0.84
1978	0.40	-0.80
1979	1.67	+1.12
1980	1.65	1.22
1981	1.51	1.09
1983	1.58	1.18
1988	2.45	2.27

Estimated Operating and Maintenance Cost Public Ownership

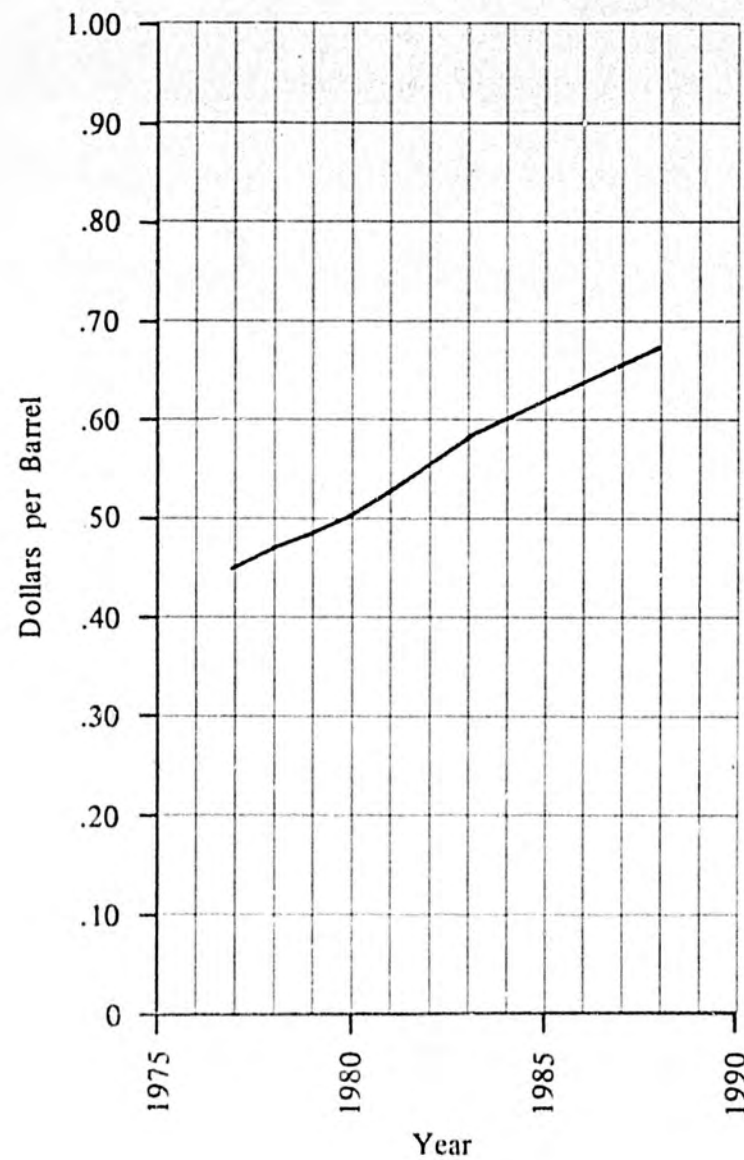


Year	Operating and Maintenance Cost
1977	\$21.99
1978	22.65
1979	30.89
1980	31.82
1981	32.77
1983	34.77
1984	57.42
1988	64.99

Estimated Refinery Gate Price of Crude
Los Angeles Area



Estimated Tanker Transportation Cost
Valdez to Los Angeles



<u>Year</u>	<u>\$/Bbl</u>
1977	.455
1978	.472
1979	.484
1980	.503
1981	.526
1983	.580
1988	.670

AGD 530657

ANALYSIS OF STATE INCOME
OF VARIOUS CONDITIONS OF
PIPELINE OWNERSHIP & OPERATION
STATE OF ALASKA
MARCH 6, 1972

The attached charts display the total income to the State under various conditions of pipeline ownership and operation. In every case total revenue to the State is the appropriate combination of dividends from pipeline ownership, state tax on pipeline income, and the total of oil and gas royalty and production tax payments.

Method of Analysis:

The major portion of the analysis was performed by an economic computer model developed to simulate pipeline operation each year under a variety of conditions. Under varying assumptions regarding ownership, debt structure, taxes and earnings limitations the computer model forecasts pipeline net revenues, cash flows, tariffs and wellhead values.

Description of key variables:

Variables held constant:

1. Total cost - equal to \$3.5 billion. This total cost reflects the full expenditure for engineering construction and overhead for the pipeline and terminal through all phases of construction.
2. Oil throughput - calculated at a rate consistent with the capacity limitations as stated in the Pipeline Impact Statement. The design capacity of the line for the first two years will be 600,000 barrels a day, for the next five years 1,200,000 barrels a day, and after seven years of operation would increase to 2,000,000 barrels a day. In addition, an efficiency factor of 85% was applied against the design capacity of the line to provide an effective daily average of 510,000 barrels per day during the first two years, 1,020,000 barrels a day for the next five years, and 1,700,000 barrels a day thereafter.

3. Operating expenses - were calculated by independent consultants to the State for operation of the trans-Alaska pipeline. Each year's operating expense estimate fully reflects the cost of labor, mainienance, fuel, materials, supplies, contingency reserves, insurance, and the effect of an assumed 3% price level increase each year.

4. Depreciation - was calculated on the basis of a straight line depreciation over a 30 year life to a salvage value of 15%.

5. ICC Valuation - was simulated on the following basis: pipeline investment less ICC calculated depreciation plus 6% of that value for going concern value plus 4% of original investment value each year.

6. Wellhead price calculation for oil -

Wellhead price (oil) = Refinery price less tanker charges less pipeline tariff.

a. Refinery prices - the price of Alaska crude oil at a typical District 5 refinery in 1977 is calculated to be \$3.45 rising approximately 5 cents each year thereafter.

b. Tanker charges - the charge paid to transport oil from Valdez to Los Angeles was calculated to be 45.5 cents per barrel in 1977 increasing to 52.6 cents by 1981 and 67.0 cents by 1988. The increase in tanker charges over this period of time was due to the estimated continuing increase in labor costs and purchase prices of tankers. These estimates were prepared for the State by Temple, Barker, Sloane, Inc. who used a computer model in their analysis.

c. Pipeline tariffs - as calculated.

7. Wellhead price calculation for gas - The price of gas at the wellhead was assumed to be 20 cents/MCF during the first year of production in 1977 and increases one cent every five years thereafter.

8. Effective royalty and severance tax rates - The royalty payments for both oil and gas were calculated at 12.5% of wellhead value. The severance tax rate for oil was assumed to be 7.2% for pipeline oil volumes less than 1.7 million barrels per day and 6.751% for 1.7 million or more barrels per day.

Wells with lower individual production rates are expected to contribute a significant share of oil during phase III operation of the pipeline. Because the severance tax rate varies with the volume of production at each well, a lower average tax rate of 6.751% was calculated to represent the effective average rate.

Variables:

1. Dividend limitation - The 1941 Consent Decree held that the dividend paid by the consolidated subsidiary pipeline company to its parent company must not exceed 7% of the valuation of the pipeline. The dividend is composed of net income after tax payments plus additional cash flow from any excess of depreciation charges greater than bond amortization payments. The dividend percentages calculated were 4%, 5-1/2%, and 7%.

2. Financing of pipeline:

a. Private Ownership - In the case of private ownership of the pipeline 90% of the cost of the pipeline was assumed to be financed by bonds of 30 year term with an 8% interest rate and semi-annual interest payments. The level debt service costs of five bond issues were calculated:

- Issue 1 - \$900 million for the first year of construction.
- Issue 2 - \$900 million during the second year of construction.
- Issue 3 - \$810 million during the third year of construction.
- Issue 4 - \$225 million during the first year of operation to finance phase two.
- Issue 5 - \$279 million during the fifth year of operation to finance phase three.

b. Public Ownership - In the case of public ownership of the line, 100% of the cost was assumed to be debt financed. All bonds are of 25 year average term with semi-annual interest payments:

- Issue 1 - \$1 billion for the first year of construction at 8% interest.
- Issue 2 - \$1 billion for the second year of construction at 8% interest.
- Issue 3 - \$900 million for the third year of construction at a tax exempt interest rate of 6-1/2%.
- Issue 4 - \$250 million at 8% during the first year of operation to finance phase two.
- Issue 5 - \$310 million at 8% during the fifth year of operation to finance phase three.

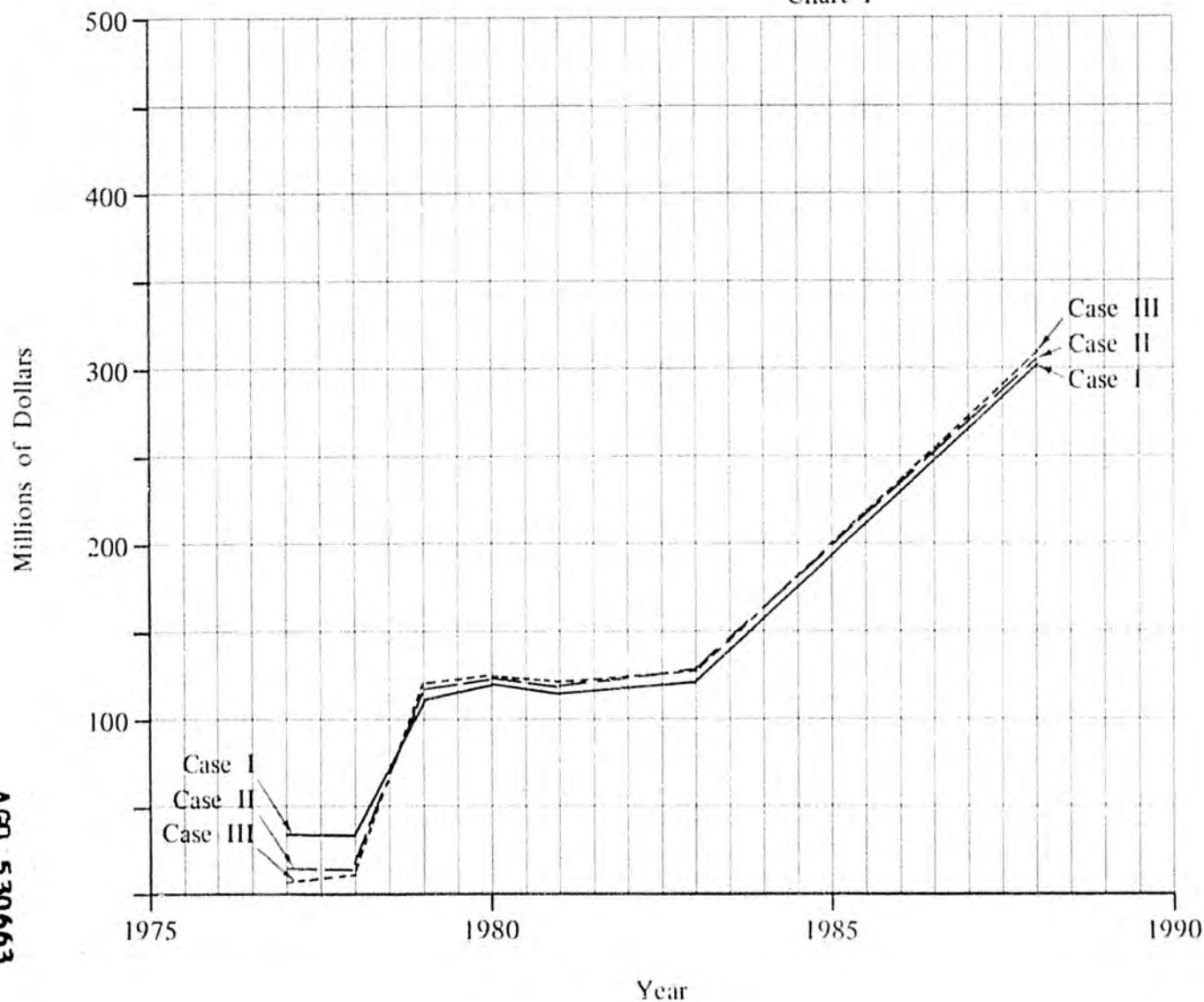
3. State and Federal tax on pipeline income:

Case 1. The full effective state income tax rate of 9.36% of net income and 43.51% of net income for federal income taxes.

Case 2. An overall tax rate of 30% with the same distribution between state and federal taxes as in Case 1. This calculates to be a state income tax rate of 5.31% of net income and federal tax rate of 24.69% of net income.

Case 3. That of no taxation with both state and federal taxes at a zero rate.

Estimated Income to State
Private Ownership
Chart I



Case I - Base Case
7% Dividend Full 9.36% Tax

Year	Pipeline Income	Royalty & Production Payments	Total
--- (Millions of Dollars) ---			
1977	\$33.73	\$ 3.22	\$ 36.95
1978	33.62	3.22	36.84
1979	34.01	84.66	118.67
1980	33.97	91.82	125.79
1981	37.05	82.91	119.96
1983	36.67	89.48	126.15
1988	30.98	277.13	308.11

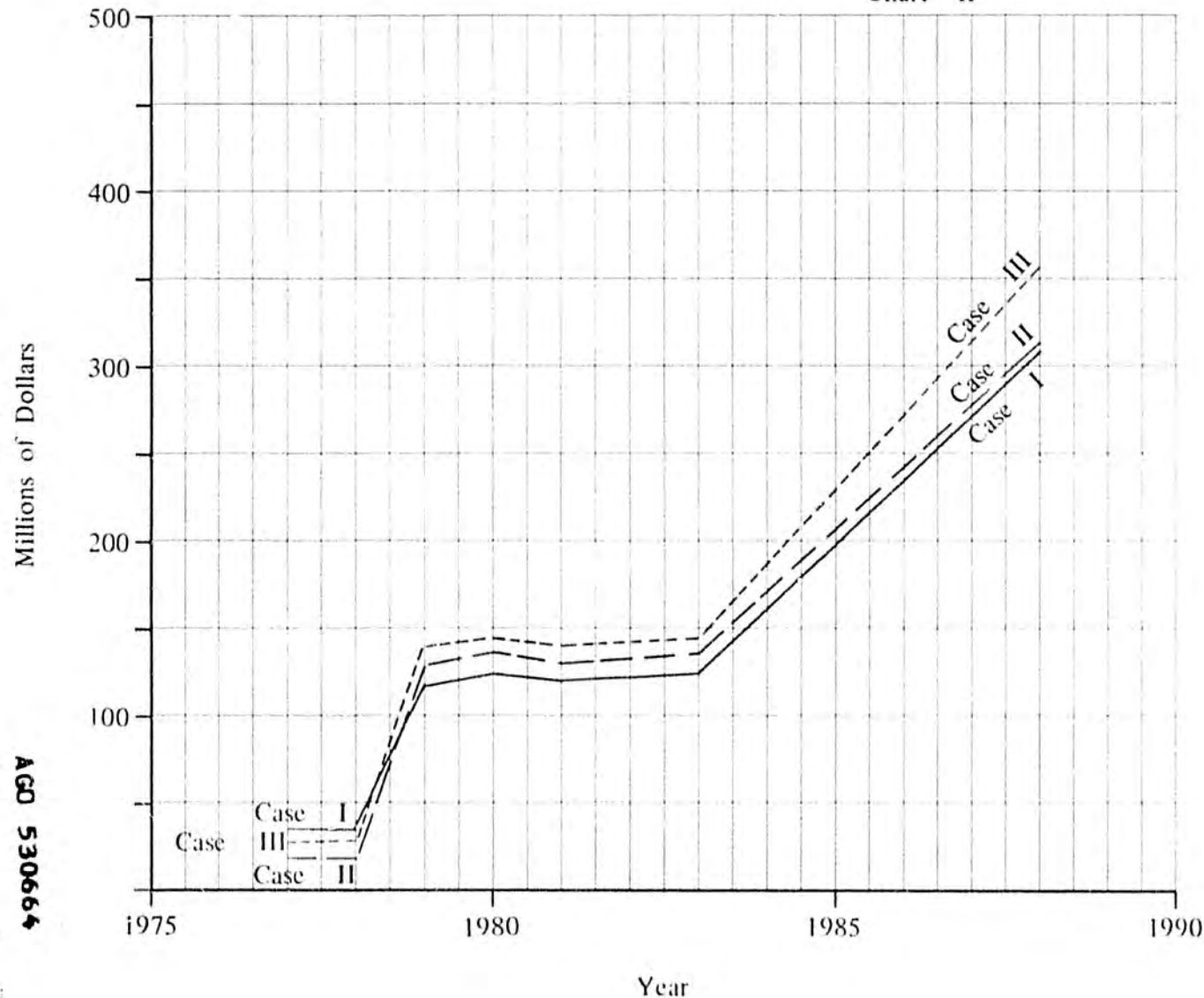
Case II
7% Dividend, Industry Average Tax

Year	Pipeline Income	Royalty & Production Payments	Total
--- (Millions of Dollars) ---			
1977	\$12.88	\$ 3.22	\$ 16.10
1978	12.84	3.22	16.06
1979	12.99	106.98	119.97
1980	12.98	114.12	127.10
1981	14.15	107.22	121.37
1983	14.01	113.54	127.55
1988	11.83	297.46	309.29

Case III
7% Dividend Zero Income Tax

Year	Pipeline Income	Royalty & Production Payments	Total
--- (Millions of Dollars) ---			
1977	0	\$ 9.68	\$ 9.68
1978	0	10.96	10.96
1979	0	120.78	120.78
1980	0	127.90	127.90
1981	0	122.25	122.25
1983	0	128.42	128.42
1988	0	310.03	310.03

Estimated Income to State
Private Ownership
Chart II



Case I - Base Case
7% Dividend Full 9.36% State Tax

Year	Pipeline Income	Royalty & Production Payments	Total
--- (Millions of Dollars) ---			
1977	\$ 33.73	\$ 3.22	\$ 36.95
1978	33.62	3.22	36.84
1979	34.01	84.66	118.67
1980	33.97	91.82	125.79
1981	37.05	82.91	119.96
1983	36.67	89.48	126.15
1988	30.98	277.13	308.11

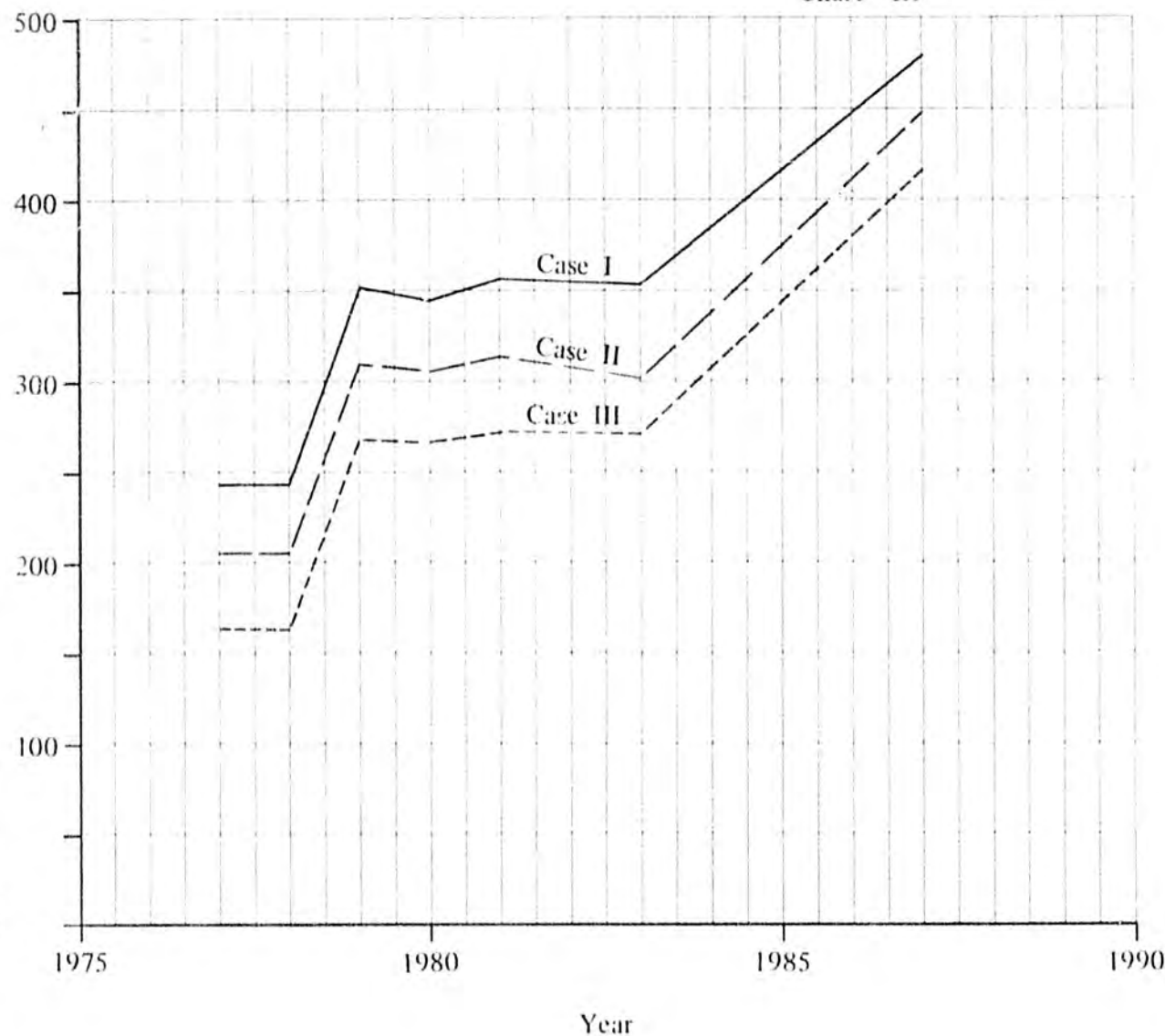
Case II
5.5% Dividend Industry Average Tax

Year	Pipeline Income	Royalty & Production Payments	Total
--- (Millions of Dollars) ---			
1977	\$ 9.13	\$ 9.28	\$ 18.41
1978	9.13	10.44	19.57
1979	9.29	120.07	129.36
1980	9.33	127.04	136.37
1981	10.19	121.23	131.42
1983	10.19	127.05	137.24
1988	8.86	307.99	316.85

Case III
0% Dividend Zero Income Tax

Year	Pipeline Income	Royalty & Production Payments	Total
--- (Millions of Dollars) ---			
1977	0	\$ 28.28	\$ 28.28
1978	0	29.33	29.33
1979	0	139.10	139.10
1980	0	145.99	145.99
1981	0	141.87	141.87
1983	0	147.33	147.33
1988	0	356.11	356.11

Estimated Income to State
Public Ownership
Chart III



Case I - Base Case
7% Dividend

Year	Pipeline Income	Royalty & Production Payments	Total
-- (Millions of Dollars) --			
1977	\$230.86	\$ 15.70	\$246.56
1978	228.00	17.28	245.28
1979	227.47	123.47	350.94
1980	224.60	122.26	346.86
1981	243.56	112.35	355.91
1983	234.69	117.53	352.22
1988	183.01	297.92	480.93

Case II
5.5% Dividend

Year	Pipeline Income	Royalty & Production Payments	Total
-- (Millions of Dollars) --			
1977	\$181.39	\$ 25.00	\$206.39
1978	179.14	26.47	205.61
1979	178.72	132.64	311.36
1980	176.47	131.31	307.78
1981	191.37	122.16	313.53
1983	184.40	126.98	311.38
1988	143.79	305.29	449.08

Case III
4% Dividend

Year	Pipeline Income	Royalty & Production Payments	Total
-- (Millions of Dollars) --			
1977	\$131.92	\$ 34.30	\$166.22
1978	130.28	35.65	165.93
1979	129.98	141.80	271.78
1980	128.34	140.36	268.70
1981	139.18	131.97	271.15
1983	134.11	136.44	270.55
1988	104.58	312.66	417.24

Private ownership, 15 year projection with .07 dividend, low throughput option, .10 equity, no income tax option and no Ad Valorem tax. Total cost is \$3.5 billion at .08 for 30 years, two periods per year.

Year:	4	5	6	7	8	10	15
INCOME (\$ millions)							
Gross Income	523.36	522.72	532.25	507.05	551.62	544.75	523.28
Operating Expenses	21.99	22.85	30.89	31.82	32.78	34.77	64.99
Depreciation	89.25	89.25	89.25	89.25	98.03	98.03	98.03
Interest on Bonds	242.28	241.80	240.87	214.91	234.27	227.30	204.26
Income before Taxes	169.84	189.27	171.24	171.06	186.54	184.64	156.00
State Income Tax	-0-	-0-	-0-	-0-	-0-	-0-	-0-
Federal Income Tax	-0-	-0-	-0-	-0-	-0-	-0-	-0-
Income after Taxes	169.84	169.27	171.24	171.06	186.54	184.64	156.00
ICC ROFV (%)	12.50	12.61	12.68	12.03	12.09	12.29	13.78
CASH FLOW (\$ millions)							
Income after Taxes	169.84	169.27	171.24	171.06	186.54	184.64	156.00
Depreciation	89.25	89.25	89.25	89.25	98.03	98.03	98.03
Bond Amortization	28.22	30.53	33.02	35.71	41.02	47.99	71.03
Net Cash Flow	230.86	228.00	227.47	224.60	243.56	234.69	183.01
Tariff (cents)	281.15	280.84	142.96	136.19	148.17	146.32	84.33
Flow/Day	.51	.51	1.02	1.02	1.02	1.02	1.70
ROCF (%)	7.00	7.00	7.00	7.00	7.00	7.00	7.00
Pipeline Valuation (\$ billions)	3.298	3.257	3.250	3.209	3.479	3.353	2.614
Wellhead Price (\$)	.18	.22	1.63	1.74	1.65	1.74	2.56
(\$ millions)							
Wellhead Value (oil)	34.39	41.18	608.21	646.09	614.32	647.14	1586.37
Wellhead Value (gas)	20.10	20.10	40.21	40.21	42.22	42.22	73.72
Total Wellhead Value	54.48	61.28	648.42	686.30	656.53	689.36	1660.08
Total Royalty & Severance (oil)	6.47	7.74	114.34	121.46	115.49	121.66	298.24
Total Royalty & Severance (gas)	9.68	10.96	120.78	127.90	122.25	128.42	310.03

Private ownership, 15 year projection with .07 dividend, low throughput option, .10 equity, .30 income tax option and no Ad Valorem tax. Total cost is \$3.5 billion at .08 for 30 years, two periods per year.

Year:	4	5	6	7	8	10	15
INCOME (\$ millions)							
Gross Income	596.15	595.32	605.63	580.36	631.57	623.89	590.14
Operating Expenses	21.99	22.65	30.89	31.82	32.78	34.77	64.99
Depreciation	89.25	89.25	89.25	89.25	98.03	98.03	98.03
Interest on Bonds	242.28	241.60	240.87	214.91	234.27	227.30	204.26
Income before Taxes	242.63	241.82	244.62	244.38	266.49	263.78	222.86
State Income Tax	12.88	12.84	12.99	12.98	14.15	14.01	11.83
Federal Income Tax	59.90	59.70	60.40	60.33	65.79	65.12	55.02
Income after Taxes	169.84	169.28	171.24	171.07	186.54	184.65	156.01
ICC ROFV (%)	12.50	12.61	12.68	12.03	12.09	12.29	13.78
CASH FLOW (\$ millions)							
Income after Taxes	169.84	169.28	171.24	171.07	186.54	184.65	156.01
Depreciation	89.25	89.25	89.25	89.25	98.03	98.03	98.03
Bond Amortization	28.22	30.53	33.02	35.71	41.02	47.99	71.03
Net Cash Flow	230.87	228.00	227.47	224.60	243.56	234.69	183.01
Tariff (cents)	320.25	319.81	162.67	155.89	169.64	167.58	95.11
Flow/Day	.51	.51	1.02	1.02	1.02	1.02	1.70
ROCF (%)	7.00	7.00	7.00	7.00	7.00	7.00	7.00
Pipeline Valuation (\$ billions)	3.298	3.257	3.25	3.209	3.479	3.353	2.614
Wellhead Price (\$)	(.21)	(.17)	1.44	1.54	1.44	1.53	2.45
(\$ millions)							
Wellhead Value (oil)	(38.40)	(31.37)	534.83	572.78	534.37	568.00	1519.51
Wellhead Value (gas)	20.10	20.10	40.21	40.21	42.22	42.22	73.72
Total Wellhead Value	(18.29)	(11.26)	575.03	612.98	576.59	610.22	1593.22
Total Royalty & Severance (oil)	(7.22)	(5.90)	100.55	107.68	100.46	106.78	285.67
Total Royalty & Severance (gas)	3.22	3.22	6.43	6.43	6.76	6.76	11.79
Grand Total Royalty & Severance	(4.00)	(2.68)	106.98	114.12	107.22	113.54	297.46

Private ownership, 15 year projection with .055 dividend, low throughput option, .10 equity, .30 income tax option and no Ad Valorem tax. Total cost is \$3.5 billion at .08 for 30 years, two periods per year.

Year:	4	5	6	7	8	10	15
INCOME (\$ millions)							
Gross Income	525.48	525.53	536.00	511.60	557.01	552.04	534.12
Operating Expenses	21.99	22.65	30.89	31.82	32.78	34.77	64.99
Depreciation	89.25	89.25	89.25	89.25	98.03	98.03	98.03
Interest on Bonds	242.28	241.60	240.87	214.91	234.27	227.30	204.26
Income before Taxes	171.95	172.03	174.99	175.62	191.93	191.93	166.84
State Income Tax	9.13	9.13	9.29	9.33	10.19	10.19	8.86
Federal Income Tax	42.45	42.47	43.20	43.36	47.39	47.39	41.19
Income after Taxes	120.37	120.42	122.50	122.94	134.35	134.36	116.79
ICC ROFV (%)	11.00	11.11	11.18	10.53	10.59	10.79	12.28
CASH FLOW (\$ millions)							
Income after Taxes	120.37	120.42	122.50	122.94	134.35	134.36	116.79
Depreciation	89.25	89.25	89.25	89.25	98.03	98.03	98.03
Bond Amortization	28.22	30.53	33.02	35.71	41.02	47.99	71.03
Net Cash Flow	181.39	179.14	178.73	176.47	191.37	184.40	143.79
Tariff (cents)	282.29	282.32	143.97	137.42	149.61	148.28	86.08
Flow/Day	.51	.51	1.02	1.02	1.02	1.02	1.70
ROCF (%)	5.50	5.50	5.50	5.50	5.50	5.50	5.50
Pipeline Valuation (\$ billions)	3.298	3.257	3.25	3.209	3.479	3.353	2.614
Wellhead Price (\$)	.17	.21	1.62	1.72	1.64	1.72	2.54
(\$ millions)							
Wellhead Value (oil)	32.27	38.43	604.46	641.53	608.93	639.85	1575.53
Wellhead Value (gas)	20.10	20.10	40.21	40.21	42.22	42.22	73.72
Total Wellhead Value	52.38	58.53	644.67	681.74	651.15	682.07	1049.25
Total Royalty & Severance (oil)	6.07	7.22	113.64	120.61	114.48	120.29	296.20
Total Royalty & Severance (gas)	3.22	3.22	6.43	6.43	6.76	6.76	11.79
Grand Total Royalty & Severance	9.28	10.44	120.07	127.04	121.23	127.05	307.99

Private ownership, 15 year projection with no dividend, low throughput option, .10 equity, no income tax option and no Ad Valorem tax. Total cost is \$3.5 billion at .08 for 30 years, two periods per year.

Year:	4	5	6	7	8	10	15
INCOME (\$ millions)							
Gross Income	292.50	294.78	304.78	282.45	308.07	310.06	340.28
Operating Expenses	21.99	22.65	30.89	31.82	32.78	34.77	64.99
Depreciation	89.25	89.25	89.25	89.25	98.03	98.03	98.03
Interest on Bonds	242.28	241.60	240.87	214.91	234.27	227.30	204.26
Income before Taxes	(61.03)	(58.72)	(56.23)	(53.54)	(57.01)	(50.05)	(27.00)
State Income Tax	-0-	-0-	-0-	-0-	-0-	-0-	-0-
Federal Income Tax	-0-	-0-	-0-	-0-	-0-	-0-	-0-
Income after Taxes	(61.03)	(58.72)	(56.23)	(53.54)	(57.01)	(50.05)	(27.00)
ICC ROFV (%)	5.50	5.61	5.68	5.03	5.09	5.29	6.78
CASH FLOW (\$ millions)							
Income after Taxes	(61.03)	(58.72)	(56.23)	(53.54)	(57.01)	(50.05)	(27.00)
Depreciation	89.25	89.25	89.25	89.25	98.03	98.03	98.03
Bond Amortization	28.22	30.53	33.02	35.71	41.02	47.99	71.03
Net Cash Flow	.00	.00	.00	.00	.00	.00	.00
Tariff (cents)	157.13	158.36	81.86	75.87	82.75	83.28	54.84
Flow/Day	.51	.51	1.02	1.02	1.02	1.02	1.70
ROCF (%)	.00	.00	.00	.00	.00	.00	.00
Pipeline Valuation (\$ billions)	3.298	3.257	3.250	3.209	3.470	3.353	2.614
Wellhead Price (\$)	1.42	1.45	2.24	2.34	2.30	2.37	2.85
(\$ millions)							
Wellhead Value (oil)	265.25	269.17	835.68	876.69	857.87	881.83	1769.37
Wellhead Value (gas)	20.10	20.10	40.21	40.21	42.22	42.22	73.72
Total Wellhead Value	285.36	289.28	875.89	910.90	900.09	924.05	1843.09
Total Royalty & Severance (oil)	49.87	50.00	157.11	163.69	161.28	165.78	332.64
Total Royalty & Severance (gas)	3.22	3.22	6.43	6.43	6.76	6.76	11.79
Grand Total Royalty & Severance	53.08	53.82	163.54	170.12	168.03	172.54	344.44

Public ownership, 15 year projection with .04 dividend, low throughput option, no debt, no income tax option and no Ad Valorem tax. Total cost is \$3.5 billion at .08 for 30 years, two periods per year.

Year:	4	5	6	7	8	10	15
INCOME (\$ millions)							
Gross Income	392.41	391.44	420.42	440.76	499.90	502.09	509.29
Operating Expenses	21.99	22.65	30.89	31.82	32.78	34.77	64.99
Depreciation	89.25	89.25	89.25	89.25	98.03	98.03	98.03
Interest on Bonds	238.50	238.50	238.08	235.91	256.69	244.81	203.79
Income before Taxes	42.67	41.03	62.20	83.78	112.39	124.47	142.48
State Income Tax	-0-	-0-	-0-	-0-	-0-	-0-	-0-
Federal Income Tax	-0-	-0-	-0-	-0-	-0-	-0-	-0-
Income after Taxes	42.67	41.03	62.20	83.78	112.39	124.47	142.48
ICC ROFV (%)	8.53	8.58	9.24	9.96	10.61	11.01	13.24
CASH FLOW (\$ millions)							
Income after Taxes	42.67	41.03	62.20	83.78	112.39	124.47	142.48
Depreciation	89.25	89.25	89.25	89.25	98.03	98.03	98.03
Bond Amortization	-0-	-0-	21.47	44.69	71.25	88.39	135.94
Net Cash Flow	131.92	130.28	129.98	128.34	139.18	134.11	104.58
Tariff (cents)	210.81	210.28	112.93	118.39	134.27	134.86	82.08
Flow/Day	.51	.51	1.02	1.02	1.02	1.02	1.70
ROCF (%)	4.00	4.00	4.00	4.00	4.00	4.00	4.00
Pipeline Valuation (\$ billions)	3.298	3.257	3.250	3.209	3.479	3.353	2.614
Wellhead Price (\$)	.89	.93	1.93	1.91	1.79	1.85	2.58
(\$ millions)							
Wellhead Value (oil)	165.34	172.52	720.04	712.38	666.04	689.80	1600.36
Wellhead Value (gas)	20.10	20.10	40.21	40.21	42.22	42.22	73.72
Total Wellhead Value	185.44	192.62	760.24	752.59	708.26	732.02	1674.07
Total Royalty & Severance (oil)	31.08	32.43	135.37	133.93	125.22	129.68	300.87
Total Royalty & Severance (gas)	3.22	3.22	6.43	6.43	6.76	6.76	11.79
Grand Total Royalty & Severance	34.30	35.65	141.80	140.36	131.97	136.44	312.60

Private ownership, 15 year projection with .04 dividend, low throughput option, .10 equity, no income tax option and no Ad Valorem tax. Total cost is \$3.5 billion at .08 for 30 years, two periods per year.

Year:	4	5	6	7	8	10	15
INCOME (\$ millions)							
Gross Income	424.42	425.07	434.76	410.79	447.24	444.17	444.85
Operating Expenses	21.99	22.65	30.89	31.82	32.78	34.77	64.99
Depreciation	89.25	89.25	89.25	89.25	98.03	98.03	98.03
Interest on Bonds	242.28	241.60	240.87	214.91	234.27	227.30	204.26
Income before Taxes	70.90	71.56	73.75	74.81	82.16	84.06	77.57
State Income Tax	-0-	-0-	-0-	-0-	-0-	-0-	-0-
Federal Income Tax	-0-	-0-	-0-	-0-	-0-	-0-	-0-
Income after Taxes	70.90	71.56	73.75	74.81	82.16	84.06	77.57
ICC ROFV (%)	9.50	9.61	9.68	9.03	9.09	9.29	10.78
CASH FLOW (\$ millions)							
Income after Taxes	70.90	71.56	73.75	74.81	82.16	84.06	77.57
Depreciation	89.25	89.25	89.25	89.25	98.03	98.03	98.03
Bond Amortization	28.22	30.23	33.02	35.71	41.02	47.99	71.03
Net Cash Flow	131.92	130.28	129.98	128.34	139.18	134.11	104.58
Tariff (cents)	228.00	228.35	116.78	110.34	120.13	119.30	71.69
Flow/Day	.51	.51	1.02	1.02	1.02	1.02	1.70
ROCF (%)	4.00	4.00	4.00	4.00	4.00	4.00	4.00
Pipeline Valuation (\$ billions)	3.298	3.257	3.250	3.209	3.479	3.353	2.614
Wellhead Price (\$)	.72	.75	1.90	1.99	1.93	2.01	2.68
(\$ millions)							
Wellhead Value (oil)	133.33	138.89	705.70	742.35	718.70	747.72	1664.80
Wellhead Value (gas)	20.10	20.10	40.21	40.21	42.22	42.22	73.72
Total Wellhead Value	153.43	158.99	745.91	782.55	760.92	789.94	1738.51
Total Royalty & Severance (oil)	25.07	26.11	132.67	139.56	135.11	140.57	312.98
Total Royalty & Severance (gas)	3.22	3.22	6.43	6.43	6.76	6.76	11.79
Grand Total Royalty & Severance	28.28	29.33	139.10	145.99	141.87	147.33	324.78

Public ownership, 15 year projection with .055 dividend, low throughput option, no equity, no income tax option and no Ad Valorem tax. Total cost is \$3.5 billion at .08 for 30 years, two periods per year.

Year:	4	5	6	7	8	10	15
INCOME (\$ millions)							
Gross Income	441.88	440.29	469.17	488.89	552.09	552.38	548.51
Operating Expenses	21.99	22.65	30.89	31.82	32.78	34.77	64.99
Depreciation	89.25	89.25	89.25	89.25	98.03	98.03	98.03
Interest on Bonds	238.50	238.50	238.08	235.91	256.69	244.81	203.79
Income before Taxes	92.14	89.89	110.94	131.91	164.58	174.76	181.69
State Income Tax	-0-	-0-	-0-	-0-	-0-	-0-	-0-
Federal Income Tax	-0-	-0-	-0-	-0-	-0-	-0-	-0-
Income after Taxes	92.14	89.89	110.94	131.91	164.58	174.66	181.69
ICC ROFV (%)	10.03	10.08	10.74	11.46	12.11	12.51	14.74
CASH FLOW (\$ millions)							
Income after Taxes	92.14	89.89	110.94	131.91	164.58	174.76	181.69
Depreciation	89.25	89.25	89.25	89.25	98.03	98.03	98.03
Bond Amortization	-0-	-0-	21.47	44.69	71.25	88.39	135.94
Net Cash Flow	181.39	179.14	178.72	176.47	191.37	184.40	143.79
Tariff (cents)	237.38	236.53	126.02	131.32	148.29	148.37	88.40
Flow/Day	.51	.51	1.02	1.02	1.02	1.02	1.70
ROCF (%)	5.50	5.50	5.50	5.50	5.50	5.50	5.50
Pipeline Valuation (\$ billions)	3.298	3.257	3.250	3.209	3.479	3.353	2.614
Wellhead Price (\$)	.62	.66	1.80	1.78	1.65	1.72	2.52
(\$ millions)							
Wellhead Value (oil)	115.87	123.66	671.29	664.25	613.85	639.51	1561.14
Wellhead Value (gas)	20.10	20.10	40.21	40.21	42.22	42.22	73.72
Total Wellhead Value	135.97	143.77	711.50	704.46	650.07	681.73	1634.86
Total Royalty & Severance (oil)	21.78	23.25	126.20	124.88	115.40	120.23	293.49
Total Royalty & Severance (gas)	3.22	3.22	6.43	6.43	6.70	6.70	11.79
Grand Total Royalty & Severance	25.00	26.47	132.64	131.31	122.16	126.98	305.29

Public ownership, 15 year projection with .07 dividend, low throughput option, no equity, no income tax option and no Ad Valorem tax. Total cost is \$3.5 billion at .08 for 30 years, two periods per year.

Year:	4	5	6	7	8	10	15
INCOME (\$ millions)							
Gross Income	491.36	489.15	517.91	537.02	604.28	602.67	587.73
Operating Expenses	21.99	22.65	30.89	31.82	32.78	34.77	64.99
Depreciation	89.25	89.25	89.25	89.25	98.03	98.03	98.03
Interest on Bonds	238.50	238.50	238.08	235.91	256.69	244.81	203.79
Income before Taxes	141.61	138.75	159.69	180.04	216.77	225.05	220.91
State Income Tax	-0-	-0-	-0-	-0-	-0-	-0-	-0-
Federal Income Tax	-0-	-0-	-0-	-0-	-0-	-0-	-0-
Income after Taxes	141.61	138.75	159.69	180.04	216.77	225.05	220.91
ICC ROFV (%)	11.53	11.58	12.24	12.96	13.61	14.01	16.24
CASH FLOW (\$ millions)							
Income after Taxes	141.61	138.75	159.69	180.04	216.77	225.05	220.91
Depreciation	89.25	89.25	89.25	89.25	98.03	98.03	98.03
Bond Amortization	-0-	-0-	21.47	44.69	71.25	88.39	135.94
Net Cash Flow	230.86	228.00	227.47	224.60	243.56	234.69	183.01
Tariff (cents)	263.96	262.77	139.11	144.24	162.31	161.88	94.72
Flow/Day	.51	.51	1.02	1.02	1.02	1.02	1.70
ROCF (%)	7.00	7.00	7.00	7.00	7.00	7.00	7.00
Pipeline Valuation (\$ billion)	3.298	3.257	3.250	3.209	3.479	3.353	2.614
Wellhead Price (\$)	.36	.40	1.67	1.65	1.51	1.58	2.45
(\$ millions)							
Wellhead Value (oil)	66.40	74.81	622.55	616.12	561.66	589.22	1521.95
Wellhead Value (gas)	20.10	20.10	40.21	40.21	42.22	42.22	73.72
Total Wellhead Value	86.50	94.91	662.66	656.33	603.88	631.44	1595.64
Total Royalty & Severance (oil)	12.48	14.06	117.04	115.83	105.59	110.77	286.12
Total Royalty & Severance (gas)	3.22	3.22	6.43	6.43	6.76	6.76	11.79
Grand Total Royalty & Severance	15.70	17.28	123.47	122.26	112.35	117.53	297.92

Private ownership, 15 year projection with .07 dividend, low throughput option, .11 equity, full income tax option and no Ad Valorem tax. Total cost is \$3.5 billion at .08 for 30 years, two periods per year.

Year:	4	5	6	7	8	10	15
INCOME (\$ millions)							
Gross Income	713.89	712.67	724.34	698.95	760.88	751.89	698.29
Operating Expenses	21.99	22.65	30.89	31.82	32.78	34.77	64.99
Depreciation	89.25	89.25	89.25	89.25	98.03	98.03	98.03
Interest on Bonds	242.28	241.60	240.87	214.91	234.27	227.30	204.26
Income before Taxes	360.36	359.17	363.33	362.96	395.80	391.78	331.01
State Income Tax	33.73	33.62	34.01	33.97	37.05	36.67	30.98
Federal Income Tax	156.79	156.27	158.08	157.93	172.21	170.46	144.02
Income after Taxes	169.84	169.27	171.24	171.06	186.54	184.64	156.00
ICC ROFV (%)	12.50	12.61	12.68	12.03	12.09	12.29	13.78
CASH FLOW (\$ millions)							
Income after Taxes	169.84	169.27	171.24	171.06	186.54	184.64	156.00
Depreciation	89.25	89.25	89.25	89.25	98.03	98.03	98.03
Bond Amortization	28.22	30.53	33.02	35.71	41.02	47.99	71.03
Net Cash Flow	230.86	228.00	227.47	224.60	243.56	234.69	183.01
Tariff (cents)	383.50	382.85	194.56	187.74	204.37	201.96	112.54
Flow/Day	.51	.51	1.02	1.02	1.02	1.02	1.70
ROCF (%)	7.00	7.00	7.00	7.00	7.00	7.00	7.00
Pipeline Valuation (\$ billions)	3.298	3.257	3.250	3.209	3.479	3.353	2.614
Wellhead Price (\$)	(.34)	(.80)	1.12	1.22	1.09	1.18	2.27
(\$ millions)							
Wellhead Value (oil)	(156.13)	(148.71)	416.12	454.19	405.05	440.00	1411.36
Wellhead Value (gas)	20.10	20.10	40.21	40.21	42.22	42.22	73.72
Total Wellhead Value	(136.03)	(128.61)	456.33	494.40	447.27	482.22	1485.08
Total Royalty & Severance (oil)	(29.35)	(27.96)	78.23	85.39	76.15	82.72	265.34
Total Royalty & Severance (gas)	3.22	3.22	6.43	6.43	6.76	6.76	11.79
Grand Total Royalty & Severance	(26.14)	(24.74)	84.66	91.82	82.91	89.48	277.13

Private ownership, 15 year projection with .07 dividend, low throughput option, .10 equity, .11 income tax option and no Ad Valorem tax. Total cost is \$3.5 billion at .08 for 30 years, two periods per year.

Year:	4	5	6	7	8	10	15
INCOME (\$ millions)							
Gross Income	613.16	610.54	620.70	602.05	653.78	642.18	579.97
Operating Expenses	21.99	22.65	30.89	31.82	32.78	34.77	64.99
Depreciation	89.25	89.25	89.25	89.25	98.03	98.03	98.03
Interest on Bonds	161.52	161.07	160.58	143.27	156.18	151.54	136.17
Income before Taxes	340.40	337.57	339.98	337.70	366.79	357.84	280.77
State Income Tax	31.86	31.60	31.82	31.61	34.33	33.49	26.28
Federal Income Tax	148.11	146.88	147.92	146.94	159.59	155.70	122.16
Income after Taxes	160.43	159.10	160.23	159.16	172.87	168.65	132.33
ICC ROFV (%)	9.76	9.83	9.87	9.43	9.46	9.55	10.27
CASH FLOW (\$ millions)							
Income after Taxes	160.43	159.10	160.23	159.16	172.87	168.65	132.33
Depreciation	89.25	89.25	89.25	89.25	98.03	98.03	98.03
Bond Amortization	18.82	20.35	22.01	23.81	27.35	31.99	47.35
Net Cash Flow	230.86	228.00	227.47	224.60	243.56	234.69	183.01
Tariff (cents)	329.39	327.99	166.72	161.71	175.61	172.49	93.47
Flow/Day	.51	.51	1.02	1.02	1.02	1.02	1.70
ROCF (%)	7.00	7.00	7.00	7.00	7.00	7.00	7.00
Pipeline Valuation (\$ billions)	3.298	3.257	3.250	3.209	3.479	3.353	2.614
Wellhead Price (\$)	(.30)	(.25)	1.40	1.48	1.38	1.48	2.47
(\$ millions)							
Wellhead Value (oil)	(55.41)	(46.59)	519.76	551.09	512.16	549.71	1529.69
Wellhead Value (gas)	20.10	20.10	40.21	40.21	42.22	42.22	73.72
Total Wellhead Value	(35.31)	(26.48)	559.97	591.29	554.37	591.93	1603.40
Total Royalty & Severance (oil)	(10.42)	(8.76)	97.72	103.60	96.29	103.35	287.58
Total Royalty & Severance (gas)	3.22	3.22	6.43	6.43	6.76	6.76	11.79
Grand Total Royalty & Severance	(7.20)	(5.54)	104.15	110.04	103.04	110.10	299.38

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12:2

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12440 Recor
and Tape #1

TAPE 2 3/9/72

Recessed (McVay's chair)
Question y Markham ~~chair~~

Rakar / Markham
Markham with Markham

Ratig / Donaldson
The Vay / Donaldson

John / Markham #86
Donaldson

Galetha / Donaldson
Markham

Gratt / Donaldson
The Vay / Vayt / Donaldson

McVay
The Vay / Donaldson

Thomas / Donaldson
Markham

Robert / Markham
McVay

Wendy Markham
Donaldson

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McVeigh
Chairing

0063.0 Rettig / Markham
0064.8 Donaldson
0067.0 Rettig / Markham
0070.8 Young / Markham / Donaldson
0076.0 Rose / Markham
0088.3 Donaldson / Rose
0090.5 Barber / Donaldson
0096.8 McVeigh / Donaldson
0097.5 Palmer / Donaldson
0100.0 Ten minute break
0100.3 Reconvened - McVeigh
0104.5 Donaldson intro Seymour
0110.5 Hubert
0123.6 Craft / Seymour
0125.0 End of testimony
0125.3 Donaldson intro Patton
0150.0 Hubert / ~~Seymour~~ Patton
0153.3 Miller / ~~Seymour~~ Patton
0155.0 McVeigh / Patton
0157.8 Mercedes / Patton
0161.0 Barber / Patton
0167.0 Colletta / Patton
0168.0 Radar / Patton
0169.5 Colletta / Patton

0173.5 Galletta
 0175.3 End of Patton
 0176.7 Miller
 0178.0 Donaldson intro Cortese
 0179.0 Cortese statement
 0249.0 Rose / Cortese
 0252.8 Harris / Cortese
 0254.8 Barber / Cortese
 0257.8 McVeigh / Cortese
 0258.0 Groh / Cortese
 0243.8 Holm / Cortese
 0268.8 Recess until 3:00
 0270.0 Reconvened
 0271.0 Donaldson intro Gary
 0272.5 Gary statement
 0333.5 Rettig / Gary
 0343.3 Groh / Gary
 0353.0 Holm / Gary
 0361.0 Gary: "Yeah, I think it does."
 0372.3 Rettig / ~~Gary~~
 0374.3 McVeigh / Gary
 0383.8 Rose / Gary
 0397.0 McVeigh
 0398.0 Ten minute recess

(4)

0400 - 4:00

0398.0	Reconvened. - (Rettig)
0400.5	Wahlfarth / Gary Chairman
0413.0	Rettig / Wahlfarth
0415.0	Craft / Gary
0418.5	Rettig / Gary / Craft
0420.5	Rettig / Gary
0422.0	Holbert / Gary
0427.0	Rettig adjourn
0427.8	Josephson / Gary / Rettig
0430.0	Josephson / Gary
0432.5	Donaldson intro Broussard
0455.5	End of Statement
0456.0	Holm / Broussard
0461.0	Rettig
0462.5	Wahlfarth (update)
0463.3	Barber / Broussard
0484.8	Radar / Broussard
0466.5	Donaldson intro Seymour
0486.0	Barber / Seymour
0490.5	Rettig / Seymour
0492.0	Craft / Seymour
0497.0	Rose / Seymour
0502.5	Radar / Seymour
0504.8	Barber / Seymour

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(5)

0505.5 End of Seymour
0506.0 Donaldson intro Cortese
0507.0 Cortese spoke
0548.0 Croft / Cortese
0560.0 Rettig / Croft / Cortese
0568.0 Rettig / Croft
0569.3 Cortese / Croft
0573.5 Rettig
0575.5 Recess until 8:00
0576.5 Reconvened 8:03/10/72
0576.8 Rettig clearing
0577.8 Hubert / Cortese
0591.3 McVeigh / Cortese
0599.0 Rettig
0601.0 Croft / Cortese
0605.0 Donaldson
0615.0 End of Statement
0615.5 Hubert
0617.3 Mrs Fischer / Donaldson
0620.3 Mr. Sandusky Statement
0648.3 End of Statement
0649.3 Phil Halsworth statement
0666.0 End of Statement
0666.3 Groh / Halsworth

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(6)

0669.5 Mrs. Fischer / Halsworth
0671.5 Mike Miller /
0674.0 10 min break
0674.3 Reconvened
0676.5 Wm. Hopkins statement
0681.0 End of statement
0681.5 Havelock
0690.5 Havelock intro Allen
0694.0 Mr. Allen's statement
0725.3 End of statement
0727.0 Barber / Allen
0732.3 McVeigh / Allen
0734.0 Calletta / Allen
0737.8 Rettig
0744.5 McVeigh / Allen
0748.0 Calletta / Allen
0750.8 Calletta / Havelock
0753.5 Craft / Allen
0760.0 Rettig / Donaldson
0761.3 Donaldson / Cabanas
0763.0 Cabanas
0788.3 Donaldson
0790.0 Barber / Cabanas
0793.5 Donaldson

(7)

0795.8 10 min. recess.
 0796.0 Reconvened.
 0800.0 Havelock
 0802.5 Havelock intro. Wohlfarth
 0803.0 Wohlfarth intro Jamison
 0812.0 Jamison statement
 0833.8 Holm / Jamison
 0837.3 Palmer / Jamison
 0840.3 Colletta / Jamison / Wohlfarth
 0844.8 Fischer / Jamison
 0846.0 Meland / Jamison
 0847.5 Wohlfarth
 0848.0 Jamison
 0849.8 Palmer / Jamison / Wohlfarth
 0855.5 Eppenbach
 0856.8 Palmer / Wohlfarth
 0857.0 Jamison
 0857.3 Rettig / Jamison
 0859.0 Wohlfarth
 0859.5 Jamison
 0860.0 Colletta / Jamison
 0862.0 Rettig / Jamison
 0864.8 ~~Havelock~~ Palmer / Havelock
 0865.0 Rettig Recess until 1:30

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(8)

- 0866.0 Reconvened. Rettig Chaining
0870.0 Listen for gravel / Rettig
0870.8 Havelock Summaring Chaining
0904.5 Rettig joke
0906.5 Halm / Havelock
0909 - about Halm / Havelock / Wohlfarth
0915.0 Miller / Wohlfarth
0919.8 Harris / Havelock
0922.8 Wohlfarth / Rettig
0925.0 Harris / Havelock
0926.0 Barber / Havelock
0928.3 Palmer / Allen / Palmer
0934.0 Havelock / Kades
0945.5 Palmer / Havelock
0949.0 Halm / Havelock
0950.5 Colletta / Kades
0954.5 Colletta / Havelock
0956.3 McVeigh / Kades
0963.0 Rettig / Havelock
0966.0 Wohlfarth / Rettig
0973.3 Rose / Havelock
0977.0 Nubert / Havelock
0981.0 Wohlfarth
0983.0 Havelock

0983.5 Colletta / Wohlfarth / Havelock
0985.0 Rose / Havelock
0985.5 Havelock
0986.8 Recess 10 min
0987.0 Reconvened.
0987.8 Rottig intro Croft
1014.3 End of statement
1015.5 Hubert statement
1017.5 Barber statement
1023.0 Harris statement
1026.8 Rose statement
1029.8 Muller statement
1034.0 Holm statement
1034.5 Fischer statement
1038.8 KIEH SPECKING
→ ~~KAY POLAND~~
~~1045.0 Jay Hammond~~
1041.5 Mike COLLETTA
1045.0 Jay Hammond statement
1049.0 Thomas statement
1053.8 Kay Poland statement
1055.0 McVeigh statement
1058.8 Rottig statement
1064.3 End

PLEASE NOTE: THE FOLLOWING PAGES WERE TREATED
AS A UNIT IN THE ORIGINAL DOCUMENT.

Culetta: ¹⁸⁸ for State acquiring money, your testimony, or my interpretation, is that this money is the problem that we face and, if I interpret your testimony correctly, one of the alternatives was the State ownership proposal. With supplementary income from severance and royalties we were going to make up the deficit in monies that we need through the profit that is allowed on the pipeline. Have you looked into any other alternatives?

Henri: Well, Representative Culetta, when you mean alternatives do you mean other natural resource development or just what is the general thrust of this.

Culetta: Yes, either in that field or coupled to the Prudhoe Bay. Is consideration being given to, recently we read in the paper where gas research not taken out of the ground. Have we considered selling our pre-owned, you know approximately 20%?

Henri: Well, right, I think that should be the essence of it is Commissioner Herbert's. But, I would say in general that I have looked at every conceivable possibility for getting income for the State, more or less, I don't mean to tell you that we spent several hundred thousand dollars on each conceivable possibility. We certainly have tried to imagine any income source. There isn't anything, including gas, that is anywhere near like oil. That is the problem. I mean the oil is so far and above the great yield~~er~~ of revenue to the Treasury that there just isn't anything else remotely comparable to it.

Culetta: Mr. Chairman. Again, I was apparently misinformed but it seems that I recall from the news article that between two and five hundred million dollars in one gas sale had been negotiated.

Henri: Well, I don't doubt, Mr. Culetta, that if they sold all the oil in the Prudhoe Slope right today that they could get a figure quite a bit higher than that, obviously, but that is the total figure over many years. My concern, of course, is to funding the budget in 1978 and 1979, not that I am representing to you that I'm going to be the one who's doing it then, but at least we have

to fund the budget then and those are the years, particularly the late seventies, that are so critical to our State.

Culetta: Mr. Chairman. Commissioner, what I am driving at is until the line is on full capacity we seen to be facing the problem . It seems conceivable to me that we should sell some of the future production now to make up the deficit until the line is on stream so that we could solve our problem.

Havelock: If I may answer that for the Commissioner. I have discussed this with a number of people as a prospect, but the effect is, and it is a strategy the State may wish to use at the appropriate point, but the strategy does not change basic lines of the projection. What you can do through the advance sale, lets take sale of oil and gas futures, is to nip off the bottom of the deep part of the V when you hit bottom. You can't sell anything, or you can't sell for any kind of advantageous price until you have the assurance that the product is going to be marketed, otherwise, you are going to be selling a highly discounted comodity. Even if you do sell it, you are selling something that otherwise you would count on in the future. So, the effect is that you can round off the bottom of the V in the bottom of the dip but you don't change the basic trend of the decade by that kind of strategy. As far as other alternatives go, I do call to your attention one of the measures the Legislature may wish to consider, one of measures we had introduced does call for a twenty mill property tax on the pipeline and related oil property as a method of raising revenue and, of course, the legislature may wish to consider the utilization of the property tax as one of the various tax tools that is available to the State in meeting its fical problems.

Rettig: In several different ways the question has been posed, why can't we not increase severence taxes to make up for what, otherwise, would be pipeline profit. Perhaps Mr. Wohlforth could explain where most of this pipeline profit really comes from under State ownership. Would you care to do that Eric?

Wohlforth; Yes I would be glad to. The pipeline profit is shown under pipeline income

in the years 1977, 78, and 1979 to some extent, comes from pipeline income, that is to say, in the amount of the charge which the State is entitled to make as the owner of the pipeline.

Rettig: Perhaps I didn't make myself clear. For example,

Wohlforth: as well as the fact that we are not taxable as a pipeline owner.

Rettig: That is the point I was trying make. Out of perhaps four hundred million dollars of pipeline income, perhaps two hundred fifteen million of that ^{MEANLY} ~~MEANLY~~ is money that would otherwise go to Uncle Sam for taxes.

Rose: My curiosity is getting the best of me, what is a

?

Henri: It is an example of figures.

Groth: Joe this is the last question and I realize that I am probably being argumentative but I don't mean it. If you refuse to put anything in the budget on the value of the 1.5 million acres on the slope or the seventy seven million acres that the State otherwise has, would you sell it to me for a hundred million dollars? Of course you wouldn't, so you do have a figure on it someplace and it seems to me that that figure has to be put in your revenue projections someplace.

Henri: Senator, you're referring to lands that the State has?

Groth: Yes sir.

Henri: Of course, the lands, whether they are oil bearing lands is question number one. Again, I would have to ask whether Chuck Herbert thinks they are, but even Chuck has missed one or two acres in Alaska as to whether they have oil under them or not. So that in itself seems to be problematical, and then the question of when the oil companies would be interested in taking the oil is the thing that clenches us up. All we are talking about is a ten year period. I think that over the long run of time that we can get through the next ten years probably, our future is particularly bright in this State.

Adjournment until 2 p.m.

McVay: This is a continuation of the hearings on the pipeline proposals of the administration. Our schedule calls for us to go straight through until 6:00 this afternoon and we'll have breaks approximately every hour and fifteen minutes. Mr. Attorney General do you have the next witness?

Havelock: Mr. Co-Chairman and members of the committee, at this time the State would like to call Mr. Charles Kades of Barker, Stella, Field and Wood, special council of the State on public financing. He will discuss the statutory framework of State ownership. In connection with Mr. Kades testimony I have a distribution in line with the previous comments that I have made and other witnesses have made regarding a proposed introduction of the proposed amendment to the constitution of Alaska and with the Chairs permission I would like to distribute that now for your perusal and, in addition, we have to the amendment bill already committed to the committee we have two other proposed amendments to HB 569 which the committee may wish to consider.

McVay: Mr. Kades, when you are ready to begin would you give us a little bit of your background for the records.

Kades: Mr. Co-Chairman, my name is Charles L. Kades. I am a partner in the firm of Barker, Field, Stella and Wood of New York City. I have been a partner for some twenty some odd years. Prior to that I was overseas during WW II until about 1942. In an earlier period I had been Assistant General Council of the United States Treasury in Washington from 1933 or 1934 until 1940. After we were retained to advise the Attorney General and other members of the administration in connection with the ownership of the, or possible ownership of the pipeline by the State, we conferred at length and concluded that the device that was best adapted to providing the State ownership of the pipeline would be public authority. The authority device is not a new device. It is not untried and, at its best, under competent members, it has advantages of full private and public management. It must pay its way and usually it has no access to the public treasury. It has no stock; it is operated under Government and after its debt is paid it properly belongs to the State and to the people. Although there

has not been any project of which I am aware of comparable size to the pipeline under consideration here, there have been authority financings amounting to billions of dollars. For example, the Port of New York Authority now has outstanding about one and a half billion dollars worth of bonds and it has retired about an equivalent of that amount of bonds. The Los Angeles Power and Light Authority has outstanding about a billion dollars worth of bonds. The Power Authority of the State of New York has outstanding a billion and a half of bonds. The New York State Thruway has a billion in principle amount of bonds outstanding. The New Jersey Turnpike Authority has approximately three quarters of a billion; Illinois Turnpike Authority has over six hundred million; and the Nebraska Public Power Agency has a half a billion dollars in bonds outstanding. All of these projects have been financed without any recourse whatever to tax revenue. These projects have been self-liquidating, self-supporting, and are managed by the authority as an autonomous, independent, separate corporate legal entity. That is the purport of HB number 569 which creates the Trans-Alaska Authority as an independent corporate entity. Its membership is appointed by the Governor with the confirmation of both houses in joint session of the Legislature. It has all the general powers of a private corporation as well as a public corporation. It has specific powers to issue bonds or notes and to make agreements with the bond holders and note holders for the financing of the project and it can make rates and charges and revise them from time to time without the surveillance of any other regulatory agency sufficient to pay the interest and principal on the bonds as well as its debt service as well as the operating and maintenance expenses. It has the power to acquire the property of any other pipeline company, either by purchase of stocks or by purchase of property, or by physical property or, if necessary, by exercising the right of eminent domain upon payment, of course, of just compensation. The Act is not mandatory. The Act is purely permissive. All it does is set up the framework from which the State can then determine its next move. It is purely enabling legislation. It might never be used or it might be used in part or in whole, but it is indispensable some legal framework if the proposals that there may be State

ownership is to move forward. The hearings, I think, became confused at one point in regard to pledge of credit of the State. An independent public authority such as should be self-supporting. All of the authorities that I have mentioned are self-supporting. Sometimes it has been desirable, although I only know of one case, to guarantee the bonds, although no recourse has ever been had to that guarantee. That is in the case of the New York State Throughway, where some bonds were issued guaranteed by the State, after a constitutional amendment was adopted authorizing the guarantee, but the project has been completely self-liquidating and there had never been any of payment of any of the interest or principals out of the revenues. Did one of the amendments that the Attorney General introduced or offered to the committee at the opening of this session eliminates from this act the recital or from this bill, the recital in the legislative findings that it is clear to be in public interest for the State to guarantee the principal and interest on bonds issued to finance the facility. The other amendment eliminates the section which provided to the extent that the constitution permitted the bonds might be guaranteed. Now, that section was pure surplus and really doesn't belong in the bill because the constitutional amendment provides that, if it is adopted by the people, then the Legislature is authorized by an act to guarantee the bonds but, first of all, the constitutional amendment is required to pass the people and, secondly, another Legislature must act to pass a law before any of the bonds are guaranteed. So there (Its redundant) for anything of that character to be in this bill, thats why it has been eliminated. As it stands, the bill authorizes an authority to make plans and to proceed with the project but doesn't require the authority to do anything, and doesn't in any way pledge directly, or indirectly, the credit of the State or the taxing power of the State. I may say of this connection that the project, as defined in the Act, is much broader than the pipeline. There are many other things that are required to be built which would be revenue producing. For example, port facilities, airports, docks, wards, storage

facilities, electric energy facilities, pollution controls, possibly recreation areas. The authority would have broad powers to consider construction of those undertakings incidental to, and along with, the pipeline. That, in broad, outlines what is the proposed authority which would be the framework for State ownership of the pipeline. I would be glad to answer any questions.

McVay: Do we have any questions from members of the Senate group or the Senate Commerce Committee?

Groth: It appears to me that under the proposed constitutional amendment the question of incurring of debt is not put to the vote of the people under this proposal whereas under existing law, any bonds that have a guarantee by the State would be put to a good vote of the people. Is my analysis correct?

Kades: Your analysis is correct. The purpose of this constitutional amendment is to delegate, is for the people to delegate to the Legislature and vest in the Legislature the power to guarantee the bonds if the Legislature should want to guarantee the bonds of the authority which simply is a delegation of power to the Legislature so that it wouldn't be necessary to come back to the people again. Of course, there is no reason to suppose at this time that it will ever be necessary or desirable to guarantee the bonds, but this would put the Legislature in a position where, if the Legislature in its wisdom decided that the bonds of the Trans-Alaska Authority should be guaranteed in whole or in part, then the Legislature would be able to make that decision rather than mean it must be, there would be a further delay to go back to the people, but nothing can happen without a subsequent vote of another Legislature which would meet after this Legislature. It would meet after the election at which the constitutional amendment would be considered.

Groth: One other quick question. Generally, if we were to categorize between general obligation and revenue bond, these would be considered revenue bonds I suppose?

Kades: Yes, although all the funds of the authority would be placed to their payments so technically they would be general obligation bonds of the authority, but, in fact, they would be revenue bonds because they would be payable solely out of revenues of

the authority and the authority would have no revenues except from the project because the authority has no tax account.

Groth: Generally, again the interest rate on revenue bonds is slightly higher than those on general obligation bonds.

Kades: I am really not in a position to answer that, but I think it depends on the project and the issue. I don't know whether there is a general rule on that or not.

Mr. Macy, who is following is a financial man who probably could answer that.

Christenson: Mr. Chairman, sorry I was late, I didn't get the first part of this. Is this the resolution that you are talking about? Does this go to a vote of the people?

Kades: The House joint resolution?

Christenson: Yes. Here again I would say, suppose it didn't pass?

Kades: If it didn't pass it would not effect the Trans-Alaska Authority Act because the Trans-Alaska Authority Act does not contain any powers to pledge the credit of the State, or pledge the severance taxes, whatever. In other words, the Trans-Alaska Authority stands or falls on its own feet. Well, lets assume that it didn't pass the Legislature, it was never submitted to the people. It wouldn't effect the enabling Legislature. This enabling Legislature is necessary for a number of reasons if the State is to proceed at all. For example, we have the problem on tax exemption. Only one way we will have an answer, final answer, on that, is to secure a ruling from the United States Treasury. We can't go through a ruling because there is no authority to go through a ruling. There is no State agency with the statutory power to request a ruling. The Treasury won't rule on purely hypothetical cases, they want a specific case. Where is the law, where is the plan, then we can get a ruling. The meaningful discussions can't hardly be held on a plan with the oil companies or even with the investment bankers without knowing how the plan can be implemented. It is indispensible as a matter of statute that there be some law on the books under which the officials of the State can proceed in our case.

Rettig: Thank you Mr. McVay. I believe you referred to the possible guarantee by the Legislature, as authorized in this amendment, would not this in effect add a general obligational feature to the bond?

Kades: If the bonds are guaranteed, Mr. Chairman, then it would. It would then be general obligation bonds to the State in a contingent section. If the revenues were insufficient then the *bonds* would pull on the taxing power of the State.

Rettig: It would generally have a G. O. feature supplemented by a revenue pledge of some sort?

Kades: That is correct in substance, but the primose security would be the revenue. If the constitutional amendment is not acceptable to the Legislature or, is not acceptable to the people, then the bonds would be exclusively revenue bonds payable solely from the revenues of the project and, as I stated earlier, the authorities which I mentioned which are just typical of authorities throughout the United States, are all cases where the projects are completely self-supporting without a guarantee. With the one exception on the part of Throughway. For example, lets suppose that three billion dollars worth of bonds were issued by the authority that were purely revenue bonds payable solely from the revenues of the project. The bankers and said, well for the last half a billion it might be desirable if the State pledged its credit, especially since these are going to be not just pipeline facilities but they are going to be parks and recreational facilities, one or the other subsidiary projects. Then this would put the State in a position where it could, if the Legislature, in its discretion, determined it was a good idea to guarantee the bonds, but all it does is give a flexible mechanism, it doesn't bind the Legislature in any way. The bonds of the authority would not be a debt of the State in any sense of the word.

Rettig: As I understand it, the whole constitutional amendment would remove from our constitution the prohibition against the dedication of tax revenue and, in effect, would permit the dedication of tax revenues for a particular purpose?

Kades: Would permit the Legislature to dedicate the tax revenues.

Rettig: Now, recognizing that the severance taxes involved from possible pipeline operation may be relatively minor with

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... Kades: ... by the State then the entire tax power of the State would be available to pay bonds.

Rettig: I understand that. ^{First} Short of a formal guarantee by the legislature they could still pledge particular tax revenues could they not, which would not be a general guarantee, but would be limited to those particular revenues pledged.

Kades: Well, this amendment was drawn with the severance tax only in mind. Now whether there are other taxes that could be pledged, ^{I don't} I haven't considered it because it was only the severance tax that was under consideration. I think it's probably broad enough to cover other tax.

Rettig: I believe it does in effect remove the prohibition against the dedication of taxes in toto, does it not? ^{That's right.}

Kades: Yes. For this purpose, the ^{of the, its limited for the purpose of} purpose of securing the payment of bonds and notes of a public enterprise or a public corporation of the State. ^{What is the purpose?}

Rettig: Thank you. Mr. Kades I am familiar with your firm and have great respect for it, as experience bond counsel, in your opinion would a dedication limited to severance taxes only, satisfy the requirements of bond underwriters in this type of deal.

Kades: I think, Mr. Macy is better equipped to answer to answer this question, but I think based upon our experience with authority bonds that it may be you wouldn't need to pledge even the severance ^{Rettig: I see.} ^{But I'm just not sure.} ^{It depends on} the ^{say what they} investment bankers and what they underwrite. For example they might say well, we don't need more than the royalties. It would be sufficient if royalties were pledged. Or they might say that revenues were so good we don't need even royalties, or they might say in view of the delays which have ^{taken} been placed, we'd better have severance ^{pledged} tax as well. I'm really...

Rettig: Thank you very much. We will perhaps take this up a little further with Mr. Macy. Thank you.

Young: ^{Mr. Young, Senator Young} Mr. Kades, the ~~example~~ you gave of the other authorities have been were public ~~authorities~~ authorities in New York primarily, were they not? These authorities were strictly public convenience. I just wonder if there has been any authorities, like private conveniences, since private ~~conveniences~~ ^{authorities} own that oil as well as the State.

Kades: Well I did give you examples of the power authority in New York in the example which, and also the Los Angeles ^{Electric} power and Nebraska power which generate and transmit power.

Young: I understand that, but they ~~don't buy the use~~ ^{were built by} the authority and generated ~~delivered~~ ^{delivered} by the authority, and it would be another party in the State, such things ~~as~~ ^{as} belong to private industry. And I just wanted another example where ^{possibly} ~~might be~~ an oil line or coal field or something else, ~~curiosity~~ ^{just} curiosity...

Kades: I don't know of a case where the natural resources is owned by the State except again the power authority owns the water rights in New York. The situation as far as the power authority is concerned in ^{your} situation is not too different but when ~~the~~ Charles Evans Hughes was the ~~with the~~ Governor in New York in 1910 he decided to send a message to the legislature that the water resources of New York were just too essential to New York to permit the development by private ^{public} utility companies which were subject to the regulation of course of the public service commission and the federal power commission and as a result of that the power authority of New York was established which

developed the water resource of New York in complete cooperation with the private utilities. They sell the private utilities and they also transmit the private power which is produced by the private utilities. It is a joint cooperative arrangement. It is handled by contracts between the private utility^{ies} and the power authority. It didn't come about ~~many~~ over a few months, it took some ~~x~~ time before there was mutual confidence. That's the current situation.

Young: Thank you. You mentioned also that the authority would have the right to raise the tariff on the pipeline, the usage of the pipeline if necessary to raise funds, ~~additional funds~~.

Kades: Yes, the Act provides that the authority must fix rates and charge its tariffs sufficient to pay the interest and principle on the bonds, the maintenance of reserves, operation of maintenance expenses and also to yield a reasonable return to the state on its capital or on its investment.

Young: Do you foresee any way this might ~~serve to prevent~~ the ~~exercise~~ powers of the legislature as far as the increase in the severance tax they so desire, their form of taxation, limit the form of taxation on the oil.

Kades: I don't think it would, ^{it} it simply is an agreement for the protection of the bond holders, that ^{tariffs will be fixed} ~~the~~ tariffs will be fixed sufficient to pay the bonds.

Young: And they couldn't ~~pay~~ raise the tariff beyond the point where they would be paying the bond back from capital investment, They couldn't use the money they had been given as far as the authority.

Kades: I am not clear on the question.

Young: What I am saying is they have the authority to raise the tariff, ~~use~~ could they use this for the State, the authority has a great deal of power, use

it for generating money rather than to pay back just on the bonds.

Kades: So long as the tariffs were reasonable, I think that the Act is broad enough to permit a yield of excess revenues to the State.

Young: It would be under this bill there would be the power to, that is what I am asking. There would be that authority.

Kades: There is that authority, yes. In other words, I want to be sure I understand. The , there is not a maximum rate in , ~~that~~ the sense that

only them enough to pay back the market, and only enough for operation and maintenance, that is a minimum rate. There is room and it is anticipated in the Act that the rates will be sufficient to provide a reasonable return to the State. But the rates would still have to be reasonable.

Young: Whose term is reasonable. I'm always worried about the term used reasonable. It is a catch all. ^{unusually the discussion of you will find} What I'm worried about is the authority superceding with the authority of the Legislature. If we grant this act will they end up being the super power as far as raising money through the oil lines and other taxations?

Kades: No because they are always a creature of the legislature. The authority is , would be subject to the control of the legislature in the event it ^{you may find} were to ^{Young - Right} raise the rates to a point where it was impairing severance tax? I don't think it would be able to do that under the act.

Havelock: ^{The only Attorney General involved in the question of raising rates} Mr. Kades, so the committee may be fully informed , I wonder if ^{of some} you might talk for a moment or two about the , how you would arrange for, or ^{that out of} what the principles which would apply to tax exemptions of the bonds which the ^{and some, but} authority might issue for this purpose.

Kades: Well the , first of all , there are a number of these projects where there

is no problem about tax exemption. For example, ^{only of} ~~on a~~ minor nature, ^{for example} there is no problem in regard ^{of bonds, the} ~~to applying~~ proceeds/which would go for roads, court facilities, airports, docks, ; there is some problem in regard to electric energy, the question being whether or not it is local furnishing of electrical energy. It's a very technical problem, but the real problem comes in ^{as far} as the interest on the bonds is concerned is, as distinguished from profits of the pipeline itself, profits of the authority, it was those two cases that have to be distinguished. If the volume of oil ~~that~~ the pipeline companies can put through the pipeline is subject in some way to reduction on reasonable notice by the authority in order to make capacity available for use by other companies and the obligation of the oil companies to pay, is not opposed by any so called take or pay, or hell or high water contract which means in effect a guarantee by the oil companies, that the interest ~~and~~ principle of the bonds will be paid, then it is our opinion that more likely than not we can secure a favorable ruling from the treasury. The cardinal point is, that if the benefits and the burden of the ownership ~~of~~ the pipeline is transferred to the oil companies by imposing ~~with~~ all the rights, all the burdens on the oil companies such as guaranteeing the debt service that would be incurred by the authority and if the oil companies have all the rights in the pipeline, then the chances are unfavorable that we would be able to secure a favorable ruling on the bonds. In other words, if, what the statute provides ^{is} if the proceeds of the bonds ~~are~~ issued by the authority are going to be used in the ~~treasury~~ ^{trader} business not of the authority but in the trader business of the oil company ^{that is} the interest on the bonds is taxable, ^{that is} it's simply the oil companies using the credit of the authority in order to finance the project. But if the benefits ^{are} of the States and the burdens

are the States also, with adequate protection of course, for the bond holder, then the interest on the bonds should be exempt. Now on that we would, because this is a grey area, it would be necessary for us to secure a ruling from the Commissioner of Internal Revenue. In Last November, when the Attorney General first raised this point with us, we prepared an opinion to Governor Egan that was agreeable to the Attorney General, I think it is complicated. . .
perhaps we might say...
In so far as the profits of the pipeline are concerned, it is our opinion that they will not be subject to taxation, in other words any excess revenues that the authority derives for use by the State for ^{it's} general purposes, this rule is not in the grey area, such as the question of the interest on the bonds, it has been well settled for a hundred years that the State or an agency of the State is not subject to the internal revenue code, it is not a person within the meaning of the code, it is not a corporation within the meaning of the code. This is decided by the Supreme Court of The United States in 1872 in a case involving the Civil War income tax case and it has been consistently followed by the treasury. Robert Jackson, Justice of the Supreme Court when he was the chief counsel for the Bureau of Internal Revenue gave an opinion in 1933 which reiterated the fact the revenues of the State for State agencies were not subject to Federal Income Tax in connection with Ohio liquor stores who had a tidy profit. Since then, other state instrumentalities have secured rulings that their profits were not subject to taxation and as recently as last year the rationale of the decisions was reiterated in a published ruling. The same thing is true of all these other authorities that engage in what one might call business activities. ^{they} All make some money and they're not subject to taxation and if that were the only point

involved, we wouldn't think it was necessary to ask for a ruling, but because of the fact that we don't have any regulations, so this law which troubles us passed in 1969, the regulations have not yet been issued. Under the proposed regulations there are several examples given and without being too technical at this point, we mention that in ^{this} opinion, this case falls in the middle, between two examples, one of which says ^{that} the interest is exempt and the other which says that the interest is not exempt. Depending upon the contract between the authority and the ^{companies} ~~companies~~. That's, as I think I mentioned before, a reason why it's important to have enabling legislation because we can't get this question settled and it's a very important question, until there's some enabling authority on the statute books.

McVay: Mr. Barber.

Barber: I have a question, Mr. McVay. Say that the Trans-Alaska Authority Act was passed, HB 569, as amended, would subsequent legislators have the authority and right to change that authority, that authorizing legislation?

Kades: Subject to one provision, they would have plenty of power to change it, for there is a provision in the bill which states ^{that} the legislature will not do anything to impair the rights of the bond holders, or diminish the powers of the authority which would adversely affect the bond holders. It might be well if I mentioned it because ---- this is on page 23, this section 44.58.340, and the subject of this provision, the legislature could at will change and in this stage, if it's inaccurate. The State pledges to, and agrees with the holders of notes, bonds or other obligations of the authority ^{that} ~~of~~ the State will not limit or alter the rights by this chapter vested in the authority to possess and use property acquired by it or for its use, so long as its corporate existence continues; and to establish and collect tariffs, tolls, rates and charges as may be convenient or necessary to produce/revenue ^{sufficient} to meet the expenses of maintenance

and operation , and to fulfill the terms of any agreements made with the holders of notes, bonds or other obligations of the authority. And further pledges it will not, in any way, impair the rights and remedies of the holders ~~with~~ the notes, bonds and other obligations, together with interest thereon, and interest on unpaid installments of interest are fully met and discharged. That's the only limitation on the power of the legislature to control the activities of the authority and that's understandable because the bond holders, especially if they're relying solely on revenues of the authority, will be taking the risk that the revenues will be raised and if the legislature withdrew the power from the authority to charge tariffs sufficient to pay the bonds, the bond holders would not have any recourse against the State. ^{There would} Their recourse would be only against the authority under the revenue type - bond type of obligation which the authority would be authorized to issue. Thank you.

McVay: Are you through Mr. Barber? Mr. Rose.

Mr Rose: Mr. Kades, you have indicated that these revenue bonds would not in anyway obligate the credit of the State. As a practical matter though, isn't the credit of the State behind the revenue bonds in the event the project is not as successful as anticipated?

Kades: With all due respect I don't think so. The bonds will say on their face, the offering circular will carry language to the effect that the State is not liable on the notes or bonds, or the interest on the notes or bonds, and no one will be misled - the bond holders will be looking solely to the revenues of the project. Some revenue bonds have gone into the pool, one, an authority of the State of Virginia and I daresay, although I rather, again I'm not a financial expert, have Mr. Macy or Mr. Guildhouse testify to this, but I doubt if that's in any way hurt the credit of the State of Virginia. There's an authority in California now but no one thinks that California should pay

those bonds. Here and there, some authorities have gone into the pool without adverse affects, I believe, so far as the credit of the state is concerned. And everyone is put on complete notice and there's no misrepresentation or anything to cause anyone to seek recourse against the State, and in those instances where an authority or a project was bonded by ^a revenue ^{based} basis ~~the~~ state in question, or the municipality in question, had not come through and back it up with its own credit. At the present time, there are a hundred million dollars of bonds of the Cheasepeake Bay Bridge and Tunnel Authority in float in the state of Virginia, has nothing whatever and they have been under pool ever for two or three years. I don't even think a bill has been introduced to do anything about the bonds. Ultimately, I suppose the reason is, I'm out of my field now, but I suppose the reason is the bond holders will ultimately get paid. There are tolls coming in but they're not coming in as fast as was anticipated so they're getting, I think, two-thirds of the interest. Eventually they'll be paid off, but there's no move against the state, or by the state, to - that's been one of the - in fact, that's ^{been} one of the basic reasons for the authorities being created in the first instance was to take the burden off the taxing power and put it on the revenues of enterprises that were revenue producing. If you take the Port of New York Authority with three billion dollars worth of bonds, of which half are now outstanding, it would be a terrific debt even for states like New York or New Jersey. One of the reasons for setting up that authority was so there would be no recourse against the states and that was also the reason for setting up the Power Authority of New York, and the Power Authority of Los Angeles.

Rose: I do see that as far as the people of Alaska are concerned, they wouldn't have to worry about their children and grandchildren being obligated in anyway

in the event that the state is not able to pay the bonds.

Kades: That's true correct.

Rose: Thank you.

Kades: Mr. Holm

: Mr. Kades, as I get it then there are three stages going to be passed: 569, is that right? 569, and then the people will vote on a change of constitution so that we can dedicate the funds and thirdly, the legislature will have to act to dedicate the funds. Now, in your judgement, will it be necessary for us to go through all ^{through} these stages in order to optimize the interest rate on these bonds, especially a bonding of this size?

Kades: I don't really know. I am an attorney and ^I think perhaps I'll let that question be answered by Mr. Macy and Mr. Guildhouse. I don't mind giving you my private opinion, but it's not an expert opinion---

What I don't know is this ^{now} field now

I would think that anybody, I was just thinking to myself now as if I were going to buy the bonds, I would rely on the revenues of the pipeline, not the taxing power of the state of Alaska, my feeling it would be that ^{to} the security is the oil that would be flowing through the pipelines, not what real estate or income taxes Alaska can extract from its limited population.

Holm: Now you people are bond counsels?

Kades: It's attorneys, a bond counsel is, ^{we're} / lawyers. We're not financial experts such as are going to follow me, that's why I say-I say I'm out of my--

Holm: Now, if we do go the route, bonding ourselves for three and one-half billion dollars, then you people will also act to advise the State, or someone will act to advise the State, involving this bonding, in addition to the broker house or whoever is going to sell the bonds?

Kades: The underwriting group have their own counsel, we've been acting as counsel to the State. The -- I just might say because we've had many meetings ^{that} with the

underwriting group's counsel who are much _____ in New York, agree with, generally agrees with what I've testified. But we would represent the State to be sure that, for example: to be sure that there wasn't anything in the circulars or in the offering prospectus or in the resolutions which indicated, ^{that} /directly or indirectly, there was any obligation on the State to resort to its taxing power in the absence of the guarantee, of the state.

Holm: Could you tell us what it costs the State to enlist services like yours in case we went to sale of the bonds?

Kades: ^{For many years} No, we have never charged a fee without first consulting with our client and being sure that he, or the public body, felt that it was reasonable because we're - we're - we live in a fish bowl and our fees are a matter of public record. So, I think we probably have to be more cautious than many private corporate lawyers.

Holm: Well, we kinda live in a fish bowl too and we'd kinda like to know what it's going to cost us if we're going to sell three and one-half billion-dollars worth of bonds.

Kades: Well, I think it's a very fair question, but I may say that so far, it hasn't cost the State anything.

Holm: Are there other questions by any other members of the legislature?

Hester: Mr. Rettig has another question.

Rettig: Just one ^{short} ~~more~~ question Mr. Kades. In the proposed constitutional amendment, I suspect there may be some reluctance on the part of the legislature, and perhaps the public, to open wide ^{or remove entirely} only-momentarily, this prohibition against the dedication of tax revenues for a particular purpose. In your opinion, if this - in your opinion, if this dedication were limited to the tax revenues arising from a particular enterprise, such as the pipeline, if it were restricted to those particular taxes, would this in any way adversely affect the non-tax status of,

the possible non-taxable status, of the bond?

Kades: No, I think it would be a good idea, and I think your suggestion is well taken, to insert the language that's in Section 8 and Section 7, where it's limited to public enterprises or public corporations created or empowered to construct the pipeline, so that it would be more limited than it is.

Rettig: Now, I believe that what I really meant was to restrict the dedication to the taxes arising from that operation of that, for example, the pipeline.

Kades: Such as the severance tax.

Rettig: Correct

Kades: Well, that really depends on how much of the purchasers of the bonds feel they can rely on the revenues of the pipeline plus the severance tax.

Rettig: Now I'm not speaking of the security to the bond holders but the tax status of the bond interest, only. If it were tied directly and restricted to the tax revenue

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The log I've kept is strictly the name of the people who are talking. There is one bad part of the hearing and you'll have to rely on the Department of Revenue transcript which is enclosed.

The Department of Revenue has kept a transcript of the hearing. The equipment that I've recorded on is much superior to theirs but think the ideal way to transcribe this is for someone to edit their transcript and let someone else type. This seems the most expeditious to me. Just glancing at their transcript I notice that the names are spelled very poorly. I think that most of the people who testified have their names listed on one of the enclosed sheets. You can get the spellings from there. The people who did the questioning not on the committee were either Senators or Representatives and you can get their spelling. There is enclosed for your convenience the statment copies that were provided to the members of the committee. I'll try enclose anything that I think might help you in transcribing.

Joe Bryson

March 6, 1972

0003.5 Called to order by Rettig
0005.3 Introduction of committees
0010.0 McVeigh
0011.0 Rettig
0012.5 John Havelock introduction
0014.0 Boucher makes statement
0038.0 End of Boucher
0038.3 Rettig intro. Havelock
0042.0 Herbert makes statement
0052.0 Herbert returns to seat from across room
0055.0 Herbert returns to seat
0064.8 End of Herbert statement.
0066.5 Havelock's statement (Rettig introduced)
0084.3 Havelock intro. Temple
0084.3 Rettig's "fine"
0085.0 Temple statement (no copy)
0141.0 End of statement
0141.0 McVeigh
0142.5 Groh
0143.3 Temple
0144.0 Groh/Temple
0145.0 Groh/Temple
0146.0 Groh/Temple
0150.3 Young/Temple
0154.3 Meland/Temple (just tell Joe Blow on the street)
0157.0 Holm/Temple
0166.0 Hubert/Temple
0169.0 Rose/Temple
0175.0 Barber/Temple

(McVeigh chairing during
question and answer period)

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