

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 86 / 2

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

Page 2

0179.0 Miller/Temple
0182.5 Rose/Temple
0185.3 Radar/Temple
0187.5 Bowman/Temple
0188.5 Josephson/Temple
0191.5 Swanson/Temple
0193.5 Mike Colletta/Temple
0196.5 Farrow/Temple
0198.0 McVeigh/Temple
0198.3 Rettig/Temple
0203.0 Temple - End of statement
0203.8 Recess -- reconvened
0204.0 Bruce Campbell statement
0212.3 End of Campbell statement/Rettig
0213.3 Holm/Campbell
0214.3 Rose/Campbell
0218.0 Christiansen/Campbell/Havelock
0220.5 Rettig
0221.8 Havelock
0222.3 Recessed until 8:00 a.m. tomorrow.

March 7, 1972

0224.0 Reconvened
0224.3 Rettig intro. Wohlforth.
0225.0 Rettig
0226.0 Wohlforth statement
0269.5 End of Wohlforth to Havelock
0271.0 McVeigh "can everyone hear...."
0273.0 Larry Eppenbach statement

AGO 530708

0284.0 McVeigh
0284.3 Groh
0285.8 Wohlforth
0287.5 Groh/Wohlforth (McVeigh "speak up, etc.")
0288.3 Christiansen
0289.0 Havelock
0290.5 Holm/Eppenbach
0294.0 Wohlforth answers
0299.0 Havelock "May I comment." Holm
0297.8 Havelock
0306.5 Christiansen (McVeigh chairing during
question and answers)
0307.5 Wohlforth
0308.5 Havelock
0309.0 Young/McVeigh
0310.8 Rettig/Wohlforth
0312.8 Eppenbach
0315.0 Palmer
0316.3 Wohlforth
0317.5 Eppenbach
0318.5 Wohlforth
0319.0 Rettig
0320.3 Havelock
0322.0 Recess for ten minutes

(From this point to the noon recess is a bad tape and you
will have to go to the Department of Revenue transcript
to take your transcript. I will give what I have down on
my log anyway.)
0322.0 McVeigh
0324.5 Havelock intro Henri
03226.3 Henri

0368.0 End of Henri statement
0368.3 McVeigh chairs - Groh/Henri
0378.0 Young/Henri
0380.0 Wohlforth
0386.8 Eppenbach
0388.3 Holm/Henri
0394.0 Hubert/Henri
0396.0 Barber/Henri
0398.0 Thomas/Henri
0401.5 McVeigh/Josephson/Henri
0404.0 Palmer/Henri
0407.8 Rettig
0408.5 Eppenbach/Palmer
0411.5 Palmer/Havelock
0414.8 McVeigh
0415.8 Colletta/Henri
0420.0 Havelock
0422.8 McVeigh/Rettig/Wohlforth
0425.3 Groh/Henri
0429.3 McVeigh - recess.
(End of bad tape)
0428.5 Reconvened McVeigh
0430.5 Havelock intro Kades
0433.0 McVeigh
0433.5 Kades statement
0450.8 End of statement
0451.0 Groh/Kades
0455.0 Christiansen/Kades
0468.5 Young/Kades

Page 5

0478.0 Havelock/Kades
0489.8 Barber/Kades
0494.8 Rose/Kades
0501.0 Holm/Kades
0507.3 Rettig/Kades
0519.8 McVeigh/Havelock
0520.5 Kades
0521.3 McVeigh/Havelock
0522.0 Kades
0523.0 Rose/Kades
0525.5 Recess until 3:15
0527.8 Reconvened
0532.5 McVeigh
0532.8 Havelock/Wohlforth
0535.3 Havelock intro Gildehaus
0536.0 Gildehaus statement
0568.0 End of statement
0568.5 Groh/Gildehaus
0572.3 Rose/Gildehaus
0575.8 Wohlforth
0578.3 Rettig/Gildehaus
0589.5 Havelock/Gildehaus-Rettig
0594.0 McVeigh/Gildehaus
0600.8 Eppenbach/McVeigh
0604.3 Gildehaus
0611.0 Rettig/Gildehaus
0612.0 Eppenbach
0612.5 Wohlforth

AGO 530711

Page 6

0684.8 Havelock

0686.0 Groh/Rettig

0687.5 Havelock intro

0687.5 Havelock introduced Hellen
0688.8 Hellen statement
0704.0 End of statement
0704.5 Rettig/Hellen
0713.0 Holm/Hellen
0714.0 Holm/Havelock
0717.3 McVeigh/Hellen
0774.3 Groh/Hellen
0726.3 Havelock/Groh
0727.3 Rose/Hellen
0734.8 Hubert/Hellen
0738.8 Rettig/Havelock
0741.0 Holm
0741.5 Christiansen/Rettig
0743.5 Wohlforth
0743.8 Rettig - adjourn until 8:00

March 8, 1972

0745.0 Reconvened
0746.0 Sen. Croft statement
0778.3 End of statement
0779.0 Groh/Croft (Rettig chairing)
0786.5 Radar/Croft
0789.0 Rose/Croft
0792.0 Hubert/Croft
0797.5 Barber/Croft
0802.5 Croft statement
0805.0 Rettig/Croft
0807.3 Rose/Croft
0810.0 Hubert/Croft

AGO 530713

0813.0 Croft finish
0813.3 Rettig statement
0817.8 Recess until 9:15
0818.0 Reconvened
0821.0 Rettig introduction of Spahr
0876.8 End of statement
0876.3 Holm/Spahr
0897.3 Miller/Spahr
0910.0 Groh/Spahr
0916.5 Radar/Spahr
0921.0 Croft/Spahr
0925.3 Thomas/Spahr
0930.0 Josephson/Spahr
0938.0 Merdes/Spahr
0949.0 Recess until 1:30
0950.3 Reconvened at 2:00
0952.0 Rettig/Donaldson
0953.0 Donaldson intro Williamson
1005.8 End of statement
1006.0 Groh/Williamson (Rettig chairing)
1008.0 Donaldson
1009.3 Holm/Williamson
1012.0 Donaldson
1013.5 Rose/Williamson
1015.3 Donaldson/Rose
1017.5 Williamson
1019.3 Donaldson/Rose
1022.3 Williamson
1025.0 Rettig
1025.5 Donaldson

1028.3 Radar/Williamson
1032.5 Donaldson/Radar
1036.3 Hubert/Rettig/Donaldson
1041.3 Croft/Williamson
1047.0 Barber/Williamson
1048.0 McVeigh
1052.8 Palmer/Williamson
1056.5 Croft/Williamson
1058.0 Radar/Williamson
1060.0 Donaldson
1061.3 Thomas/Donaldson
1068.5 Donaldson
1063.0 Recess for 10 min. - Reconvened
1066.0 Donaldson intro net three witnesses.
1068.0 Harry Jones statement
1097.5 End of Statement
1098.0 Rose/Jones
1100.3 Miller/Jones
1106.3 McVeigh/Jones (Rettig chairing)
1112.5 Groh/Jones
1116.5 Hubert/Jones
1124.5 Holm/Jones
1130.5 Donaldson intro Markham
1131.5 Markham statement
1196.5 End of Statement--recess
1197.00 Reconvened - Rettig
1200.0 Holm/Spahr
1200.8 Groh/Spahr
1206.3 Palmer/Spahr
1210.3 Donaldson/Palmer

1213.8 Hubert/Spahr
1222.5 McVeigh/Spahr
1229.5 Rose/Spahr/Donaldson (we'll try to get an answer...)
1242.8 Mr. Spahr left.
1244.0 Recess

End of Tape #1

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

OUTLINE OF PROPOSED TESTIMONY
BEFORE
THE SENATE COMMERCE COMMITTEE
HON. RON L. KETTIG, CHAIRMAN
AND
THE HOUSE LOCAL AFFAIRS COMMITTEE
HON. RICHARD C. McVEIGH, CHAIRMAN
3:00 p.m., March 6

1. The Concerns of State Policy
Statement of Governor (Lt. Gov. Ted Boucher)
2. Alaska's Stake in North Slope Oil
leases, royalty, severance and netback (Charles Herbert,
Commissioner of Natural
Resources)
3. The Federal Role in North Slope Oil
I.C.C. regulation - how it works,
federal pre-emption (John E. Havelock,
Attorney General,
Pipeline Coordinator)
4. The Cost of Building the
Trans-Alaska Pipeline System (Bruce Campbell,
Commissioner of Highways)
5. The Impact of Costs on Revenue
(Eric E. Wohlfarth,
Commissioner of Revenue)
- Methodology - Comparison of State
and Private Ownership Cases (Larry Eppenbach,
Department of Revenue)
6. Impact of State Revenues on the
State Budget (Joseph R. Benet,
Commissioner of
Administration)
7. The Advantages of State Ownership
Issues and Answers (H. B. Temple III,
Temple, Barker & Stone)
8. The Statutory Framework for
State Ownership (Charles Kaden,
Hawkins, Delofield & Wood)
9. Arrangements for the Public
Financing of Pipelines (Tom Giddens,
Temple, Barker & Stone)
10. The Marketing of Public
Pipeline Issues (Robert May, Kuhn,
Loeb & Co.)

Page No. 6
Mr. Rettig: Now at this time we will proceed with the administration witnesses,
Attorney General John Havelock.

Mr. Havelock: Thank you Mr. Chairman. The opening witness we present for the Committee here today is the Honorable Eric E. Wohlforth, Commissioner of Revenue, who will speak generally to the impact of pipeline costs on revenue. Commissioner Wohlforth.

(Mr. Rettig)

Before Mr. Wohlforth commences his testimony, I would like to point out just a slight kink in our plans. We ^{are} ~~are~~ going to commence questioning from ^{committee} members and legislators immediately following testimony of all out-of-town witnesses. It would be helpful if you do have questions, ^{concerning} the administration staff and others who reside in Juneau to save your question, certainly make notes of them so that you can ask those questions at a later time at the individual committee meetings when these measures are being considered.

(Mr. Wohlforth)

Thank you, Mr. Chairman, members of the committee, let me first point out one of those unhappy events which happens in the course of preparing documents and that is for these two years 1980 and 1981 some typist made a reversal of some of the figures. The figure 3397 should be under state taxes, the figure ³⁷⁰⁵ ~~3305~~ should be under state taxes, that's converse taxes should be in the other column. I think that we see readily from the sequence of figures that that typing reversal did occur and I'm very much indebted to ^{gentlemen} the unidentified/who called it to my attention at 7 o'clock this morning.

The figures which are, although done graphically, are hard to see from, by any of those who are sitting in back of the room or any person who doesn't happen to be ^{far} farsighted, are depicted in a hand-out entitled, Exhibits to support testimony before these Committees, with yesterday's date. Committee members have those exhibits now and they will see ~~XXXX~~ little tick marks after the two places where the unfortunate figure ^{is} reversal occurred. My job this morning ^{is} to summarize past projections of North Slope revenues and those presented today based upon private ownership and to contrast the effect of private ownership case with the case of the pipeline owned by the State of Alaska. The most recent public North Slope ^{oil} revenue projections before those which

Governor referred to 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 impact statement which was released by Governor Egan in July of 1971. These projections were developed from a computer model which was based on the information then available to the State of Alaska and showed various and numerous economic cases on differing assumptions again, based on facts then assumed to be ascertainable. The July 30 report which is contained in the State's contribution to the impact statement states, ^{CN} page 166, that "the originally estimated \$900,000,000 cost of the pipeline has already increased considerably, present cost estimates range from one million to 2.1 billion, that will occur I am sure, frequently, to 1 billion to 2.3 billion dollars. These revenue projections use the assumption of one billion dollars, as the lowest ^{installed} cost of the pipeline and 2.5 billion as the highest estimate. A footnote to this statement gives backup for the State's then cost estimates. This footnote notes that as late as July 19, 1971, Aleyska furnished the State Department of Revenue an estimate of \$969 million dollars as the cost of the entire contract and the footnote concludes with a reference to a statement from Interior Secretary Rogers C. Morton, in the late spring of 1971 that environmental regulations and environmental precautions are contributing to a higher price tag of about 2.3 billion dollars. So it was this figure of 2.3 billion dollars which was used on the State's most likely estimate of North Slope revenues. ~~The revenue estimates included in the State's report developed from this estimates of total cost, the revenue estimates most likely estimate of North Slope revenue.~~ The revenue estimates included in the State's report developed from this estimate of total cost assumed refinery value in the year, fiscal year 1975, which was the then estimated start-up year, that is refinery value on the West coast of \$3.37 a barrel, marine transportation costs of 44¢ and pipeline tariff initially of 80¢ per barrel, giving a wellhead value of \$2.12 per barrel. From these figures it was estimated that total royalties and taxes would amount to \$164,000,000 a year in fiscal year 1976. The first year, then assumed, of pipeline operations. In the second year of operations fiscal 1977, the total revenue was estimated at 278,000,000, the third year,

\$282,000,000, in the fourth year \$311,000,000. In the then-estimated, and I repeat then-estimated, fifth year of operation, fiscal year 1980, pipeline tariff was calculated at \$.47 a barrel with marine transportation costs of \$.52 leaving a wellhead value of ^{of} 2.56 per barrel. In that year, fiscal 1980, we showed then, a total of \$348,000,000 in total royalties and severance taxes from the pipeline. And we didn't stop with one set of assumptions. Other assumptions were run with different assumptions. Estimates were run with different assumptions. For example, one set the pipeline cost \$1 billion again with the initial production year 1976. A wellhead value of \$2.75 with lower marine transportation and tariff, ^{produced} ~~showed~~ fifth \$212,000,000 in revenues the first year of production and the ~~second~~ year of production on this optimistic, optimistic ^{from} on the point of view of the billion cost of the pipeline, was assumed to capture, ^{the State} ~~the~~ was assumed to capture in that year \$412,000,000 in pipeline revenues. A then pessimistic case which assumed a pipeline cost of 2.5 billion showed a wellhead value of \$1.76 in the initial year of 1976 and royalties and taxes ^{value} of \$136 million in that year. In 1980, however, at a wellhead/ ^{value} of \$2.20 a barrel, royalties and severance taxes reached the figure of \$297,000,000. Incidentally, and obviously, in all these case, one of the main reasons wellhead value increases over the years is that transportation costs go down as the volume of oil/ ^{shipped} increases. Now several important events have come to light which have required the State to revise downward drastically its revenue estimates. The first indication of the fact that the State was incorrect in assuming as it did, in July, 1971, for its contribution to the Impact Statement, the first indication that the State was incorrect at that time in making ^{flow} a ^{description} ~~a~~ assumption that a production/starting at 600 barrels per day would reach 1.7 million barrels per day in the second year of production was disclosed in the summary projection of the transalaskan pipeline system received by the State this fall. On page 55 of ^{that} ~~the~~ document it is stated the pipeline will be brought to full capacity in ~~three~~ stages. In the initial phase of operation the system will have the ability to transport 600,000

barrels a day, and I'm paraphrasing page 55 of the summary impact statement. The reports goes on to state that the second phase is tentatively scheduled to be completed approximately 2 years after initial start-up. In this phase the report states the system will have the designed capacity of 1.2 million barrels per day. The final phase so says the report, is expected to be completed approximately seven years after initial start up, that is a pumpage flow at which time the pipeline will reach its ultimate capacity of 2.0 million barrels per day according to the description in the statement. In other words, ^{there} ~~it~~ will be, according to the statement, at least five hundred thousand barrels per day less production in the second year of operations and each year thereafter for the initial seven years. The next shock to the State was ~~xxx~~ disclosed by the S.E.C. Registration Statement filed by British Petroleum Company *Ltd.* submitted on October 12, 1971. In the offering circular accompanying that registration statement the following statement is made on 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 1.2 million barrels per day, and the second ^{total} a capacity of 2.0 million barrels per day. Parenthetically, no reference to the time of build-up. 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 million barrels per day would increase the cost by \$400,000,000. On November 10, 1971 Atlantic Richfield, together with the City Service Company, filed a registration statement with the Security and Exchange Commission stating that "the cost of the system upon completion ^{to} ~~of~~ 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 \$675,000,000. The additional costs to all participants of increasing the capacity to 2 million barrels per day is estimated to be at least \$400,000,000. Thus by mid-November, 1971, the total pipeline costs ^{had} ~~were~~ escalated to 2.8 billion, or \$500,000,000 over the average case assumed in July when the State made its revenue estimates. In fact, it increased \$100,000,000

in less than one month between two SEC filings by companies involved in the North Slope pipeline. 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 independently the likely magnitude of the pipeline costs. Commissioner Campbell has already indicated the independence study which the State has made through its consulting engineers, Tibbets, Evan, McCarthy and Stratton, and the foundation for the present estimate of 3.5 billion. These figures have been recently 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 revenue. And incidentally, in the hand-out of exhibits there is a breakdown in addition to the comparison of public and private ownership of the construction costs table which Mr. Campbell ~~referred~~ referred to yesterday. We will make additional copies of those available if they are in short supply, ^{if possible} ~~other~~ senators, representatives or members of the public desire to see them. The base case shown 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 Aleyska throughput assumption of full production only in the 7th 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 or the first year of operation, for 1977 we now show a negative well-head value or no state revenues. This was the year comparable to that in which it was earlier shown that the state would capture at least \$164,000,000 in total revenues consisting of royalties and severance fees. The fifth year, 1978, the second assumed year of operation we earlier estimated \$278,000,000 in State revenues. In these two years alone the net revenue loss to the State over earlier estimates amount to \$442,000,000. By the sixth year, or 1979, the new projection shows \$84.6 million ~~in~~ in oil severance and royalties revenues. Earlier we estimated \$282,000,000 for that year. The net loss by that year over earlier estimates is \$640,000,000. Not until the 15th year of pipeline operation do royalties and severance taxes amount to near the amount shown in ^{our} ~~the~~ previously made estimate before the second calculated year **AGO 530722**

In that 15th year we show severance and royalty revenues of \$277 million. Now the question ~~is~~ ^{it} has been asked, and not only has been asked, it has been asserted that this is the most pessimistic of all/cases ^{possible} which can be produced by the State for its revenue picture in the late 1970's and 1980's. I'd say that the answer to that is clearly no, for three reasons. In the first place the revenue loss figure mentioned above is no effect to our expectations now of first pipeline operation in the year 1977 whereas in July we assumed the full year of revenues ^{starting} on July 1, 1975. That is to say we show a \$640,000,000 loss comparing three years of operation regardless of start. In the second place we show state taxes in each year of operation of approximately \$33,000,000. For these first three years of operation ~~the~~ ^{state} income taxes are estimated to total approximately \$100,000,000 or 3 times the \$33,000,000 a year. This assumes full state ^{income tax} ~~impacts~~ on pipeline profits. Experts have indicated that this itself may not be ^a realistic assumption. Even, however, with the most optimistic income tax estimate, net revenue loss from earlier projections amounts to \$540,000,000 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. This was alluded to yesterday by Mr. Temple as the legalities of the possibilities were discussed by Attorney General Havelock. I can only say that the leading text on the ~~XXXXXX~~ subject which is 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 ^{to} on figures supplied by industry. And it's well known to the Committee and the public at large that the Cook Inlet pipeline valuation itself took nearly three years to complete. The 7% figure again is not high when it is remembered that there are seven separate proposed pipeline owners, each of whom may aggregate earnings of each of its other pipelines when the 7% rate is considered. We will hear further expert testimony on this later. The point here is that it is entirely possible that higher return rates ^{may} ~~will~~ be permitted at least until the valuation of the pipeline is complete and possibly there after when earnings of other pipeline companies are aggregated to arrive at a total rate of return for a particular pipeline company. The next case shown on the chart and to some, seeable on the wall, assumes the case

of the economic effect of State ownership of the pipeline. Financing is assumed in the amount of \$1 billion dollars in each of the first two years of construction at 8%. \$900,000,000 in the third year, ^{of construction} at 6.5%, \$215,000,000 at 8% in the first year of operation and \$310,000,000 in the second year of operation, and I may say that Mr. Eppenbach who will follow me will give you some more precise detail on the assumptions that went into the assumed case of public ownership I'm now discussing. This case also assumes the same ICC permitted rate of dividend payoff as assumed for the private case. ^{mainly} The 7% percent which is a cash ~~XXXXXX~~ ^{dividend} ~~limited~~ payout limitation in each year of the projection. In arriving at the State's net cash flow which is indicated at the top of the chart assuming public ownership, pipeline income, royalty and production payments, in arriving at the State's net cash flow operating expenses, amortization and interest on bonds, are deducted ~~XXXX~~ from gross income. During the first year of operation net cash flow to the state ^{there is} ~~tariff~~ is, as you can see from the chart, \$230,000,000 and royalty and severance taxes amount to \$15.7 million for a total of \$245,000,000 ~~XXXXX~~. Obviously, in State ownership no Federal or State income taxes are calculated ^{on} ~~in~~ pipeline income. Mr. Kades will speak to ^{this} ~~us~~ later today, explaining ~~XXXX~~ in detail the assumption legal rationale for that statement. In the fifth year from the beginning of construction, or the second year of operation, net cash flow is \$228,000,000 which together with royalty and severance taxes of \$17,000,000 produce a total ^{of} \$245,000,000 for the State. In the sixth year from the beginning of construction and the third year of operation, net cash flow amounts to \$227,000,000 through the tariff and total royalties and severance taxes amount ^{to} ~~XXXX~~ to \$123,000,000 for a total \$350,000,000 or for those who are farsighted, \$350.94 ^{million} as shown on the chart. In the 15th year cash flow is reduced to ^{\$183,000,000} ~~\$180,000,000~~ by reason of the fact that the pipeline has depreciated but total royalties and severance taxes amount to \$297,000,000 for a total to the State Treasury of \$480,000,000. Now let me emphasize that this case makes almost identical assumptions to the private case described before. It should be

emphasized that net income 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 private borrowing, we show all but \$900,000,000 in state bonds at the same 8% rate as shown in the private case. I think the 8% can be, we could spend the day arguing 8%, 7% or 9%, we all know the trend of interest rates in recent years, the fact that double AA corporate ~~XXX~~ bonds are selling today at about an interest rate level of 7.23 gives me comfort that 8% is as good an estimate of interest on both state and public borrowing and indeed conservative on state borrowing ^{as} ~~which~~ can be arrived at today. The main differences between the assumptions lie of course ^{in the fact,} as I have stated before, ~~is~~ that the State is not subject to Federal income tax and obviously will receive no State income taxes from the pipeline since ^{it} ~~XXX~~ is assumed to be the owner. The timing of the bond issues for both the public and the private cases is the same, although the term of the public bond issue is ^{shorter} ~~shorter~~ 25 years, indicating heavier debt service loads and the state of course is assumed to finance the pipeline 100% ~~and~~ on a step basis. Now we ~~can~~ ^{could} make numerous additional assumptions, and we have made additional assumptions, ^{on} the question of the matter of public financing, the manner of private of private financing, the assumed debt equity ratio of private financing, the rate of return permitted either to the State or to private pipeline owners, interest rates payable by the State and private pipeline owners, the effective tax rate in private ownership, to mention only a few. We know and the Committee knows, and I believe ~~that~~ each Senator and Representative in this room knows, that estimating the effect of a project of this size and magnitude based on events three to seven years away, must rest on ~~an~~ assumptions which are to a degree speculative and you will hear testimony that our assumptions are probably incorrect. The point is that no one can say with absolute certainty what our revenue picture will be with the pipeline in private ownership. We have now, ^{prior} however, tested ~~XXXX~~ assumptions based on new and in two instances, official information before us. I refer to the Aleyeska Impact Statement and the more recent SEC

filings of ~~the~~ two of the member companies. This effort and this information has convinced the administration that it must attempt to do now what it can to remove the uncertainty of the revenue picture in the late 1970's and the late 1980's and this attempt to remove the speculation and to give the State the tool to move forward in this regard is the thrust of the bills that are here before ~~you~~ you today. The details of the bills, the theory and rationality ~~XXXXXXXXXX~~ will ~~be~~ addressed by other members to come before you, but I see it in the context of State's effort to remove the degree of speculation about which we are in when the pipeline ^{starts} ~~is~~ to flow and when State revenue's can, to some degree begin to be hoped for.

Mr. Larry Eppenbach, L. E. Eppenbach, will explain to you now how our projections were made ⁱⁿ ~~and~~ some additional details, and some of the detail on the chart before you.

Thank you.

Thank you Commissioner.

Mr. Havelock. A little comments, perhaps, about now to explain the methodology used in discussing with Commissioner Wohlforth, Mr. Chairman, he acknowledged recognition that there is considerable complexity to the testimony as presented by himself and Mr. Eppenbach and if the Chairman wishes that...so that details are not lost in the minds of those

END TAP 6

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Date of meeting: March 7, 1972

MR. EPPENBACH: Mr. Chairman, Committee Members: In testimony already presented, you have heard a great deal about revenues, talks of pipelines, calculations of royalties and production 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 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 ^{called} the most important piece of information thus far--that is, the new estimates of total annual income from the North Slope. As has already been indicated, we employed a computer model which simulated each year the economic operation of the pipeline, the various 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 these expressions, from that of any other income statement. Gross revenues to the pipeline are derived from its tariff charge in barrels of oil transported through the line. That gross revenue less the cost of operating and maintaining the line less depreciation less interest cost of financing the line will produce the net income figure. From that we deducted any Federal or State income taxes paid to calculate a net-after-taxes income. Similarly, the cash flows to a pipeline company is much like that of any other business, is equal to 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 volume of bond retirements made by the company. The only place the 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. Again, as was discussed yesterday and this morning, that dividend is not some percentage of equity or some rate of return on capital investment,

but 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 very general terms, during the first year of operation we calculated ICC valuation to be about \$3.25 billion. In the following years it decreased and increases slightly as additional phases of operation were under way providing for a higher throughput and eventually decreased in value as the line began to depreciated.

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 on the pipeline 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 per cent dividend limitation provides for a dividend to the parent company of over \$230 million, a legal dividend provided only to the owner or owners of the pipeline.

If I may turn your attention now to the large chart located up there, which is also the first chart on the Committee Members' chart portfolio here, it is that very dividend that accounts for the vast difference in estimated income to the State of Alaska under conditions of public ownership on the top line, shown in red on the large chart, 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 Two, 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 taxes. You will note that there are no State income taxes included here as a revenue source to the State under conditions of public ownership of the line.

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? Three million two hundred thousand dollars 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 per cent 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 those first two years, the dividend payments must be no greater than 4.75 per cent, and even if the dividend was lowered to zero during those two years, the State's income of approximately \$53 million under those conditions would be, of course, 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 per cent 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 from 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.

That finishes my testimony. I believe now questions are in order.

CHAIRMAN: We'll take questions from the Committee, Senate group, Senate Commerce Committee; Senator ^{Groth} Groth?

SENATOR ^{Groth} GROTH: At one time when the legislative oil consultant testified before the Legislature he indicated that it would be possible that the oil companies may hasten the date on which the 2-million-barrels-per-day capacity goes into the line. Assumptions here, as I understand you, are based on the premise that ^{the capacity} 2 million barrels per day will not be achieved for a period of seven years. My question is: Have you inquired of the companies as to whether they intend to hasten that throughput arrangement to sometime earlier than seven years?

WOHLFORTH: We plan to answer that, Senator ^{Groth} Groth. The official document which came to the State is dated August 1971, and received and analyzed about in the September-October time frame. We made reference as recently as Friday directly to the main Impact Statement itself to determine where that seven-year throughput date was ^{the date} in the official Impact Statement. Commissioner Brewer called the several officials in Washington who could make that determination, and he has assured us that that is the figure that's there. I feel it's a figure we have to live with, and we may hear testimony from oil companies later that indeed that is not the correct assumption, but I really think that's a matter for them to ^{reach} ~~see~~ to and perhaps Mr. Sparr, himself, whom I understand is the lead-off and direct witness.

GROTH: Eric, I understand that if you've looked at the Statement, but insofar

as a direct inquiry then, gentlemen, do you intend to do this sooner than seven years? That discussion, I gather, has not taken place.

WOHLFORTH: We've had discussions. I, personally, have not discussed it with any oil company official. Others have, may have, discussed it. I do not know what their direct answers may have been to that statement.

GROTH: Thank you.

CHAIRMAN: Thank you. Are you through? Senator Christiansen. Please stand up and speak up as loud as you can, please, so they can hear in the back.

CHRISTIENSEN: Mr. Chairman, yesterday just before we left I asked a question and I believe Mr. Havelock said that I would be answered later on. As a matter of fact I think you answered part of it when I asked the question came out where this bond, in case it didn't pass, then what would happen? Would we still have the pipeline or what would we do?

HAVELOCK: I think I indicated, Senator, that we are not now proposing that a bond issue be proposed to the people, but we do have a constitutional amendment to propose that will allow State guarantee. That question would be an academic one. There is always the question of whether the people or the Legislature of the State of Alaska wants to do something, and if the Legislature does not wish to do something, then ~~something~~^{nothing} will happen. The wishes of the people, the wishes of the Legislature are binding on the State.

CHAIRMAN: Are there any other questions? Senator Meland? Members of the, Senator Holm.

HOLM: Perhaps you can tell me why you only made it a ten-year projection or an eleven-year projection on this chart. What happens if project it to maybe 20 years?

EPPENBACH: For reasons of room and also time here, and having our ^{computer} results transmitted from Massachusetts to here in Alaska, we confined the analysis to specific years--first five years and then the eighth, tenth, and fifteenth year of operation. We have the ability to make a longer term estimate. We have analyzed ten years of operation with fifteen years of time periods overall. A more direct answer to your question--~~we tried to~~ ^{in the end} establish in a graph to about 1988 within stock since you would be in Phase Three Operation at that point. They would tend to level off a bit. There may be some marginal increases but on the whole we would expect the effects of inflation to just about equal both in costs and in higher refining prices of oil.

HOLM: So then you expect the next ten years the distance would level--would start to narrow.

EPPENBACH: That's right. The capacity of the pipeline, as we understand it now, will not be increased ^{during these} in another ten years. It would take an increase in capacity to have those charts continue to move up right off the paper.

HOLM: Then one further question. If I were the Alyeska Pipeline Company and knew I wasn't going to get any additional profit from ownership and operation of the pipeline, I doubt if I'd contract with you to build at the same price that I would build if I were building for my own use. Now, are you assuming that they will build at the same price for you as they would build for themselves?

WOHLFORTH: Well, I think we try to achieve comparability in the suit cases. I indicated in my testimony (I hope I sufficiently indicated) that we had now achieved something which we felt was a great deal firmer in concept than we had certainly last July. To achieve comparability in the one case versus the other the \$3.5 billion total landed cost of the figure was assumed. It may be, indeed, that that is not the ultimate price. It may be, indeed, that some of the \$3.5 billion cost is not an allocable, ascertainable cost of the State or some slight

amount may be more, but as a gross, and I should say perform an economic projection, we thought it would do the Committee a service to stay with the basic landed at stall cost figures.

HOLM: I also assume that you have not considered any other contractor for the construction of this pipeline because they are already the owners of all this pipe and a lot of construction so far.

WOHLFORTH: Mr. Campbell is far better--is he here this morning?

CHAIRMAN: Yes, he's here.

WOHLFORTH: Far better to speak to the composites of the \$3.5 million (\$3.5 billion --I guess I'll do that every five minutes for the next couple of days) which are set forth in the chart which is here before you and indeed there is a figure here which shows costs to date before start of construction and makes component references to costs thereafter. I defer anything further on that to Commissioner Henri.

? With your permission, may I comment first?

HOLM: I just wanted to assume (1) that Alyeska is the only party that you considered as being the contractor for this, and that they then will probably build in a little bit extra ~~cost~~ to the pipeline because they are almost a captive contractor.

HAVELOCK: First of all, Mr. Holm, the State ownership of the pipeline does not mean that there is no interest or profit available to the industry. Their interests and our interests basically identical in one respect--that we all expect to enjoy a substantial benefit to getting that pipe, that oil underground, and moving it to market, and the fact that the incidence of their benefit shifts from the profits obtained from the pipeline to other aspects of the chain of commerce

doesn't seem to me reduces their incentive. As to the particular incentives in operation, if the pipeline is owned by the State of Alaska and they are a contractor to build that pipeline, they have a particular incentive to operate with maximum efficiency in that construction because under the ICC rule the contractual costs will become the valuation base which we will in turn charge back to the shipping companies for the cost of transportation. So they would then have an incentive which in fact does not exist now to keep costs down. Thirdly, you touch upon a question, or applied in a question which I believe Senator ^{Cross} Groth commented on yesterday or addressed you yesterday, which is: What if the pipeline owner/company just don't cooperate? And I think there are three responses to that. First of all, the first response that comes to my mind is: What if the sovereign State of Alaska doesn't cooperate? This is not exactly a situation where the State is without bargaining position. Not only do we have bargaining position, but we also have a substantial interest. This is a situation where the private interest involved vastly exceeds the interests of the public of the State of Alaska.

I may say that in our discussions with the industry we have given some consideration to alternative contractors, but in our discussions have mainly assumed with the industry that in the event that public ownership was deemed to be in the public interest that in fact they would be willing and agreeable to contract. Once they get by the hurdle of public ownership in the first place, as a question of State public policy, I don't believe that we would expect their non-cooperation. There has been no sign in the hundreds of man hours we had in talking with various representatives of the industry that they that they in any ultimate sense, that ^{the industry} they would refuse to cooperate. They approach our negotiations with the most--we have had occasional confrontations--type of meetings where tempers where tempers have got up, which is expectable under the circumstances, but they have approached it by and large as a gentleman and

responsible businessman. I have not heard anybody speak in the terms used as to noncooperation. Which reminds me of Commodore Vanderbilt's famous line: "The public be damned--ain't it my railroad?" Nobody has said to us: "The public of Alaska be damned--ain't it our pipeline?" So in the discussions we had, rather than and the people of the State of Alaska, our discussions have pretty well worked themselves out based upon feasibility and the desirability from the point of view of the public policy of the State, and the extent of the commitment or sacrifice that we might be calling upon the industry to make in adjusting these new arrangements. And it is not only a question of sacrifice, of course, but of benefit to the industry. We have not asked them to give up, without compensatory advantages, which we can see for the industry in these arrangements.

The last point I might make on it is that we aren't really going to find out where we are until we have the tools, that is, the permissive legislation which would enable us to go forward and talk with them and move into the next stage of negotiation with the industry based upon an authority bill that the Legislature might adopt. I think it is first for the Legislature of the State of Alaska to decide whether it is the public policy of the State, or should be the public policy of the State, to have public ownership of the line and then to ask questions as to what the attitude of the industry is and whether they are willing to go along rather than the other way around.

Sorry to have talked at such length, but that does meet some of your points.

CHAIRMAN: Are there any other questions on State affairs? Senator Christiansen.

CHRISTIANSEN: Mr. Chairman, I hate to keep asking this question, but talking about \$3.5 billion, and if we don't bond out^{we}self, where are we going to get that \$3.5 billion to build the pipeline? Then if we do build it, are we going to use

this first revenue to pay it back, or?

WOHLFORTH: I may just point out that the pipeline income here is shown under public ownership. This income is after debt service, Senator. Debt service is off before you get to this, that's been calculated. On the assumptions we've made so far, the debt service is shown as a deduction from gross income and this is net income, and I think that may answer a tiny portion of your question. It is assumed that the money would be borrowed in all events.

CHAIRMAN: The next three witnesses will be addressing themselves to the question you raised as to the market situation. Senator Young.

YOUNG: Will we be allowed to call any of these witnesses back again?

CHAIRMAN: That's the plan. The reason we're departing from the regular procedure is that because this witness will probably not be available at that time. Address questions to the administrative or administration officers. Mr. Rose.

ROSE: Only one question, Mr. Chairman. That's on the difficulty on our payment during the initial payment period. First revenue starts going in. Now, I assume that the bonds require a yearly net interest payment, and how would that be met?

WOHLFORTH: Again, we'll address more specifically the ^{technical} bond issue by Mr. Kades. As with other public authority issues, interest is borrowed or capitalized during the construction period.

CHAIRMAN: Any other ^{to them} questions, members of the State Affairs Committee? Senator Rettig.

RETTIG: Question to Mr. Wohlforth. You referred to the first table in the ^{table} income from the pipeline under "Private and State Ownership." In the year 1988 you called our attention to the sharp drop in pipeline income from \$235 million

in 1983 to \$183 million in 1988, and I believe you attributed that to the impact of depreciation that had then taken place. Recalling Mr. Temple's testimony of yesterday, it indicated that pipeline valuation, which is the base ICC permitted profit, you stated, I believe that this valuation was based on replacement costs. Well, what effect would this depreciation have then, if that be the case?

WOHLFORTH: First, let me say, Mr. Chairman, I'm going to turn this over to Mr. Eppenbach who will have the full text of Mr. Temple's testimony before you hopefully within an hour or so, and you take it away on that basis, Larry.

EPPENBACH: Senator, replacement cost is clearly a function of replacement from original cost. The higher the value of the line, then, the larger the dividend, assuming a constant rate of dividend, whether it be 5.5 or 7 per cent, or higher. Now, ^{Palmer}Herbert Temple did testify that replacement cost was a significant component of the ICC valuation formula. In developing this model to simulate what ICC valuations would be in any particular year, we did include a percentage inflation factor to estimate replacement costs. We found, however, that the formula was quite complex, and in later years it was also ~~component~~ of the formula, we'll call that depreciation, so that the net effect was yes, inflation was there ~~it was building~~ up the value of the pipeline for a period of time, but then eventually using the ICC's own table for depreciation. The value of the pipeline fell off. Now, I can't tell you more than that right now other to say what we did--what will happen--how the ICC will value the pipeline. As far as I'm concerned, it is a matter of great uncertainty right now. Thank you.

RETTIG: That's all I have.

CHAIRMAN: Are there any questions now from other members of either the House or the Senate? Senator Palmer.

PALMER: Yes, Mr. Chairman. Perhaps this information has already been given

and, if so, please forgive me, but I do have four questions--they are all related. We will all hope, of course, that there will be many more structures found on the North Slope that will use the pipeline. On the other hand, we have to assume that there may not be. Therefore, what figures do you ^{have} for ^{Prudhoe} First of all for total Bay Reservoirs and then the amounts recoverable? We did think of that yesterday, I think, but I would like to know what figures you used.

WOHLFORTH: Really, Mr. Herbert is the expert witness on this subject. We know, Senator Palmer, that 9.4, which is the de ^{Gaulle} Gaulle, or 9.6 billion, which is the de ^{Gaulle} Gaulle-McNaughton proven reserve estimate, has been variously assumed to have been increased to \$14 billion, and in a Canadian magazine referred to as 50 billion in the total field and adjoining field. The figures that we used, very frankly, showed enough oil to flow for 25 years to amortize at the rates of, amortize a \$3.5 billion bond issue.

PALMER: Do you have that figure?

EPPENBACH: No sir. We made that assumption that given the ^{9.6 billion barrels} 9.6 billion barrels proven today that there would be additional ^{reserves} (cough) by the time ^{after the fact or} (cough) the last bond issue was issued to support a 25 year debt. They contrasted that on private financing, that is, ownership of the line by private industry. We calculated 30-year debt, assuming they would also ^{budget} their credit ^{on} their bonds.

PALMER: ^{Will you agree} You are basing the debt service on the assumption that there will be a reserve found? The pipeline will be utilizing those reserves in addition to the Prudhoe reserve?

WOHLFORTH: That's correct.

CHAIRMAN: That concludes my group of questions.

CHAIRMAN: Are there any further questions? Senator Rettig.

RETTIG: Just one item of clarification to Mr. Havelock. Perhaps in your

in reference to your comments that the State does have a certain amount of bargaining power because its, oh

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

TAPE # 8

Senator Rettig: The oil that we are speaking about, have we not already sold the 7/8th interest in that oil and is not that now ^{the} a right to the 7/8ths of the oil invested in the oil companies, doesn't this perhaps give them some sort of a weighted vote in these matters:

Havelock: Well I think that certainly in our discussions Senator, we have attempted to weigh and recognize the private rights that are involved, and I don't mean by any means to suggest that the private rights of the industry should not be given all the considerations appropriate. While the oil is in the ground, my understanding is that it is the oil of the people of Alaska and if the leases are not exploited it will revert to the people of Alaska, but certainly you are quite correct that 7/8ths that one, as the oil comes out of the ground, it's theirs and it is entitled to be given recognition as we recognize any body else's right to private property in the State.

Senator Rettig: Are there any other questions now? (Ten minute break)

The State of Alaska would like to call the Honorable Joseph Henri, Commissioner of Administration who will testify as to the impact of State revenues on the State budget and related issues. I ^{may} state as Mr. Henri has found, that in discussion with him he has indicated that he would like to have the opportunity to get full presentation before the committee in advance and that ~~if~~ he has no objections to questions relating to his testimony when he concludes his remarks. I would like further to say with regards to, I said the later witnesses would be answering Senator Christianson's questions, I was really referring to Mr Kades, Mr. Gilderhouse, and Mr. Macy who are the witnesses that follow Commissioner Henri.

Joseph Henri: Written Testimony

TESTIMONY OF JOSEPH R. HENRI
Commissioner of Administration, State of Alaska,
Before the Senate Commerce Committee
And the House State Affairs Committee
At Juneau, Alaska, 6 March 1972,
Regarding Income From North Slope Oil and Gas,
And How it Affects the State Budget

Mr. Chairman and Members:

I am Joseph Henri, Commissioner of Administration. This part of the State's presentation deals with budget expenditures vis-a-vis income to be derived from North Slope oil and gas extraction. The essential questions are:

1. Will we be able to maintain our current level of services, adjusted for population growth and inflation?
2. Will we be able to increase our level of service to meet compelling needs recognized by this administration, the legislature and the citizens of Alaska?
3. Will we have to reduce our level of service, and if so, what are the activities affected?

The answers to these questions rest in the amount of dollars the State can expect as its share of the Prudhoe Bay oil basin. Once upon a time, the Department of Administration felt much more certain about future State income than it does today. When will the

pipeline begin? What extraordinary man-caused interruptions will delay its completion? What will be the first year capacity of the line? The second year? The third? What is the maximum extraction rate the basin structure will prudently allow? What volumes of oil can be expected in any of the first seven years of the pipeline? What will be its final cost?

All of these variable factors, well known to each of us in this room, make budget planning extremely difficult, because the major part of Alaska's State revenue has come and will come from the North Slope resources. In the budget now pending before the legislature, we have recommended a total general fund expenditure of \$311.7 million; ^{these are state dollars} of this sum, \$97 million will have to come directly from the Prudhoe Bay bonus money, the principal, and \$52 million more from interest earnings on the investment. As we dip heavily into the corpus - invade the principal - interest earnings diminish, compounding the revenue problem. Our present or anticipated recurring revenues are simply too low to fund our present and anticipated expenditures. We are depleting our savings account. As the following year's budget figure increases, more of the principal will have to be spent; the interest yield will dwindle further. Obviously, we will soon hit the bottom of the barrel. Only large and new revenues from the North Slope can allow us to continue our present budget growth rates.

What is the growth rate we have recommended for Fiscal Year 1973? For the general fund, it is 3.5%; for the total budget, 4.6%. We have had to slash so dramatically the rate of increase because pipeline delays and cost escalations have darkly influenced

our future revenue projections. With ~~such~~ a small increase in the budget, a number of programs have already felt the chill winds of dollar scarcity. The proposed Fiscal Year 1973 budget contains such unpalatable things as holding school foundation funding to the current year's level, regardless of enlarged student population; keeping the University's ^{of Alaska} increase to \$800,000 in the face of a claimed need for an addition of over \$5 million just to maintain current activities; a limitation of nursing home care and general medical relief; foregoing general obligation bonds for lengthening two more ferry boats, and for a larger program of airport construction. There are many more "pinches" in the budget, besides ^{those I have mentioned.} Nonetheless, so far we have not jeopardized any State activity essential to health and safety. These painful adjustments herein noted were recommended in spite of the fact oil was projected on stream in July 1976; now another year's delay - or more - seems probable. The consequences are obvious.

Our budget book for Fiscal Year 1973 projects a growth rate of 6% compounded annually through 1976, and 8% thereafter through Fiscal Year 1981, ¹⁹⁷⁷ covering a ten-year period. Further, it envisions capital improvement bond authorizations of \$60 million in 1974, and \$100 million in the next biennial election, and each one thereafter. I can only characterize these projected budgets as "modest." They are very little more than maintenance figures. Program dollars will still be limited. Careful budgeting and allocation will still be required. New starts and new programs will be exceedingly selective. The 6 and 8% growth rates ^{now or hereafter} most likely mean a shortage of funding for the school foundation plan, and for the revenue sharing program with local governments. Yet, I express to you, ^{to you} the gravest concern that actual receipts in the State treasury during the next ten years may be pitifully shy of the sums needed even to maintain our austerity.

Previously, in the testimony of Commissioner Wohlforth and the Department of Revenue, test cases have been articulated regarding revenue to be derived under (A) private ownership and (B) State ownership of the crude oil pipeline. All of us realize that a multitude of variations in revenues and expenditures are possible under each heading, that is under private ownership ^{of} ~~public~~ ~~ownership~~ ownership. Nevertheless, for purposes of comparison we have presented two likely cases and their dollar results: Both examples entail the seven-year oil volume build up delineated in the Department of the Interior Environmental Impact Statement submission by Alyeska, a 7% dividend to the owner, a line cost of \$3.5 billion, and oil on stream in July 1977.

Exhibits A and B, attached at the conclusion of these remarks, portray the figures - and the story - for the decade 1972 - 1982.

We might ~~a~~ just pause, Mr. Chairman, and refer the committee to those for a second if I may. Exhibit A is the computer run on private ownership, and you can see the assumptions that go into these calculations, the debt service for each year on these bonds, the growth rates of the budget for each year, and so forth. Then Exhibit B, are the same assumptions, identical assumptions based on private ownership. I beg your pardon, Mr. Chairman, Exhibit A is the private ownership and Exhibit B is the public ownership. As you can see the bottom column of the right hand side in exhibit A that is the general fund at the end of the fiscal year 1982, has a deficit of \$1,135,000,000 under the private ownership case, whereas in exhibit B, the general fund in the lower right hand column at the same year at the ~~end~~ end of fiscal 1982, has a surplus in it of \$450,000,000. Those runs of course need to be carefully studied and I shan't take up your time this morning with them.

Under the private ownership case, Exhibit A, were Alaska to continue to increase its budget expenditures at the 6 and 8% rates, mentioned earlier, the first year of

deficit would be Fiscal Year 1978, wherein we would experience a shortfall of over \$156 million. This shortage would increase so that by Fiscal Year 1982 the deficit would be \$1,135,000,000. Of course, deficits for operating expenditures are in fact impossible under our State constitution; instead of experiencing a billion dollar deficit ten years from now, we would in actuality have to reduce State expenditures radically.

Under the private ownership case the State could have in its treasury at the end of Fiscal Year 1982 the sum of \$45 million if, and only if, its operating expenditures in every year of the planning decade rose annually by only 1%. Now an increase of 1% equals in fact a huge cut in all programs, and the elimination of many. And what the figures look like in that case are portrayed in Exhibit C which is the computer run showing budget increases of 1% annually over that period. And, the assumptions there are the same, the assumptions as of the first two exhibits; when the line will start and through what volume and so forth.

The dollar crunch is graphically portrayed by the following paradigm. Under the private ownership operating budget column, increasing annually at 1%, the available dollars, are, recorded. And there, Mr. Chairman, if I may direct the committee's attention to the following page of my testimony, page 6, to the paradigm which is also available, I thought they were in big figures, they are when you try to see them on the wall over Mr. Weiner's head. In the charts called "Comparison of Funds Available, Private vs Public Ownership, and I might say all these figures are in thousands so that actually the figures on the paradigm are in millions of dollars. It addresses itself only to our operating budget. Now this year for a base of reference in our budget book is \$276 million. This figure is referenced in my testimony under fiscal year 1973. So getting into the 1974 budget, which is the one the legislature will be considering just next year, you already begin to see a difference in available dollars under public and private ownership, whereas under public ownership in 1974 we would have available to spend approximately \$293

million, under the private ownership plan there would only be available \$279 million. And so forth on up where you get into very dramatic areas. Let's compare, for instance, fiscal year 1978 which isn't too many years away, under State ownership of the pipeline in the example we furnished you here, the state would have to spend on operations, that's not the total budget, just the operating portion, \$384 million whereas under private ownership the state would have to spend in the same ^{YEAR} for operations, \$290 million. Almost \$100 million difference in that year. And as we say at the end of the column of figures the difference ^{the difference} over the planning decade, in operating expenditure ^{OPERATING DOLLARS} the State would have available to it ^{IS} ~~would be~~ \$925 million. The difference in debt authorizations, that is ^{CAPITAL} capital improvements, ^{the number of buildings and other improvements} what the legislature and the people would authorize, ^{what we could afford} is a difference of \$365 million, ^{WORTH OF BUILDINGS FOR} ~~that~~ ^{TANT}

Returning, then, to my testimony, Mr. Chairman at the top of page 5.

^{if the private ownership budget column could be}
~~The~~ Contrast ¹ these with the operating budget under public ownership, ~~the first~~ column on the left. The ~~figure~~ shows that if the State of Alaska owned the pipeline there would be sufficient dollars in each of the next ten years to meet our planned 6 and 8% annual increases. In fact, the revenue would be sufficient to raise the budget from these maintenance or austerity levels so that expansion of present services and the addition of new ones could be handily realized. Were the oil line privately owned the State would have almost a billion less dollars to spend over the next ten years. ^{and} We would be able to authorize 365 million fewer dollars for capital improvements.

^{THATS}
 I might say, Mr. Chairman that the 6% and 8% increase in the budget ~~which is~~ portrayed in our budget books ^{SUBMITTED} presented to you in January, ^{by the GOVERNOR} those increases were projected on the State Revenue Projections figures which Commissioner Wohlforth and Mr. Eppenbach ^{to the COMMITTEE EARLIER} discussed in great detail ¹ this morning. Now the projections are not valid because the revenues will not materialize at the dollar amounts portrayed to you in the revenue book. Going on to page 7.

*You might just
truly look at these
Mrs. Chairman.*

The attached graphs, Exhibits D and E, portray what I have been saying. Exhibit D is on the front of the room ^{behind the} and ^{SO-CHAIRMAN-behind MRS. BRICSON} it shows in graphic form what we have just testified to, that if the budget went up at the 6 and 8% rates under the private ownership example here, the general fund would be depleted, completely depleted in January of 1978, in the middle of fiscal year 1977, that is the blue line on the left of the chart. Whereas under public ownership, State ownership of the pipeline, the State general fund would dip to a low of \$231 million in the fiscal year 1976 and go up at the end of the decade we're speaking of, 1982, to about \$450 million in the Treasury. That's exhibit D, Exhibit E is the graph portrayal of Exhibits B and C. In other words Exhibit B is the public ownership case raising the budget at 6 and 8% and Exhibit C is the private ownership case, you might say the subsistence case, whereby the State budget would go up 1% annually. And if the State budget were to go up only 1% annually under the factors given in our private ownership example here the State treasury would have \$45 million dollars ^{in 1982} by 1982. But as I say, all of the programs we have believed in would have been decimated thoroughly.

In Exhibit D, under private ownership of the oil pipeline, the general fund would be depleted around January of 1978. On the contrary, under State ownership of the line, the precipitate dive to insolvency would stop in 1976 at a general fund balance of \$231 million, and rise to a plateau of \$450 million in the general fund by 1982. Furthermore, as Exhibit B shows, the total expenditure for that year would be approximately \$605 million, and the total revenue \$602 million; a parity between income and expenditure would have been achieved, and a surplus of almost half a billion dollars enjoyed. In actuality, no doubt, were the funds from State ownership available, the administration and the legislature would have expanded the budget faster than the 8% increase portrayed for the years 1977 and beyond so that no such surplus would likely exist at the end of fiscal year 1982.

The private ownership case I have presented to the Committees, Mrs. Chairman,

necessitates an abrupt and drastic reduction in State services and activities. I cannot tell you with certainty where the administration or the legislature would cut, but I can cite a few startling and likely areas of impingement in each of our program categories:

The State pays approximately 90% of local ~~sk~~ school district costs, constituting roughly 30% of annual State dollar expenditures. That State aid would be materially reduced; it would be impossible for the local areas to maintain present educational standards through increased property taxes. State Operated Schools and the University of Alaska would have to radically abate their present service levels.

The welfare or social services activities of the State would experience vast curtailment in the number of ⁵¹²eligible cases and the amount of benefit dollars; many people would be compelled to leave Alaska; distress or even starvation would haunt many who decided to stay. Public health and mental health retrenchments could force the closing of the Alaska Psychiatric Institute, and a diminution or abolishment of the State's work in drug abuse, alcoholism, tuberculosis testing and venereal disease control. The necessitated nullifications of State expenditure in these areas will in turn lose large amounts of federal dollars now enjoyed. Our ability to operate and maintain an effective Pioneers' Homes program will be materially impaired.

No new fish hatcheries would be built. No hunter safety program would be initiated. Salmon yields in Southeast Alaska would remain significantly below maximum sustained yield. Land use planning and the inventorying of our natural wealth would be jeopardized, thus making management of the State's surface and subsurface resources haphazard at best. Added park and recreational sites would be forgotten, and the maintenance of existing facilities lessened. Many Alaska communities would remain without sewage treatment facilities. Programs for coastal zone management, environmental engineering, permafrost and soils engineering would likely be abolished.

In the category of Public Protection, disaster planning, the Public Utilities Commission, the Alaska Transportation Commission, and most consumer protection programs would be impaired or fatally weakened.

The State police would experience a great shrinkage in manpower, and the courts and their ancillary agencies could not cope with their workloads.

Tourist promotion would have to be seriously curtailed and our work in research, in community improvements and grant assistance, and conventions and trade shows would most likely fall by the board. The work of the agricultural loan fund and the small grain incentive program would be enfeebled or eliminated. The Division of Planning and Research and the State Economic Opportunity Office would be crippled or possibly dropped.

Our program of revenue sharing with the local governments, around \$7 million in the current year, would no doubt go out the window. The Marine Transportation System for Southwest Alaska would likely be eliminated, and service in Southeast materially contracted. Airport maintenance in rural Alaska would be severely curtailed, likely forcing the winter closure of those ports, thus isolating a large part of Alaska for five months of the year, denying medical and other critical services. Likewise, winter maintenance of many of our highways would be only a pale reflection of the excellent job being performed today.

The various boards and commissions whereby Alaskan citizens take a direct and active part in the work of the State government would be minimally funded, or in some cases, unfunded. I am speaking of activities like the Western Interstate Conference on Higher Education, the Athletic Commission, the Status of Women Commission, the International Development Commission, the Pioneers' Advisory Board, the Yukon-Taiya Commission, the Rural Affairs Commission, the International North Pacific Fisheries

Commission. Our Youth in Government program, recently instituted with such great success, would likely be abandoned.

I might say, Mr. Chairman, that I notice a certain aura of disbelief when I recite these cuts here, but I can tell you from my own experience as chairman of the budget review committee, that each one of these representations I have made, is made with a lot of insight and forethought, and I am absolutely confident that if the revenues materialize as projected under the private ownership case, very many of the exact programs I have mentioned will have to be severely cut or even abolished. There is no other way to do it, our State does not have the ability to, as you know, _____ with huge annual deficits. We have to make our budget balance. I do not represent to you as the view of this administration, that each of these reductions suggested above, would come to pass under the private ownership case, where trade in Exhibits A and C. Nevertheless, no one can say that many of the above dire consequences would not eventuate under that case. Undoubtedly some would. The ~~an~~ economic and social dislocation would be grievous indeed.

The purpose of my remarks is that this State has a vital interest in an adequate share of North Slope riches. If we do not realize that share, State expenditures over the next decade will be woefully inadequate to do the job Alaskans expect from their government. The solution we propose to sufficiently fund the budget is the ownership of the crude oil pipeline by the State of Alaska.

I thank you for your attention.

mc 1/4 E

Groh: May we have questions now from the members of the Senate.

COMPARISON OF FUNDS AVAILABLE

PRIVATE VS PUBLIC OWNERSHIP

(ALL FIGURES IN 1000)

FISCAL YEAR	PUBLIC OWNERSHIP		PRIVATE OWNERSHIP	
	OPERATING BUDGET *	DEBT AUTHORIZED	OPERATING BUDGET *	DEBT AUTHORIZED
1972	260186.5	71000.0	260186.5	71000.0
1973	276232.7		276232.7	
1974	292910.7	60000.0	278994.8	15000.0
1975	310485.1		281784.3	
1976	329114.1	100000.0	284601.8	20000.0
1977	355443.1		287447.4	
1978	383878.5	100000.0	290321.5	20000.0
1979	414588.8		293224.3	
1980	447755.8	100000.0	296156.1	20000.0
1981	483576.2		299117.3	
1982	<u>522262.2</u>	<u>100000.0</u>	<u>302103.1</u>	<u>20000.0</u>
TOTAL	<u>4075433.7</u>	<u>531000.0</u>	<u>3150174.8</u>	<u>166000.0</u>

* All figures refer to expenditure from general fund only

Difference in Operating Expenditure is over \$925,000,000

Difference in Capital Debt Authorization = \$365,000,000

Exhibit A

STATE OF ALASKA DIVISION OF BUDGET AND MANAGEMENT

BUDGET PLANNING MODEL

RUN 10 RUN 3
DATE MARCH 3, 1972
COMMENTS

PRIVATE OWNERSHIP
7% TARIFF
BASE CASE
OIL IN 77

Private

ASSUMPTIONS

ANNUAL RATE OF INTEREST ON GENERAL FUND = 6.00%
ANNUAL RATE OF INTEREST ON NEW BONDS = 6.00%
MATURITY PERIOD ON NEW BONDS IN YEARS = 20.
% ABOVE G.F. UNENCUMBERED BAL. UNEXPENDED = 0.0 %

GROWTH RATES FOR OPERATING EXPENDITURE FROM PRIOR YEAR

1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
6.21	6.00	6.00	6.00	8.00	8.00	8.00	8.00	8.00	8.00

NEW BOND AUTHORIZATIONS IN EACH YEAR

1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
71000.0	0.0	60000.0	0.0	100000.0	0.0	100000.0	0.0	100000.0	0.0

FISCAL YEAR	NON INVESTMENT REVENUE	INVESTMENT INTEREST	TOTAL REVENUE	OPERATING EXPENDITURE	DEBT SERVICE	MISC EXP SHD TAXES GF CAP EX	TOTAL EXPENDITURE	SURPLUS OR DEFICIT	GENERAL FUND END OF YEAR
1972									761266.2
1973	162264.1	42456.7	204730.7	276331.0	24020.8	11358.6	311710.3	-106979.6	654288.4
1974	182367.0	35772.1	218139.0	292910.7	29646.2	11756.5	334313.4	-116174.4	538114.0
1975	190047.0	28146.4	218193.4	310485.1	329731.5	17749.8	356208.4	-138015.0	400099.0
1976	136752.0	18960.8	207712.8	329114.1	33479.2	13200.6	375843.8	-168171.1	231927.9
1977	229569.0	8673.9	229242.8	355443.1	35373.3	13153.0	403969.4	-174726.6	57201.4
1978	225954.9	-2938.6	222966.3	383878.5	39390.5	13719.0	436938.0	-214021.8	-156320.4
1979	314776.0	-14823.9	299952.1	414583.8	42474.9	23358.3	480441.8	-180469.8	-337310.1
1980	329299.9	-26743.6	302556.3	447755.8	46529.0	25105.1	519389.9	-216833.6	-554143.8
1981	332012.4	-41200.4	290811.9	483576.2	47129.4	25167.5	555873.0	-265061.1	-819264.8
82	344154.7	-59641.5	285513.1	522262.2	52063.3	8.5	60182.0	-216210.9	-1135315.0
	2490194.0	-10373.5	2479816.0	3816342.0	383809.9	176958.8	4225509.0	-1896782.0	

Exhibit B

STATE OF ALASKA DIVISION OF BUDGET AND MANAGEMENT

BUDGET PLANNING MODEL

RUN ID RUN 4
DATE MARCH 3, 1972
COMMENTS PUBLIC OWNERSHIP
7% TARIFF
BASE CASE
OIL IN 77

Decker

ASSUMPTIONS
ANNUAL RATE OF INTEREST ON GENERAL FUND = 6.00%
ANNUAL RATE OF INTEREST ON NEW BONDS = 6.00%
MATURITY PERIOD ON NEW BONDS IN YEARS = 20.
% ABOVE G.F. UNENCUMBERED BAL. UNEXPENDED = 0.0 %

GROWTH RATES FOR OPERATING EXPENDITURE FROM PRIOR YEAR
1973 1974 1975 1976 1977 1978 1979 1980 1981 1982
6.2 6.00 6.00 6.00 8.00 9.00 8.00 8.00 8.00 8.00

NEW BOND AUTHORIZATIONS IN EACH YEAR
1973 1974 1975 1976 1977 1978 1979 1980 1981 1982
710000.0 0.0 60000.0 0.0 100000.0 0.0 100000.0 0.0 100000.0 0.0

FISCAL YEAR	NON INVESTMENT REVENUE	INVESTMENT INTEREST	TOTAL REVENUE	OPERATING EXPENDITURE	DEBT SERVICE	MISC EXP SHD TAXES GF CAP EX	TOTAL EXPENDITURE	SURPLUS OR DEFICIT	GENERAL FUND END OF YEAR
1972									761268.2
1973	162264.1	42466.7	204730.7	276331.0	24020.8	11358.6	311710.3	-106979.6	654288.4
1974	182367.0	35772.1	218139.0	292910.7	29646.2	11756.5	334313.4	-116174.4	538114.0
1975	190047.0	28146.4	218193.4	310485.1	32973.5	12749.8	356208.4	-138015.0	400099.0
1976	188752.0	18960.8	207712.8	329114.1	33474.2	13279.6	375863.8	-168171.1	231927.9
1977	438209.0	15116.4	453325.4	355443.1	35373.3	14482.8	405299.1	40026.3	271954.3
1978	434394.9	16675.3	451070.2	383876.5	39390.5	15217.0	438486.0	12664.2	284558.4
1979	547046.0	19533.7	566579.7	414588.8	42494.9	27486.9	484570.4	82009.3	366567.7
1980	550369.9	23532.2	573902.1	447755.8	46529.0	28343.7	522628.5	51273.6	417841.3
1981	567522.4	26121.0	593643.3	483576.2	47129.4	28399.7	559065.2	35018.1	452859.4
1982	575119.7	27090.4	602210.1	522262.2	52813.3	29747.4	604912.9	-2767.8	450156.6 +
	3320529.0	253634.8	4041965.0	3416342.0	383899.9	195111.4	4391075.0	-311111.4	

Exhibit C

STATE OF ALASKA DIVISION OF BUDGET AND MANAGEMENT

BUDGET PLANNING MODEL

RUN ID RUN 3

DATE MARCH 3, 1972

COMMENTS

PRIVATE OWNERSHIP
7% TARIFF
1% GROWTH
GREATLY REDUCED CAPITAL EXPENDITURES

*Budget
Increases
Annual*

ASSUMPTIONS

ANNUAL RATE OF INTEREST ON GENERAL FUND = 6.00%
ANNUAL RATE OF INTEREST ON NEW BONDS = 6.00%
MATURITY PERIOD ON NEW BONDS IN YEARS = 20.
% ABOVE G.F. UNENCUMBERED BAL. UNEXPENDED = 0.0 %
ANN OPER EXPEND GROWTH RATE AFTER 1ST YR = 1.00%

1973		1974		1975		1976		NEW BOND AUTHORIZATIONS IN EACH YEAR		1981		1982	
1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
71000.0	0.0	15000.0	0.0	20000.0	0.0	20000.0	0.0	20000.0	0.0	20000.0	0.0	20000.0	0.0

FISCAL YEAR	NON INVESTMENT REVENUE	INVESTMENT INTEREST	TOTAL REVENUE	OPERATING EXPENDITURE	DEBT SERVICE	MISC EXP SHD TAXES GF CAP EX	TOTAL EXPENDITURE	SUPPLUS OR DEFICIT	GENERAL FUND END OF YEAR
1972									761268.2
1973	162264.1	42469.7	204733.8	276232.7	24020.8	11358.6	311612.0	-106878.3	654389.8
1974	162367.0	36208.7	213575.7	278994.8	29646.2	11756.5	320397.5	-101821.8	552567.9
1975	170067.0	29928.1	219975.1	281784.3	32973.5	12749.8	327507.6	-107532.5	445035.4
1976	186752.0	23147.4	211899.3	284601.6	32478.4	13290.6	330390.6	-118491.3	326544.1
1977	220569.0	16705.2	237274.2	287447.4	32921.2	13153.0	333521.5	-96247.3	230296.8
1978	225954.9	10787.1	236741.9	290321.5	33723.5	13719.0	337764.0	-101022.1	129274.8
1979	314776.0	6882.4	321658.3	293224.3	34212.3	23358.3	350794.8	-29136.4	100138.3
1980	329299.9	5394.7	334694.5	296156.1	33887.2	25105.1	355148.3	-20453.8	79684.5
1981	332012.4	4182.2	336194.5	299117.3	31872.0	25167.5	356156.8	-19562.3	59722.2
1982	344154.7	3140.6	347295.2	302108.1	33246.7	26698.5	362053.3	-14758.1	44964.1
1983	3493194.0	178845.6	2659040.0	2849986.0	310001.6	17000.0	3385343.0	-716303.9	

Exhibit D
ENDING GENERAL FUND BALANCE

Private vs Public Ownership
Budget Book Expenditure Plan

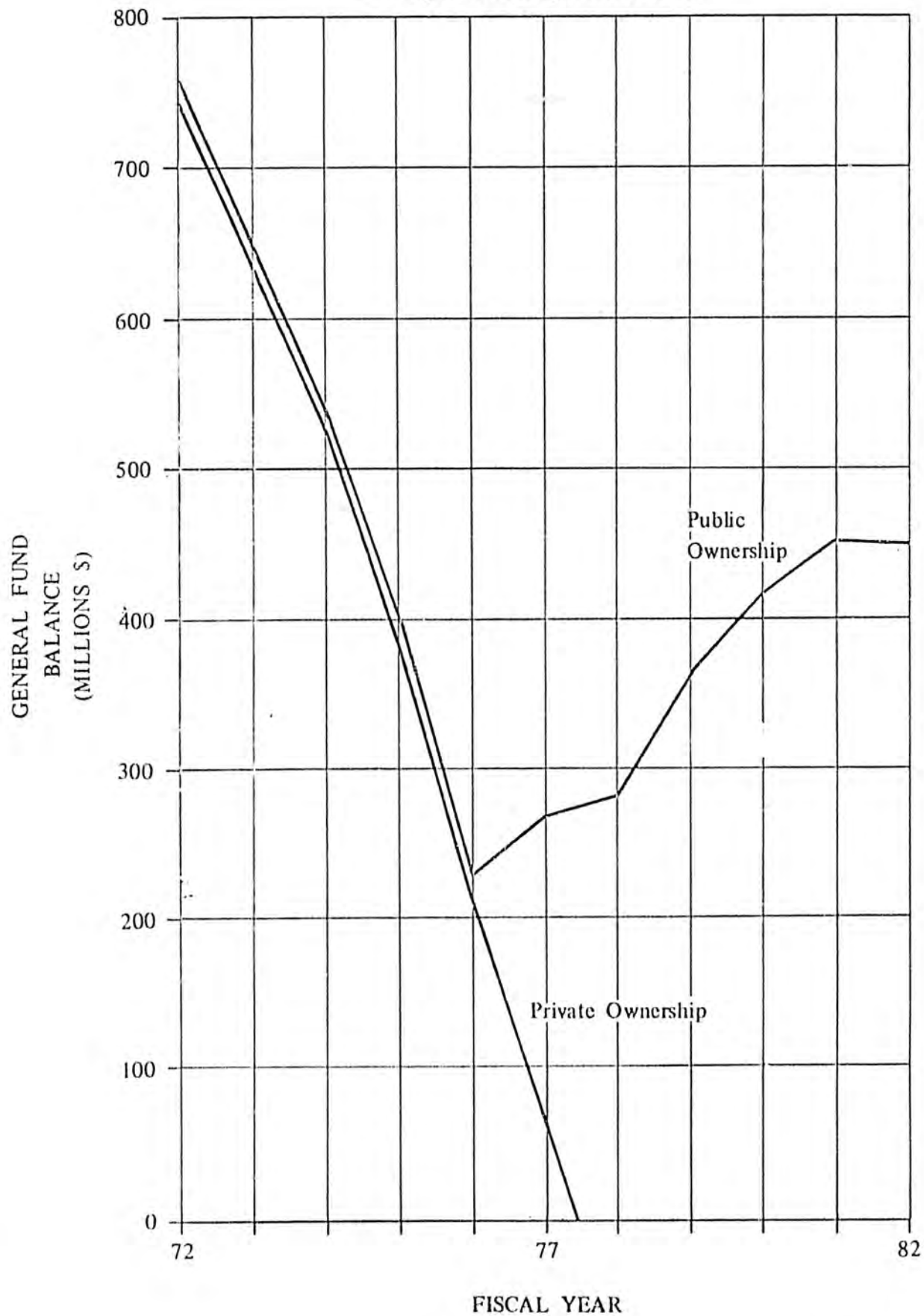


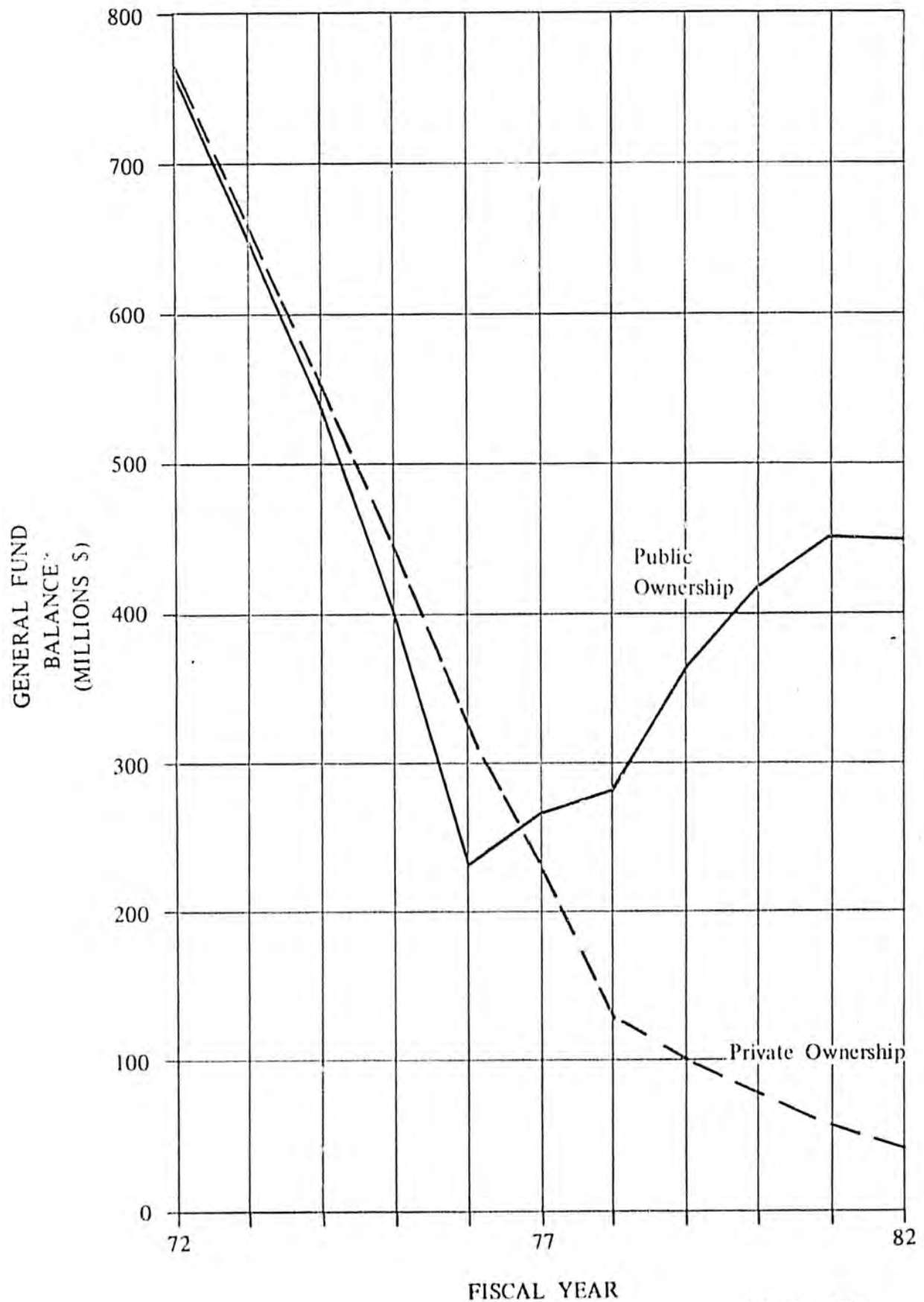
Exhibit E

ENDING GENERAL FUND BALANCE

Public Ownership Budget Book Expenditure Plan

vs

Private Ownership Subsistence Expenditure Plan



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

TAPE # 9

... Groth: ... selected land less valid federal leases, and just the other day here within the last couple of months we have selected another 77 million acres. You anticipate no revenues from any of these places?

Henri: Senator, the examples I have given you, A and C on the private case ^{exhibits} do not contain any private ownership, any further income of the ownership case ^{Private} but I'd like to fortify or expand on that observation by saying the amount we are spending over income right now is about \$150,000,000 over ^{income} this year and as the budget increases, the dollars over income will expand rather dramatically and so except for the Prudhoe Bay oil ~~in~~ in those huge volumes there would be no way in my estimation to lift further bonus sales ^{or some} from other economic development to make up the dollars we need to increase the budget even by 6% to say 8%, so let me say that just by general allusions of possible sales and possible income we analyze ~~that~~ ~~the~~ ~~possibilities~~ those possibilities the dollar volume is not there.

Groth: It still remains inconceivable to me ^{if you can} to make \$900,000,000 out of 400,000 acres which is what we did, you have a million and a half acres there ^{right} in round figures, I don't know what the correct figure is, but that is what Chuck testified to, and if you've got 77 million acres of additional land or at least in that portion ^{if it} which we're going to get out under the Statehood act, whether that's 77 million acres is it or not, I don't know how you can conceivably say that that is going to produce zero money. And in the case of the public versus private ownership of the pipeline you say that that is going to produce zero money in order to argue for the public ownership, it just doesn't seem reasonable. I can't conceive that nothing is going to come out of that.

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Henri: Senator, I am addressing my remarks for the next planning decade not presume for the next 50 years and I ~~assume~~ that once the environmental business is settled satisfactorily for this country, that leases will be valuable again, but I am very doubtful that any oil company is going to go up and lease further land until they are pretty sure about whether they know what the government is going to do about their present holdings. ^{So} I don't believe that it is prudent at all to anticipate income up there ^{in reasonably} ~~is~~ the ~~recent~~ near future. And further on the amount of dollars if we were to find a taker for our lease offering, you will notice that Commissioner Herbert's testimony covered, I think it was almost a million dollars sold before the September, 1969 sale which brought in hardly a tenth of that. *In other words, there may have been a ~~land~~ ^{unsuccessful} sale.*

Groth: Mr. Chairman, I understand Joe, my problem is that i can't conceive that in these projections that you have, did not feed anything in on these estimates on the basis that all of the other lands that the State owns, and all of the other the State interests/~~it~~ has, and the ^{the} boom and room here is to what is going to happen to get into public ownership of the pipeline is the inevitable result without putting in any bucks at all for all of these other assets. And that is where I have the problem.

That to be a reasonable estimate, believe me I am not going to be or trying to be
HENRI: My references from a budget point of view, now there is an underlying conviction that we have here from the Governor on down, and that is that the budgets of the state should be increasing steadily and systematically, in other words you shouldn't have a budget that ^{has} high rise then next year cut off a lot of people who have been depending on these expenditures, so unless we can pretty clearly say that out there somewhere ~~at the~~ at the end of the ten year period that there is going to be some more money coming in, if we can't ~~same~~

say that with some certainty then we have to adjust this years spending and next years spending as if there weren't that money there because it is too speculative, ~~it~~ too remote, and that, what I am addressing myself to is the budget and if we can't reasonably calculate some money out there then I think the budget has to be adjusted each year now as if ^{we weren't} ~~we are~~ going to get the money. Now that's based on one thing that is different since 1970, and that is that we are spending beyond our income in this State for the first time. ^{would} ^{anywhere near} We have no trouble/like that if our expenditures were equivalent to our ~~income~~ income, but it is not, as I say we are spending almost twice as much as we are taking in which means that our savings account will be depleted, and then where are we if these new revenues do not materialize.

Groth: Without being argumentative Joe, you presume those to sign in zero value to all that other land and that 77 million acres and I respectively suggest ^{feed} to you that it may have some value greater than zero, and if you ~~feed~~ ^{feed} that into the projections then all of the alcoholism, VD, mental, drug, and athletic commissions and youth commissions might still continue.

Senator Young: ^{I think I would like my remarks right at the time} Mr. Chairman, first let me say that some of the proposed

^{proposed} testimony taken place at the present place is the administration time of state transition game protection right now.

But one thing bothers me, Mr. Henri and this is if we build this pipeline we have to go into debt or a guaranteed debt of 3-1/2 billion dollars, what effect is this going to have on proposed bond issues already before the legislature, for instance 6 million for highways, sewers and waters, etc. According to my latest figures it will be so far in debt for guarantees that there will be no market for the bonds

they are putting before the legislature now.

Henri: Senator, I would like to refer the answer to that if I may to Mr. Macy, who is here from Kuhn, Loeb and also Commissioner Wohlforth who I think can do a better job.

Wohlforth: I think the basic answer to that question is that, as I represented of in New York as I stated about a month ago, a North Slope bond issue ~~is~~ would ~~have~~ necessity have to be so well secured and so able to stand on its own feet that it would ^{not} jeopardize ordinary State bonding programs, that the essential security of ^{general} state/obligation bonds are recurring revenues of the State ^{of the State} ultimate power on to tax/an ad valorem basis its 2.7 million assessed valuation. What we are talking about here and what will be described in detail by Mr. Gilderhouse and Mr. Macy is a bond issue which is essentially self liquidating and does not reflect adversely and therefore would not reflect adversely on the States general obligation bonding power. It would be I believe a separate sustaining utility type bond issue, as compared to our general obligation bond ~~is~~ issues each of which do encumber our States credit and each of which are assessed in the bond rating communities on a per capita debt basis, on the basis of assessed valuation to total bonded indebtedness. In addition it is pointed out to me that as said previously that we, the bond issue ~~on the size of~~ of this size can have a positive effect on Alaska bonds of necessity it would reach a broad market of new investors and create interests in Alaska, those, a range of investors in Alaska that are growing now but who have not yet nearly reached the number we had hoped for, and of course the net income which we show to available after debt service in the public case, is income ~~from~~ the State

treasury.

Young: O.K. Let's carry this thing a little further. Lets say the pipeline to build, if the state builds the pipeline, we're dealing with a world energy here and if they find that other oil companies or companies find a cheaper source of power for world energy, now true they have to produce a certain amount, but what if they are not competitive when does that leave the the State. In paying their bond issues off.

Wohlforth: To a certain extent I have ~~xxx~~ analogized this with the question which was posed yesterday, there was a replacement found for ~~possibletx~~ Fossil Fuels, we expect a replacement from Fossil Fuels maybe in the year 2010. The existing indications are that there is a need for North Slope oil and that will continue. The refinery price on the west coast has escalated and indeed it is much higher on the east coast, so that there are projections underlying projections that are used, just as there are in other financings based on utility type self liquidating financing which give, it seems to me, the degree of confidence necessary to finance the pipeline itself. And indeed no bond investor is going to put monies at debt, and at risk unless he ^{similarly} ~~similarly~~ is assured the State that the oil will flow in the estimated quantities. It to a certain extent has to be and will be a test of the market.

Young: Commissioner Henri, another thing, Senator Groth hit upon, that you geared our whole income into the ownership of the pipeline of the North Slope Oil. Entering the projections of the other testimonies given today is there any thought given to the possibility of revenues generated by the ^{year} ~~gap~~ field that is on the North Slope, the monies that will be generated to the mid west states, that the pipeline will possibly go through Canada?

Wohlforth: I think Mr. Eppenbach can answer that.

Eppenbach: Yes sir. They are fully included in our estimates. We assume that in 1977 the price of gas at the wellhead will be about 20 cents. Obviously the production of gas is the function of the production of oil. We've made those consistent and we assume the price of gas at the wellhead will increase ^{assuming} about 1 cent every five years, ~~and~~ that gas will be transported through Canada through a Trans Canadian pipeline into the mid western markets in the U. S.

Holm: Commissioner Henri, as I read the figures, the first chart up to the left there, and I added them ~~all~~ up, if my arithmetic is correct, we are saying that State ownership will total a billion and one half dollars net increase to the State over the next 10 or 11 years. That is if everything goes right. Presuming that the State's bargaining position is good now and might be a little bit worse in the coming years without intervention by the State, after all any oil company worth ^{it} salt can see that we are going to desperately need money due to the testimony that has been given. What is going to happen to our future oil lease sales and the net income to the ^{state} city; have you built this in; what is going to happen as the oil companies see this localization or parallel to nationalization of the oil industry in the State of Alaska and as they contemplate this couldn't we ~~lose~~ lose more money that way by investments in the State in the oil leases, by investments in the State in the oil industry than we would gain theoretically by taking over the pipeline ownership.

Henri: Representative Holm, Senator Groth referred to additional oil lands in the North, I would like to speak a little bit further on that latter, but, there are more as we all know than 7 oil companies. Now if there were other oil companies that wanted to get these future oil lease lands I think that State ownership ^{of the} ~~along these~~

lines would enhance the desirability of those leases because they would know the State, as a public agency would allow them to use the line, whereas if the line were dominated by the owner who had the existing discovery *of the oil* it may not be that way. So I think the ownership would not be a hindrance, it would be a help.

Holm: Well, aren't we presuming, at least this has been my understanding it is going to be a public carrier either way?

Henri: Yes, but I will defer to Mr. Hellen and others about how that concept works under ICC regulations of private ownership. My impression is, simply saying, ^{it is} ~~it is~~ a public carrier does not give all the answers. Furthermore in the State's case of private ownership Mr. Temple clearly brought out yesterday that there is going to have to be a voluntariness, whatever you want to call it, between the oil companies and the ~~State~~ State if the State is ever going to own the pipeline, at least under the sale of bonds, municipal bonds and I would think that if the package were not fairly palatable to the oil companies that somehow they are not going to do it anyway.

Holm: Well then you are presuming in all of your figures, projections, that the State take over the pipeline, will not depress the market for our future sale of oil leases.

Henri: I think that would be something that we ^{have} tend to guard against very carefully. We obviously would not want to do that. I think we all agree with Senator Rettigs' remarks that we want the state to be a favorable place for investment. But nevertheless we have a great stake of getting something out of our resources to?

Huber: Mr. Chairman, Commissioner Henri, on Page 3 of your testimony

Joe, you project about, rounded off, \$50,000,000 a year general obligation bonding programs for State capital programs. Now what ~~is~~ retirement term is anticipated on those bonds, and ~~can~~^{is} the interest from principal payments ~~has~~ been included in the public ownership draft line on exhibit E?

Henri: The term, Mr. Chairman, Mr. Huber, is 20 years, and debt service has been included in the run and if I may Mr. Huber, refer ~~to~~ you to exhibit B where it that information is given there. Exhibit B in the computer run/gives the interest assumptions, the annual rate of ~~interest~~ in the general fund, in other words what we have earned in the Bank of America funds of 6% and so forth, is all spelled out, and your answer ^{is} is the debt service was included for 20 year payoff.

Huber: Well what concerned me was the debt service in the initial bonding.

Barber: Mr. Henri, through the Chairman, the Committee it ~~is~~ has always been my assumption that we are currently using up our North Slope \$900,000,000 to the extent of the State ~~is~~ sharing in local government and in other efforts. In other words of our normal budget is running somewhere between 220 and 240 million dollars and we're using up somewhere between 60 and 80 million dollars a year out of our North Slope fund. Now are those figures approximately correct?

Henri: I think the, we are using this year, Mr. Huber, the Governor's budget proposed ~~is~~ taking 97 million of the principal of the North Slope Fund and of that almost entirely used for local government.

Barber: That was my understanding. Thank you.

Senator Thomas: Mr. Chairman, I have the impression that they haven't really explored all of the alternatives, and I would like to ask, since we may not have a chance to ask later on, if they have looked into the alternative of increasing

the severance tax or / and at the same time possibly substituting the cents per barrel for the severance tax; if it is so to what extent would each of those have to be changed to forestall this down the road based upon your 3.5 billion dollar figure.

Henri: Mr. Chairman I will defer a full rounded explanation of that, Senator Thomas, I do have two observations if I may. One, the severance tax as it exists, is as you know a percentage of the value of the oil ^{is} per barrel of the wellhead. Obviously, under the private case that he's giving you the wellhead has no value the first few years, so would produce no severance income. If the severance tax were amended to ^{be used} instead of an ad valorem item, to be a cents per barrel item, there is no magic to making up the deficiency in our budgetary income because no government is allowed to tax to confiscation. I haven't actually calculated that out, I would say that the, to equal the throwoff of ownership of the pipeline which is a legal, valid receipt of money, to equal that to heist up the severance portion would probably be confiscatory, I don't know. I suspect it would be a God awful amount of cents per barrel.

Thomas: Mr. Chairman, could I just ask would it be possible by using the cent barrel arrangement to persuade industry not to take such great profits out of the operation of the pipeline.

Henri: I couldn't answer that. They own their line and I presume they ^{have a right} like to take a dividend from it.

McVay: Mr. Chairman, one more, ~~it's a hard thing to do~~ when we have a chance to hear their response during these hearings, the pipeline committees have proposed a lease sale arrangement.

Josephson: Someone mentioned that ~~that's the~~ the most alarming thing about

your three r's is Joe, that we might be able even to increase legislative salary.

Henri: I carefully avoided that.

Josephson: Commissioner, have you predicated the impact of the Native Land Claim Settlement in your revenue projections, how do they fit into your revenue projections?

Henri: Yes sir, they are in there, I am going to ask Larry Eppenbach to tell you exactly how they are in there, but the impact of the native 2% over-rise is in the figures.

Josephson: No, I meant the additional economy or impact, favorable impact of the economy generated by economic activities.

Henri: Again I'd like to get Larry... My impression is that we haven't tried to estimate what the ^{funding} ~~funny~~ money of these native corporations will mean to the States economy. There again it is so speculative, and I'd just like to re-emphasize Mr. Chairman, my point of view in these hearings, it comes as chairman of the budget review committee and from a convention which is probably shared by many in the room, that the budget shouldn't be at a certain level one year then come into a cleft so to speak and fall off. I think you have to calculate your budget increases or decreases if they are necessitated gradually over a period of years. In other words at least, ^{to be} ~~while~~ we have now given to you, the legislature, a 5 year planning projection and we have tried to avoid the very speculative incomes in the future so as to keep our budget ^{steady and} ~~study~~ reliable.

Palmer: Mr. Henri, you have mentioned this matter of ^{speculative} ~~the~~ items of the budget several times, this was a response, as I understand it, as Senator Cook mentioned

Don't know
additional land sales, plugged into future revenue projections because it was to speculate ~~on~~ a few weeks ago, before the Senate Finance Committee and then later that week before the resource committee we had the same type of commentary testimony from the people in charge of the Division of Oil and Gas, Mr. Burrill and Mr. Gilbreath. When it was pointed out that the revenue projections for North Slope Oil would decrease in the 1980's because of the 9.6 million recoverable barrels, or billions rather, and that this would be decreasing in the mid 80's, I believe it is ^{estimated} ~~rated~~ 2 billion barrels a day and *in* about 14 years those reserves would be ~~exhausted~~ exhausted. Now in response to the question of, Mr. Burrel said that it was too speculative as far as any other reserves up there to slug any other values into revenues. That they could not because they had to be prudent, come up with any other figures for production through that pipeline and therefore revenues would decrease in the 1980's. And yet you are saying, as I understand it, that it will require 25 years of production rather than 12 or 13 years of production, to amortize the cost of the construction of the pipeline. If the State builds it, it is our gamble, if the company builds it, it is their gamble. I don't understand how we cannot afford to ~~use~~ be speculative in one instance and we can in the other.

Henri: Well Senator, you have spoken to two sides of the budget, income versus expenditures. My remarks on speculation were primarily about the level of expenditure and as to the ingredients of the revenue side of the budget I defer ~~the~~ it to Mr. Eppenbach who has those computer runs and why he thinks they are valid.

Rettig: Mr. Henri just to verify Senator Palmer's question, his question was a very good one, he did refer to the speculative nature of the possible lease sales, on

the other hand the State ~~has~~ in suggesting State ownership and the 3-1/2 billion dollar debt is speculating that there is a lot more/^{oil}than we now know is in the Prudhoe Bay field. Is that you^{point} Senator?

Palmer: Yes sir.

Eppenbach: Senator, when revenue estimates were prepared and discussed with you by Mr. Burrell and Mr. Gilbreath they were referring to 9.6 billion barrels of Prudhoe Bay reserves. We based our reserve figures here for purposes of financing State ownership of the pipeline from the total of the reservoirs on the North Slope already leased. And I would defer further questions on this to Commissioner Herbert. Now Have I... In terms of State financing of the lines we were not speculating on it, future reserves, we were planning that additional reservoirs would come onto line, those reservoirs already located in the lease area. Their timing may be characterized as a form of *intuitive* judgement, but *we have looked at* nevertheless we expect over the 10-20 years that there would be additional reserves of oil coming from new reservoirs that have not yet been estimated to contain reserves but are nevertheless there, that would provide oil to the Trans Alaska pipeline. That is oil in addition to the 9.6 billion barrels that Mr. Burrell talked about.

Palmer: ^{10 to 20 years} ~~Would~~ ^{that} we have the assurance of these reserves that will be recoverable from the Division of oil and gas, ~~existing~~.

Eppenbach: Commissioner Herbert already testified on that point, that there are no assurances to date, he did imply that right now it would take perhaps ~~tax~~ another year to get those assurances but he did ^{indicate} ~~communicate~~ about 100 million barrels of oil were available at least in one of the pools. I for one would like to hear the

oil companies respond to this ^{question} in some detail.

Palmer: A second question if I may then, it was stated that an increase in severance tax, this is a response to *Senator Thomas' questions* questions, in order to reach the income required by the State it might reach the confiscatory level and therefore be impossible, but it seems to me that there is a given amount of money to come from this resource regardless² whether it ~~is~~ from the pipeline or whether it is severance tax or regardless of where it comes from, that there is still X number of dollars that will be available. I don't understand how it would be confiscatory if ^{we} take it through severance tax and it would not be if we take it through a pipeline profit.

Havelock: If I may comment ^{at this point} ~~at this point~~ Senator, I think that a cent per barrel tax ~~is~~ ^{that} is one of the alternatives ~~of~~ the legislature can consider among other tax possibilities. I don't think it is our intent to say that it is not an appropriate tax. There are a number of reasons ^{-the} why it has economic disadvantages, and the man who ~~should~~ probably testify most on this would be Walter Levy. The ~~cents~~ per barrel tax is a little bit like a lot of complaints we've heard about the gross receipts tax, apply to the cents per barrel tax, that is it does not ^{necessarily} relate to economic realities in the oil industry. But it certainly is a possibility as providing a floor shall we say to revenue, I think the industry, the ^{concepts} ~~economics~~ they've made to us about it, is they would rather pay taxes in other _____ through the cents per barrel formula. That is my impression. But it certainly is one of the tax avenues that the legislature can consider.

Palmer I might add that Walter Levy

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

PAGE 1

Tape #12

Mr. Kades: It is not due to the failure to pledge credit or any special tax of the State. The reason is due to a prevailing view in the Internal Revenue Service, that if you have bonds issued for a project, companies (private companies) or non-exempt persons have a right to the use of that project for a long-term period and that isn't defined, but twenty-five years or say would be undoubtedly a long time. And they agree that they will pay for the right to put oil into the pipeline or take power even though the pipeline or the transmission line isn't available. For example, there's a forced _____ which impedes the operation of the pipeline. But nevertheless, they must continue to pay for it so that they have the risk of loss. And also they have all the rights of ownership; then there is doubt about the interest or the bonds being exempt. But it really isn't directly related to the purging of the taxes, because even though the bonds were general obligation bonds of the State such as the bill which was withdrawn provided, that would still be true in that case - that if private companies have the unrestricted right to the use of a project and they're bound over a long-term period to pay for the project even though they don't get reuse of the project; then it's considered that the bonds have been issued for the trade of business of the non-exempt persons. Now, I don't think that situation exists here, because we have a common carrier, and if other oil companies come to Alaska to explore and decide to utilize the pipeline, under my understanding of the law, ways and means must be found whereby they're served. The pipeline must open up, in other words, the rights ~~on~~ withdrawals. They're not firmament. It's not like the pipeline was leased to one or two or seven oil companies and no other oil companies could utilize it, so I have reasonable hopes of being able to secure a favorable ruling once we're in a position to make an application

for the ruling, but we've discussed this with counsel for the oil companies since last November and there's simply no answer to this question without going to the Commissioner of Internal Revenue, and as I stated we're hand strung. We're not in a position to move because all we have is a hypothetical proposition to put to the Treasury and the Treasury won't rule on that type of a proposition. But long before any bond is ever issued, long before the authority makes any firm commitment, with any oil company, we'll know what the answer is to this point and we ought to know pretty soon so that plans can be made and so there's no delay.

(Mr. Rettig)

LET ME APPROACH THIS JUST IN A SLIGHTLY DIFFERENT MANNER FOR CLARIFICATION. I THINK WE HEARD TESTIMONY AT SOME LENGTH EARLIER THAT PROBABLY AND CERTAINLY IN THE FIRST TWO YEARS OF THE OPERATION OF THE PIPELINE THERE WOULD BE NO WELL HEAD VALUE AND PERHAPS EVEN LONGER AND AS A CONSEQUENCE THERE WOULD BE NO SEVERANCE TAX REVENUE. AND RECOGNIZING THIS PLEDGING OF THAT TYPE OF SEVERANCE TAX REVENUE MAY NOT SATISFY BOND HOLDERS. COULD THEY THEN OR WOULD YOU RECOMMEND THEN THAT WE LEAVE THIS DEDICATION OPEN TO PERMIT THE POSSIBLE SUPPLEMENTAL DEDICATION OF FOR EXAMPLE INCOME TAX INCREASES TO THESE Pay SERVICE? WOULD THIS BE WHAT IS CONTEMPLATED IN THIS GENERAL OPENING UP OF THE DEDICATION FEATURE?

Mr. Kades: I'm not quite ready to answer the question. _____
It wasn't intended to open it up so that you could pledge the income taxes. On the other hand, it may be an excellent idea. It might be just exactly what the doctor ordered as far as the prospective concourses are concerned and I think again I'll have to . . . I don't like to knock squarely into the question but I think Mr. Macy _____ has poor confidence in _____.

Mr. McVay: I just have one brief question. If an authority (State) were created, would ICC control it the same way as if it were in title ownership?

Mr. Havelock: May I respond to that?

Mr. Rettig: Please do.

Mr. Havelock: The answer is that to the extent, the ICC would control the pipeline and if they would control the pipeline, they would also control it if it were publicly owned..

Mr. Kades: I suppose that's another answer to your question, sir, as to perhaps it wasn't yours but a question that was asked me about reasonableness of the rates.

Mr. Havelock: That would also be subject to the ultimate jurisdiction of the ICC so that the rates would necessarily have to be for reasons.

Mr. McVay: Is there a problem of a Federal regulatory agency, namely the ICC, controlling a State entity? Is there a constitutional problem there?

Mr. Havelock: I don't believe so, Mr. McVay. The common example would be the various court authorities which are controlled by which are municipally or State owned which are regulated by the United States. There is precedence among these for Federal regulation of State owned

Mr. Kades: The power authorities which are rather analogous are all subject to the supervision of the Federal Power Commission and the Atomic Energy Commission if they struck nuclear plans. They spend a great deal of time in Washington.

Mr. Rose: I have one additional question for Mr. Kades. Mr. Kades, the question I had before but it isn't quite clear in my mind as to what you provided by way of an answer. As I read this House Joint Resolution

for the constitutional amendment, Section 7 permits the dedication of funds but Section 8 which was the guaranty would open up the State credit to the full extent as well as permit specific funds such as rural needs or whatever. That way you have the alternative of going either way, is that right?

Mr. Kades: That's right. It was intended for flexibility to go either way or both ways.

Mr. Rose: But it could be the whole budget of the State on one hand or a specific fund.

Mr. Kades: That's right. Or both or it could be to one part of the bond issue and not to all of it.

Mr. Rose: Thank you

Mr. Havelock: Mr. Co-Chairman of the _____ chair of the committee, we forgot to enter an exhibit that should have been entered with Mr. Wohlforth's testimony. Could we have 90 seconds allowed Mr. Wohlforth to insert this for the record. Would that be permissible?

Mr. McVay: Well let's . . . we were going to take a ten minute break in a little while from now, but let's go ahead and take it now, and then we'll come back . . .

Commissioner Wohlforth: The assumptions upon which the analysis is based are contained in the first four pages and there are charts showing various assumptions of estimated incomes to State and private ownership at dividend varying dividend and tax levels showing estimated income to State under private ownership with a 5-1/2% dividend and the industry wide average facts, a 4% dividend and zero income tax, estimated income with State public ownership and a 7% dividend, a 5-1/2% dividend and a 4% dividend. And we will be submitting to the committee, very shortly, further more detailed income statements. I think you will want a moment

to reflect and read these documents, and, therefore, request that questioning be held until after the committee members have an opportunity to read. Thank you very much.

Mr. Havelock: Mr. Chairman, Members of the Committee, at this time we would like to call Mr. Tom Guilderhouse of the firm Temple, Parker & Slone, Economic Consultants, to the State. Mr. Guilderhouse. . . . He will speak about the arrangements for public financing, various alternatives for public financing available to the State, public financing and pipeline. Mr. Guilderhouse

Mr. Guilderhouse: Thank you very much Mr. Chairman, Ladies and Gentlemen of the Committee. I am pleased to have this opportunity to discuss with you this afternoon a plan to accomplish the public financing of the State ownership of the Trans-Alaska Pipeline. Before discussing the plan, however, I would like to make the following observations.

_____ to understand the plan that I will discuss and answer questions on today is a plan prepared by Temple, Parker & Slone. Although the plan has been reviewed by the State, it has been reviewed by the investment banking group, it has been reviewed by at least some of the oil companies. It has not been particularly approved by any of them. It has been looked at and discussed. The second point I would like to make is that this is a preliminary plan and is in no way intended to be definitive in nature. The definitive plan for financing an operation of this size and nature takes weeks and even months of intensive negotiations between the interested parties. One of the issues under consideration in these hearings is the creation of such an authority and such a party to negotiate on the State's behalf. Related to this point is that I'm going to refrain from trying to be terribly specific in my testimony. I will be happy to answer and respond to any questions. Financing of

Page 8

Tape #12 (continued)

this nature has a tremendous number of details, and I hope to be able to avoid my testimony getting down to the nitty gritty so to speak. As I say though, I will be most happy to answer to the best of my ability any and all questions. With that understanding, I would like to preface the plan and point out that there are essentially eight (8) general assumptions that outline our approach to try to find a reasonable and feasible financing program. The first is the assumption that the operation of a pipeline is a sound business and that the operation of the Trans-Alaska Pipeline is a sound business. The testimony that you heard today, the charts on the wall show that either set of circumstances, public or private, the pipeline itself is expected to generate revenues in excess of costs over the long run. I don't think that we would be trying to recommend State ownership if it was felt that the pipeline ownership was a bad business. Secondly, I have the greatest respect for the oil companies, These men have sound business judgment and they are very interested in getting into the pipeline business, and I think that is just a further indication of the fact that it's a good business. The second assumption is that the cost would approximate \$3.5 billion dollars. The third assumption, and most important, is that bond holders obviously need adequate guarantee^s in order to lend money to the State's authority to undertake this project. They need guarantees in essentially two areas--the guarantee that the project will be built and secondly that it will be utilized to the extent to provide payment of interest, amortization and operating costs. The fourth assumption is that the State of Alaska's credit, of and by itself, this associated from the oil, or this associated from this particular activity, is not an adequate to raise ourself \$3.5 billion dollars worth of debt. I don't think barely any state's general obligation powers from one issue are that good, but Alaska's are not very good. The fifth assumption is that the oil companies, as has been

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page 1

Tape #12 (continued)

stated many times in these areas, cannot be reasonably expected to lend their full faith and credit to secure the financing of a State-owned pipeline. It's just simply, fair is fair and it doesn't make a great deal of sense to ask them to go on the bottom line for \$3.5 billion dollars and not own the pipeline. The fifth assumption is, and this is a critical assumption, There exists both a proven supply of oil on the North Slope of Alaska in existing reserves and reserves beyond that and that there exists a demand in the lower 48 to take at least 2 million barrels of oil a day for the next twenty-five years. That's a very important assumption. We have to bear that in mind. The next assumption is that if the financing of State ownership can be achieved without the encumbrance of the oil companies credit, that this might be attractive to the oil companies who would then be relieved of having to utilize \$3.5 billion dollars in this particular project whereas there are other places in other areas where they might be able to invest that same amount of money in the construction of new refineries, further exploration or other activities. To the extent that this could be achieved, we felt that it might be attractive and the oil companies might be interested. So....those particular assumptions in mind, I would like at this point to outline the essentials of a plan, a plan that we have suggested is worthy of consideration and which has not been deemed completely unacceptable in its totality by anybody. Certain parts of it obviously are not well received by some people. The essence of the plan for financing State ownership of the Trans-Alaska Pipeline is contained within the following four major items. The first is that the oil companies enter into an agreement with the State's authority whereby the oil companies or the users, the original users and any new users to come on stream in the future years, would agree to 1.) shipped through

Tape #12 (continued)

the Trans-Alaska Pipeline taps a minimum number of barrels of oil on a quarterly or annual basis. For arguments sake, one might imagine that enter into an agreement lets say to ship a million barrels of oil a day when the pipeline is up to its capacity of 2 million barrels. The second part of this agreement would be that the oil companies would agree to use the Trans-Alaska Pipeline until its capacity was full before using any other source of shipment or transportation for North Slope oil. This is to assure before other means of transportation are used that the pipeline is full and there is not enough capacity to meet demand. The third issue, and I will try to elaborate a little bit on these in my testimony, is that the oil companies would agree to sell or otherwise assign at the well head or in the field to another member of the consortium or the unit or to the State should no other member of the unit or the consortium want the oil enough oil so that the State could assume the responsibility of shipping the oil through the pipeline to market. This is obviously relying on the oil as a "black gold" if you will to secure the interest of the bond holders. The second major part of this proposed financing plan is that the authority of the State of Alaska will provide the user oil companies with reasonable assurance on rates based on cost and volumes for as long as the minimum shipping agreement remains in force. This is a quick _____. You really can't ask or expect someone to make a deal with you unless you make a deal with him, and give him some protection for his responsibilities. The third major portion of this plan is that the Alyeska Pipeline Service Company would construct the pipeline for the State under contract to the State with full conformance and completion guarantees. Fourth - that the authority obviously would provide the appropriate and necessary

Tape #12 (continued)

guarantees to the bond holders through pledges of all surplus revenues and pipeline operations and provide a general reserve fund adequate to provide for one year to eighteen months of operating cost, interest and amortization. The basic premise in this plan, there's three basic premises, is 1.) that the oil companies in this case are only being asked to do something they are surely planning to do already, mainly ship the oil as quick¹ as possible. It's inconceivable to me, or I think alot of people that the oil companies would have invested the amount of money they have today anticipating investing an additional \$3.5 billion dollars unless they were expecting to ship oil to market just as fast as they could possibly get it out of the ground and down to wherever its going, somewhere in the lower 48. All the State is asking the oil companies to do is to promise to ship at a minimum rate probably far less than they are anticipating shipping at the moment within a guaranteed price range again based on cost of volume of movement for a period of say twenty (20) years or twenty-five (25) years depending on the negotiation or until the approximate exhaustion are put in reserves. The second basic premise is that this minimum shipping agreement and the fact that the State is ultimately taking the responsibility to move the oil to market allows for a pledge of revenues by the State's authority. For with this minimum pumping and shipping contract the State will have guaranteed income to pledge. The third major premise is concerning the risk of completion which is to address one of the other bond holder needs that the performance and completion be guaranteed to the State under a contractual basis, a negotiated contract basis, unless the bond holders will have sufficient guarantees that the project will be completed once undertaken. I would like now to

Tape #12 (continued)

go back and address in limited detail some of the four conditions and major portions of this plan. The first one with respect to the minimum shipping agreement. The first question that will obviously arise is that isn't this really a hell or high water or take or pay or an agreement of some sort, we're just calling it by another name and it's really just the same thing as people have discarded already. This is just a Rube Goldberg invention to get around to some of the problems. Though, I don't think it is. What we're doing here is guaranteeing and pledging essentially to the bond holders the oil which is in the ground, and we're not really pledging the credit of the oil companies. We have talked with commercial bankers, bond rating agencies, accounting firms and investment bankers with respect to their attitudes and thoughts as to whether an agreement of this nature would infact really encumber the credits of the participating oil companies. It's their unanimous opinion that it probably wouldn't. Now everyone always has to wait and see how things are and you never want to make a 100% opinion on anything as nebulous as this particular proposal is at this particular time, but to the extent that some of the oil companies ^{would} / be relieved of this burden that's looking over their shoulders at the moment of \$900,000,000, \$600,000,000 to them. 0 (I keep forgetting zeroes) in this project. It would be helpful/ With respect to the minimum number of barrels of oil, I think this has to be negotiated. You obviously have two factors going - you've got the depending on how few barrels that ultimately you agree with on a minimum shipment depends on the height of the tariff that you'll have to charge in order to be able to break even if you will and provide interest, amortization and operating costs. The lower the absolute guarantee you would have to assume the higher the tariff and consequently on the other side of the coin the higher the minimum guarantee the lower the tariff associated with that.

Tape #12 (continued)

With respect to using only the pipeline, I don't think it's unreasonable to request that the pipeline be used to its capacity and the State provide the facilities to its capacity before other types of transportation were used. With respect to the assignment of oil and the sale of oil at the well head, I believe and I don't think I'm incorrect that there is a considerable amount of buying and selling of oil in fields and at well heads that goes on in the industry today. It's not an entirely unusual thing for one oil company to sell to another oil company its production out of a producing field and sell it at the well head at the posted price in the field. So this is not an unusual or Rube Goldberg agreement. It's something that's done all the time. With respect to the reasonable assurance on rates, this again has to be negotiated. We are intermediaries here for the State and there is no real way that you can come to rest. We have some ideas how it might be negotiated, but it certainly is impossible at this particular point in time to say how it could be negotiated. Certainly there is an area I think of agreement where reasonable guarantees could be provided to both the authority and to the oil companies to make a workable plan. With respect to the construction contract with Alyeska, there was a question I think earlier as to would it might not be possible that the Alyeska would spend more money building the pipeline under contract ^{for} to the State than they would if they built the pipeline/themselves. I suggest that this is not a probable case. Ultimately, I think that this is a very good incentive contract, because the tariffs of the pipeline will ultimately be based in some degree on the cost of the pipeline. So to that extent that Alyeska builds the pipeline for the State, they are in fact controlling to a large part their future tariffs because the tariffs the State will charge for movement of oil will be based on the cost of the pipeline which they're

Tape #12 (continued)

responsible for bidding for and building. So they infact, under this arrangement would be controllers of their own destiny so to speak with respect to what the tariffs would have to be. The fourth item with respect to the necessary pledges, it's difficult at this point to say exactly, I think in Mr. Kades's testimony the range of full faith and credit down to a particular pledge, down to a pledge of severance or perhaps a pledge of royalty or perhaps no pledge depending on what things look like twelve (12) months from now or eighteen (18) months from now if indeed we're able to get full cooperation and interchange of information and people working together. Perhaps the revenues in the market projections will be such that a revenue bond alone could be sold, but I think the only thing you can say at this particular point in time is that there would have to be some pledges by the authority. The minimum one would be the revenues of the authority would first be pledged to the bond holders and any surpluses from pipeline operations would have to be first pledged to the bond holders to make sure all the demands of the interest, amortization and operating costs were met and there would have to be established a general reserve fund to also further protect the bond holders interest. I'd now just like to sum up this part and respond to questions on what I think are basic rationale for acceptance of this proposal by the three really interested parties - the State on the one hand, the oil companies on the other, the investment community of prospective bond holders on the third. With respect to the oil companies, it seems to me that their acceptance of a proposal of this nature or concept of State ownership and their cooperation with it is first in that they are in no way required to guarantee monies or otherwise assume

Tape #12 (continued)

contingent liability through a monetary sense with respect to this program. Their commitments are only to pump and ship at a minimum rate which they intend to do already under reasonable and negotiated tariff guarantees. Should they fail to meet that commitment, the only sanction against them is they must transfer their pumping rights; first to another person in the field, for whatever negotiated price he can get, and then to the extent that another fellow in the field doesn't want it, the State will come in and insure the movement of the oil to market. As I said before, their acceptance and cooperation is further encouraged by the fact that they're only being asked to do something they are already planning to do. From the bond holders point of view, we feel that he will be more than adequately protected by the following:

- 1.) the minimum shipping _____ from the oil companies and the State's obligation to step in and move the oil to market in the event that they chose not to. 2.)

^{Sp}
Guilderhouse: The domestic oil, the crude oil in the lower forty-eight, and the proven and expected to be realized reserves on the north slope oil. As far as the State is concerned, it seems to me that the State is accomplishing a great many of its objectives in this case. It is positioning itself in the middle of, on an equal basis or more equal basis with the very few economic entities. It becomes a part of the total development and movement to market of Alaska's natural resources. It does it in a fashion which promotes, I think, cooperation with the oil companies, and I think it gives the State a position to protect what it is seeking to protect, either through regulation or ownership, the projected income to the State from its royalties and revenues. In closing I want to point out that it is our opinion that in a hostile atmosphere with the oil companies the public financing of the pipeline is probably ^{impossible} impossible. It is our feeling that unless there is agreement and cooperation and unity it would be really ^{impossible} impossible to sell this many bonds to the public so we have to (1) establish a climate in which the oil companies and the State can work together around a ^{program} program of this or any other, to address the issues as they have been stated and I do think that we can then proceed to go to market with a ^{negotiated} negotiated security and ^{guaranteed} security. Now I will be happy to respond to any questions.

_____: We'll use the same sheet for Senator Groth.

_____: Is this on?

_____: Yes sir.

^{as a}
Groth: You said one thing that I wonder about Mr. Guilderhouse, and I'm not sure you amplified it. You said would enter into a construction contract with ^{Alaska} Alaska and then you said, how do we guarantee, who takes the risk of completion on that construction contract?

Guilderhouse: The way I would foresee it is that it would be a, let's ^{take} take a little example any contract the State lets. The State lets a contract and it's a contract with specifications and let's say it's a fixed price contract. Let's just first take the fixed price contract, obviously there is ^{some} a problem with the

fixed price contract in this case, but let's say that it was a fixed price contract well, it has been freely negotiated, openly arrived at fixed price contract and the obligation of the contractor is to finish that project. Now I suggest there is ^{SUFFICIENT} sufficient financial strength within the oil companies who are the owners of the ~~ALASKA P~~ pipeline service company to guarantee any contract ~~the State~~ ^{THAT THEY} openly ~~or~~ freely negotiated and I would look to the performance and completion of the contract from the ~~ALASKA P~~ pipeline service company as they provide their own guarantees or their own bonds that they will complete a contract that they freely entered into.

~~GROTH~~ Groth: In other words, we would ask them to guarantee the construction of the contract and take the risk of completion on this project.

Guilderhouse: The risk is included in the price, right. They're acting as general contractors like any other general contractor would operate.

~~GROTH~~ Groth: And do they make a profit here?

Guilderhouse: I would assume so, yes, just like any other contractor in their price and in their bid they would receive a mark-up on their labor, certainly.

~~GROTH~~ Groth: Do they put up bonds in the event of a noncompletion?

Guilderhouse: Well I don't think that it is necessary for Humble Oil or ARCO or these oil companies to go to the bonding market to receive bonds. I think that the assets and the strength of the oil companies are probably greater than most of the bonding companies so I do not think it would be a requirement to post bonds.

~~GROTH~~ Groth: To that extent isn't ^{THEIR} there credit seriously ^{IMPAIRED} impaired to the tune of three and a half billion dollars?

Guilderhouse: No I don't think so because they have negotiated a contract and they are going to get paid 3.5 billion dollars. Let's say ^{THAT} we negotiated a contract of ~~of~~ 3.5 billion dollars. Their only liability is to the fact that they don't meet the terms of the contract

~~GROTH~~ Groth: Okay, thank you. I have no other questions, Mr. Chairman, thank you.

Mc. Ue164: Senator

Rose: Mr. Whelan

_____: Questions from members of the house panel. Mr. Rose.

Mr. Rose: What do you want Mr. ^{CHAIRMAN} Kevin that is ^{AT PAGE} a phase four of the study that was made.

I see that you ^{ON THE BASIS OF} ~~was willing to face~~ five ISSUES of bonds and first two ~~ones~~ have an eight per cent each interest and the third one on a tax exempt rate of 6 1/2 per cent. Now why is it that if we can qualify for the 6 1/2 ^{PERCENT} tax exempt rate that we wouldn't find that in the first two?

Guilderhouse: I'm not quite sure what, okay. Well, I would say what the study shows here is just a variety of possible interest rates because until you go to market and the underwriters finally bid on your INSTRUMENT you really don't know what the interest rate is going to be. I think that one, I'm not familiar with this particular study here, but I would say that if the Interest rate is judged to be higher in the early issues than it is in the later issues the assumption is that the risk is greater and it would be a harder sell on the first issues of the ^{THE FIRST OF THESE THE EARLY ISSUES OF BONDS} bonds, when people are more accustomed to the flow of the bonds and they just won't have to pay as much money to get the money.

Rose: Say if you have to ^{ISSUE ONE} ~~have to~~ _____ which would be the last one and the smallest, not the smallest, ^{AND} almost the smallest one, second smallest ~~one~~ is also indicated at eight per cent but the thing that I don't understand if we were to qualify for tax exempt status which would appear to be the case on the assumption of issue number three then why would not that assumption hold as well on the other four issues?

Guilderhouse: I hate to duck questions, I'll have to ^{REFER IT} ~~report~~ to the fellow who made this document, I'm not clear why issue three is at a lower interest rate than issues one and two and four and five.

Wohlforth: Issue three is a gross assumption of those facilities which would be conventionally tax exempt without question, gross etc., and ^{or} would qualify under the environmental exceptions to Section 1025 of the Internal Revenue

Code about which Mr. Cady spoke at such ^Agreat length. That is the rationale behind the 6 1/2 per cent 900 million portion of the total issue.

Rose: Do we expect then that if tax exempt status is obtainable on the others that the interest rate would also be likely to be lower.

Wohlforth: It might be, although ^{we've} gotten no affirmative reading from the bankers, no banker has put himself on the line and said yes, it will absolutely be a hundred ^{basis} points lower because of the size of hundred ^{basis} point one per cent because of the size of the issue. We have bearing indications from time to time of a hundred twenty-five ^{basis} points to seventy-five ^{basis} points 1 1/4 per cent to 3/4 of one per cent but we have tried to portray the conservative case of PARITY of interest rate on the State and the private case excluding only giving ourselves credit if you will only for the ^{structural} environmental protection portion of the gross 3.5 billion dollar bond issue.

McVay: The Senator Rettig has a question?

Rettig: Mr. Guildhouse, I believe that in the early part of your remarks that you characterize your financing plan as one in which the oil companies would not be asked to do anything that they have not already planning to do; is that ^{their} statement?

Guildhouse: Well, I guess that it would not with respect to the shipment of oil.

Rettig: And I believe in that you referred as one of the elements, an agreement to ship a minimum quantity of oil, you cited as an example, I believe, a million barrels a day. That may not be the one or not, but would it be reasonable to expect that this might be something that the oil companies were not planning to do if the vagaries of the market are such that they may not plan to ship that minimum under ^{certain} circumstances?

Guildhouse: Yes, I guess that I have to say ^{that} one can't postulate circumstances one would not be planning to ship the oil. That is the reason we have the State