

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 86 / 2

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

facilities, electric energy facilities, pollution controls, possibly recreation areas.

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

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

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

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

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

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

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

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

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

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

Christenson: Mr. Chairman, sorry I was late, I didn't get the first part of this.

Is this the resolution that you are talking about? Does this go to a vote of the people?

Kades: The House joint resolution?

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

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

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

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

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

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

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

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

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

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

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

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

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

Rettig: I believe it does in effect remove the prohibition against the dedication of taxes in toto, does it not? ^{Perhaps}

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Kades: I am not clear on the question.

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

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

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

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

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

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

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

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

Havelock: ^{The only Attorney General wanted to add to the questioning} Mr. Kades, so the committee may be fully informed , I wonder if ^{to the} you might talk for a moment or two about the , how you would arrange for, or ^{options} what the principles which would apply to tax exemptions of the bonds which the ^{that and} authority might issue for this purpose. ^{and even, that}

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

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

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

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

McVay: Mr. Barber.

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

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

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

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

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

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

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

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

in the event that this idea not passed on to the next generation.

Kades: That's true correct.

Rose: Thank you.

Kades: Mr. Holm

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

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

How: I don't know if this ^{you} is ~~the~~ field now

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

Holm: Now you people are bond counsels?

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

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

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

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

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

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

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

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

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

Holm: Mr. Rettig has another question.

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

the possible non-taxable status, of the bond?

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

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

Kades: Such as the severance tax.

Rettig: Correct

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

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

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

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

Joe Bryson

March 6, 1972

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

(McVeigh chairing during
question and answer period)

AGO 530707

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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

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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

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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

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0684.8 Havelock

0686.0 Groh/Rettig

0687.5 Havelock intro

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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

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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

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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
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OUTLINE OF PROPOSED TESTIMONY
BEFORE
THE SENATE COMMERCE COMMITTEE
HON. RON L. RETTIG, 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. Red 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
Methodology - Comparison of State
and Private Ownership Cases (Eric E. Wohlforth,
Commissioner of Revenue)
6. Impact of State Revenues on the
State Budget (Larry Eppenbach,
Department of Revenue)
7. The Advantages of State Ownership
Issues and Answers (Joseph R. Hemel,
Commissioner of
Administration)
8. The Statutory Framework for
State Ownership (H. M. Temple III,
Temple, Barker & Sloane)
9. Arrangements for the Public
Financing of Pipelines (Charles Kades,
Hawkins, Delafield & Wood)
10. The Marketing of Public
Pipeline Issues (Tom Gildchaus,
Temple, Barker & Sloane)
- (Robert Macy, Kuhn,
Loeb & Co.)

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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 the unidentified ^{gentlemen} 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} ~~far~~ ^{for} ~~for~~ ^{sighted} ~~sighted~~, 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} ~~is~~ reversal occurred. My job this morning 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} ~~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, ^{on} 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 ^{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 ~~XXXXX~~ 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} ~~I say~~ 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 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 ^{a n -} ~~an~~ assumption that a production/^{flow} starting at 600 barrels per day would reach 1.7 million barrels per day in the second year of ptoDUCTION was disclosed in the summary project^{description} ~~ed~~ 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 ~~XXXXX~~ 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 a ^{total} 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} ~~income~~ 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 ~~XXXXX~~ 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 on figures supplied by industry. And its well known to the Committee and ^{to} 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 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. Eppembach 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 ^{dividend} ~~XXXXXX 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 ~~XXX~~ from gross income. During the first year of operation net cash flow to the state ^{through} 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 ~~XXXXX~~ 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} \$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} ~~short~~ 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, however, tested ^{prior} ~~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} ~~to~~ 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 TAPE 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 ^{really} 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 increased 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 ^{throughput} 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 one} 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 ^{speak} ~~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

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 ^{nothing} something 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--^{the trend} ~~we tried~~ to 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 those} ~~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 ^{Crosby} ~~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.

CHRISTIENSEN: Mr. Chairman, I hate to keep asking this question, but talking about \$3.5 billion, and if we don't bond out^{ves}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 statement. Until 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 than the case of authority bond issue by Mr. Kades. As with other public authority issues, interest is borrowed or capitalized during the construction period.

CHAIRMAN: Any other questions, members of the State Affairs Committee? Senator Rettig.

RETTIG: Question to Mr. Wohlforth. You referred to the first table in the 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~~ ^{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 ~~first of all for total~~ ^{Prudhoe} 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 ^{Galla} Gaulle, or 9.6 billion, which is the de ^{Galla} 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?

I don't have the figure.

EPPENBACH: No sir. We made that assumption that given the ^{9.6 proven oil} 9.6 billion barrels proven today that there would be additional ^{reserves proven} (cough) ^{by the time} (cough) ^{after the first or} 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 debts assuming they would also ^{pledge} their credit ^{on} their bonds.

^{Will that suffice} PALMER: 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.

Follow-up: That answered 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 ¹⁹⁷⁷ 1981; 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 on our high growth path} 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, ^{as (No. 1000000)} 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 ^{and under} 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 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} \$925 million. The difference in ^{CAPITAL} debt authorizations, that is ^{the number of buildings and other improvements} capital improvements, ^{what we could afford} what the legislature and the people would authorize, ^{THAT} is a difference of \$365 million, ^{WORTH OF BUILDINGS} worth of buildings.

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

if private ownership budget column would 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.

I might say, Mr. Chairman that the 6% and 8% increase in the budget ^{THAT'S} 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.

HAVE

*you might just
truly look at those
Mrs. Chairman.*

The attached graphs, Exhibits D and E, portray what I have been saying. Exhibit D is on the front of the room and ^{behind the} 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 ^{with it} 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 ~~xx~~ 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 ^{SP}eligible 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 ~~xx~~ economic and social dislocation would be grievous indeed.

The purport 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 DNE

Crohn: 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>302108.1</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 ID 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
6.20	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
7100.0	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	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	12749.8	356208.4	-138015.0	400099.0
1976	136752.0	18960.8	207712.8	329114.1	33479.2	13230.6	375883.8	-168171.1	231927.9
1977	220569.0	8673.9	229242.8	355443.1	35373.3	13153.0	403969.4	-174726.6	57201.4
1978	225954.9	-2988.6	222966.3	383878.5	39390.5	13719.0	436998.0	-214021.8	-156920.4
1979	314776.0	-14823.9	299952.1	414588.8	42494.9	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	-815204.8
1982	344154.7	-58641.5	285513.1	522262.2	52863.3	38.5	601824.0	-316210.9	-1135515.0
	2490194.0	-10379.5	2479816.0	3816342.0	383899.9	175356.8	4275599.0	-1896782.0	

AGO 530752

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

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

1971	1974	1975	1976	1977	1978	1979	1980	1981	1982
6.20	6.00	6.00	6.00	8.00	8.00	8.00	8.00	8.00	8.00

NEW BOND AUTHORIZATIONS IN EACH YEAR

1972	1974	1975	1976	1977	1978	1979	1980	1981	1982
71000.0	0.0	50000.0	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	33479.2	13270.6	375883.8	-168171.1	231927.9
1977	430209.0	15116.4	445325.4	355443.1	35373.3	14482.8	405299.1	40026.3	271954.3
1978	434394.9	16675.3	451090.2	383878.5	39390.5	15217.0	438486.0	12604.2	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	567942.4	26121.0	594083.3	483576.2	47129.4	28359.7	559065.2	35018.1	452859.4
1982	575119.7	27090.4	602210.1	522262.2	52863.3	29787.4	604912.9	-2702.8	450156.6
	3328529.0	253434.8	4041965.0	3816342.0	383899.9	191111.1	4393075.0	-311111.4	

AGO 530753

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
Revenue
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%

1971		1974		1975		1976		NEW BOND AUTHORIZATIONS IN EACH YEAR		1981		1982	
1971	1974	1975	1976	1977	1978	1979	1980	1981	1982	1981	1982	1981	1982
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	35208.7	213575.7	278994.8	29646.2	11756.5	320397.5	-101821.8	552567.9
1975	170047.0	29928.1	219975.1	281784.3	32973.5	12749.8	327507.6	-107532.5	445035.4
1976	188752.0	23147.4	211899.3	284601.8	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
	2993194.0	178845.6	2669040.0	2849986.0	319071.6	170000.0	3385343.0	-716303.9	

Exhibit D
ENDING GENERAL FUND BALANCE

Private vs Public Ownership
Budget Book Expenditure Plan

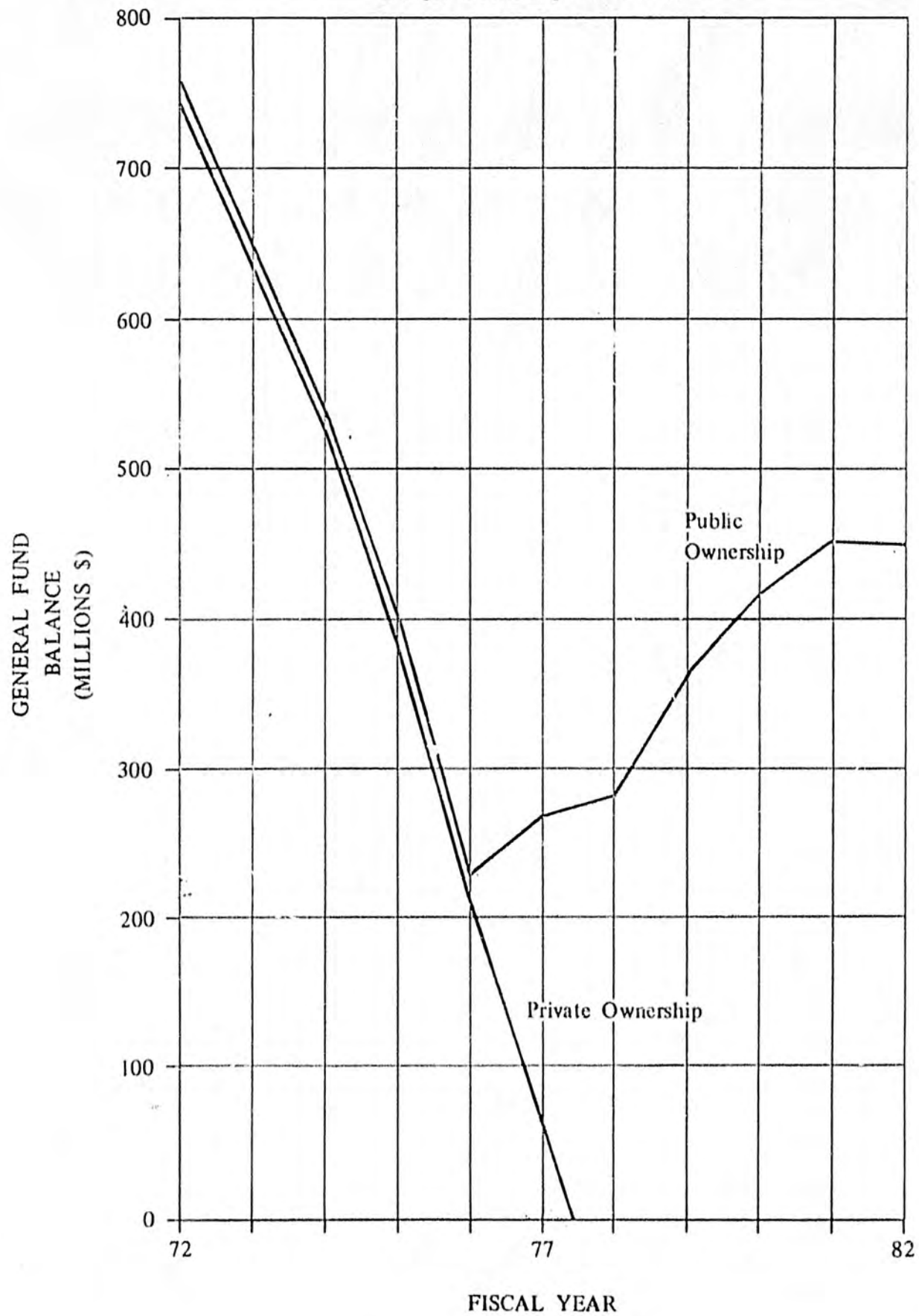


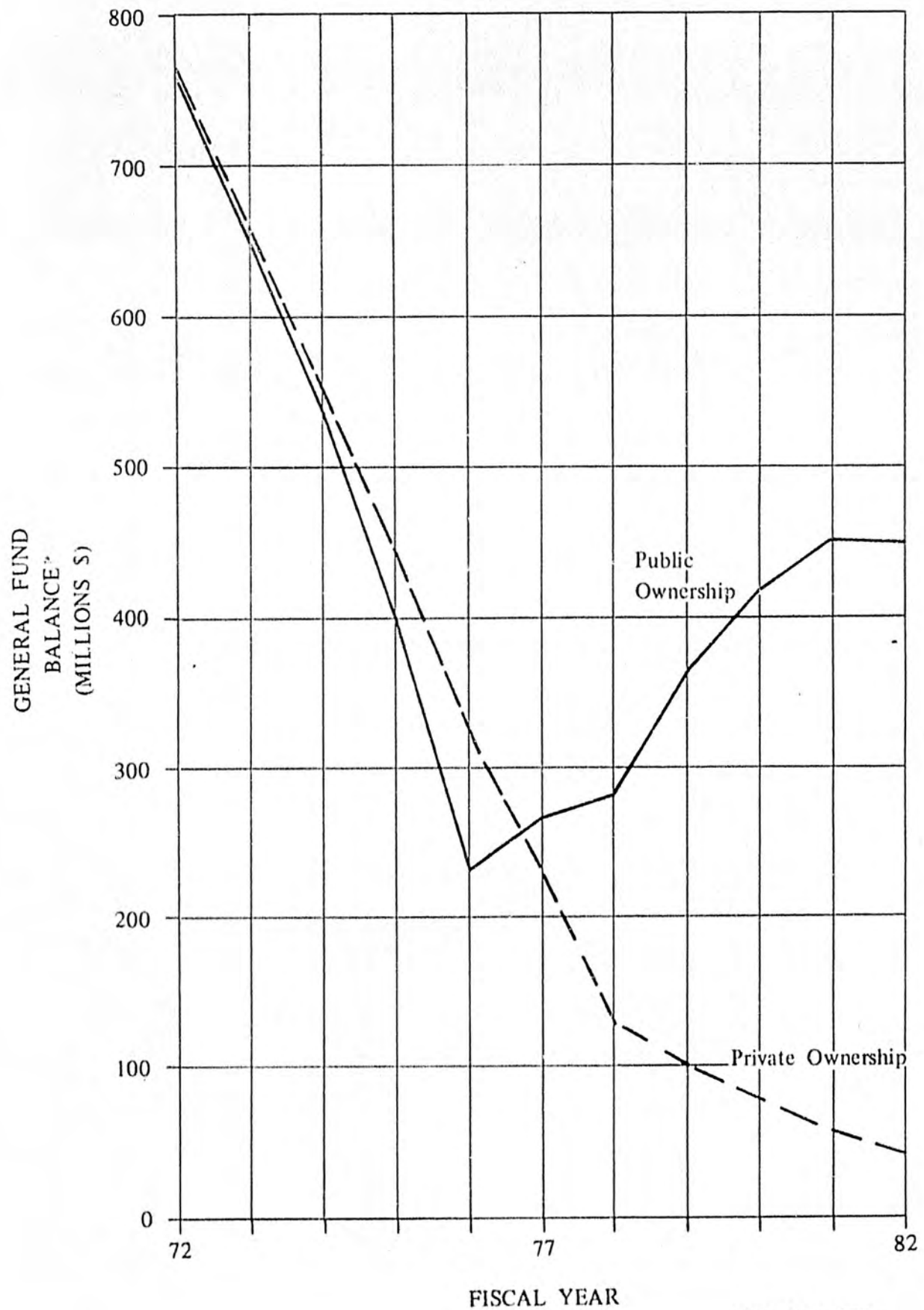
Exhibit E

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 do not contain any private ownership, any further income of the ownership case 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 this year and as the budget increases, the dollars over income will expand rather dramatically and so except for the Prudhoe Bay oil in those huge volumes there would be no way in my estimation to lift further bonus sales 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 the dollar volume 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 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.

AGO 530757 +

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. 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 ^{unique} 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 zoom 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.

Not to be representative, 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 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 ~~that~~ 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 wern'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 ~~xxx~~ that into the projections then all of the alcoholism, VD control, programs

athletic commissions and youth commissions might still continue.

Senator Young: ^{I think so. I have my remarks against the ~~presentation~~ ^{of the presentation}} Mr. Chairman, first let me say that some of the proposed

^{presented} testimony taken place at the present place is the administration time of
state treasury 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 ^{general} of 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 evaluation. 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 State's 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 ~~was~~ ~~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 where does that leave the the State. In paying their bond issues off.

Wohlforth: To a certain extent I have ~~an~~ analagized this with the question which was posed yesterday, there was a replacement found for ~~possible~~ 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 ^{gas} ~~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 States bargaining position is good now and might be a little bit worse in the coming years without ^{or exercise} 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 man 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 ^{that} 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, what ever 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 testimon v

Joe, you project about, rounded off, \$50,000,000 a year general obligation bonding programs for State capital programs. Now what ~~ix~~ retirement term is anticipated on those bonds, and ~~can~~ ^{has} 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 ~~k~~ 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~~ ^{endeavors}. 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 ~~in~~ 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 to} ~~like~~ to take a dividend from it.

McVay: Mr. Chairman, one more, ~~if we had a chance~~ 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 ~~was 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 ^{pending} ~~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, ^{which} 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 Smith mentioned,

has not been
additional land sales, plugged into future revenue projections because it was to speculate ~~for~~ 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 ~~not~~ 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 ~~that~~ it to Mr. Eppembach 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 oil dollar debt is speculating that there is a lot more than we now know is in the Prudhoe Bay field. Is that your 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: *to you* Would we have the assurance *that* of these reserves that will be recoverable from the Division of oil and gas, ~~the 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 ~~to~~ 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 regardless ^{if} 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 take it through severance tax and it would not be if we take it through a pipeline profit.

Havelock: If I may comment ^{to that} 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 ^{why} 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 ^{comments} 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

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