

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 86/2

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

Tape #12

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of the taxes, because even though the bonds were general obligation bonds of the State such as the bill which was withdrawn provided, that would still be true in that case - that if private companies have the unrestricted right to the use of a project and they're bound over a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

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

(Mr. Rettig)

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

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

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

Mr. Havelock: May I respond to that?

Mr. Rettig: Please do.

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

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

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

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

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

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

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

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

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

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

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

Mr. Rose: Thank you

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

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

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

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

Mr. Havelock: Mr. Chairman, Members of the Committee, at this time we would like to call Mr. Tom Guilderhouse of the firm Temple, Barker & Slone, Economic Consultants to the State. Mr. Guilderhouse. . . .

He will speak about the arrangements for public financing, various alternatives for public financing available to the State, public financing and pipeline. Mr. Guilderhouse

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

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

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

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

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

Tape #12 (continued)

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

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

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Tape #12 (continued)

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

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

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

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

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

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

?: Is this on?

?: Yes sir.

GROTH

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

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

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

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

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

~~GROTH~~ ^{GROTH}: And do they make a profit here?

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

~~GROTH~~ ^{GROTH}: Do they put up bonds in the event of a noncompletion?

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

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

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

~~GROTH~~ ^{GROTH}: Okay, thank you. I have no other questions, Mr. Chairman, thank you.

McVeigh: Senator

Rose: Mr. Whelan

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

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

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

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

Rose: Say if you have to ^{ISSUE 15} ~~to~~ _____ which would be the last one and the smallest, not the smallest, ^{BUT} almost the smallest one, second smallest ~~one~~ is also indicated at eight per cent but the thing that I don't understand if we were to qualify for tax exempt status which would appear to be the case on the assumption of issue number three then why would not that assumption hold as well on the other four issues?

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

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

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

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

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

McVay: The Senator Rettig has a question?

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

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

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

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

entering in under those circumstances and ⁱⁿ shipping the oil. For example, I can, let's take for example Arco who has a refinery down Seattle way. Let's say that that refinery burned up, or blew up, for some reason or another, and a hundred thousand barrels a day of Arco's oil ^{up here} would not have its normal place to flow, and it might be given away at unit rates, I am not quite sure how they can stop their percentage of the unit from flowing downstream to the market anyway. But, on the assumption that there was some way that they could, we would then have them reobligate it to offer that one hundred thousand barrels first to another member of the consortium, which I think they probably do under any circumstances as it is, but if, for some reason or another, another member of the consortium didn't want the oil either, then we would expect the State to step in and move the oil to market for the bond holders' welfare.

Rettig: Your further condition being to secure an agreement that the oil companies, failing to ship the minimum, would agree then to sell to the State, presumably as a back-up to the guarantee this minimum. Is that correct?

Guilderhouse: If it was first offered to another oil company.

Rettig: Failing in that, the State would have the option to purchase?

Guilderhouse: Yes sir.

Rettig: What would the State do with this?

Guilderhouse: Well, I said that the premise is that there exists, and will exist, continue to exist, a demand in the "lower 48" for Alaskan crude and that the assumption is that Alaska's crude will be competitive with other sources of domestic crude ~~crude~~ oil over the long run. On that assumption, I assume that the State could find a buyer for the oil. Now, ^I understand ~~that~~ there are ^{great} ~~large~~ amounts of complexity involving oil companies make their plans ⁱⁿ ~~leave~~ time six months. They know where their oil is coming from ^{from} any particular refinery. So it is entirely possible to suggest that the State could not market or sell the oil. That nobody would buy it, I think it's highly unlikely and I think ^{you} can get testimony more expert than I, to suggest that Alaska's oil will be marketable somewhere in the United States over the long run. I would suggest that is the

reason the oil companies are willing to spend six billion dollars in the long run to bring that oil to market. They believe that over the next 25 years, they'll have a place to sell it.

Rettig: Wouldn't it be reasonable to assume that if the minimum under the contract fails its probably because of failure of the market. Those who are in the business of marketing if their market fails, would you suggest a place ^{where} that the state might find a market for this oil.

Guilderhouse: I would say that if the market for Alaskan crude oil is non-existent, the State will not be able to sell oil. I also say that *I* don't think the market for Alaskan crude will be nonexistent. I do not think ^{the} the State will probably ever have to sell a barrel of oil because I think ^{the} the oil companies will sell the oil over the next 25 years and the circumstance for which we are providing in this case is highly unlikely ever to occur. And I would also say that if there was no market for Alaskan oil, the State could not sell it and ^{THAT'S THE RISK THAT} ~~that would be a risk~~ that we'd be asking the bondholder to take is that the market for Alaskan oil evaporates because we're providing to move the oil to a market that is assumed to exist. If the market is not there —

Rettig: Just one additional point--I believe you referred to this minimum guarantee requirement as in effect a mere pledge of the oil in the ground. Is that?

Guilderhouse: Yes sir.

Rettig: I don't think that term is quite clear to me. In relating it to your initial statement that we're not asking the oil companies to guarantee any credit, now this is their oil, is it not? At least seven-eighths of it is.

Guilderhouse: I think the oil belongs to the people of the State of Alaska

~~And they have~~ *AND THEY* have paid to develop the oil and bring it to market. The oil belongs to the people of the State of Alaska and the oil companies have a lease to develop and bring to market that oil. But maybe I'm wrong on that. Is that correct?

Rettig: You were telling me that this oil that we have in effect sold to the oil companies still belongs to the people of the State?

Guilderhouse: Well, I'm not--it was my understanding that a lease--the oil companies have leased the land under which the oil exists--they haven't bought the oil.

Rettig: Do they not have a right to 7/8ths of that oil?

Guilderhouse : Yes sir.

Rettig: Then....isn't that title to it, if they have full right to it?

Guilderhouse: I'm not a lawyer, and I'm not going to ---~~xxxxxxxxxxxxxxxxxxxx~~
~~xxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxx~~

Rettig: I fail to see how we can regard that oil as ours when we have sold it.....

Guilderhouse: Well, I

Rettig: and have received the money.

Guilderhouse: I'm going to have to deal with Mr. Harper the lawyer addressing the LEGALITY of the lease, in terms of what it means.

Rettig: All right, that will be fine.

SENATOR
~~SENATOR~~ : We touched on this before and I think ownership as we have discovered, such items as the Native Land Claims, is a divisible interest and certainly we recognize that there are private rights of ownership in this oil that are the property of the bidder that bid on the oil; there are also interests the State of Alaska has which might also be described as being *ownership rights in general, diversionary rights, belonging to an ownership*

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....right of ownership. Title is an intangible subject.

_____: I don't think this is really the thrust of my question, in any event, but the fact that we are pledging, asking the oil companies to pledge this minimal amount of oil to secure this bond service - something ^{THAT} they were ~~XXXXXX~~ not otherwise planning to do.

_____: Well, if you ^{TAKE IT TO} ~~figure~~ the pieces.....we are asking them as part of a mutually beneficial arrangement, and not forcing them because I have stated that there is a hostile atmosphere and we can't work this out, ^{if} this does not make sense with all the parties concerned, nothing will ever happen in terms of public financing. If this doesn't make any sense, ^{SO} ~~and~~ there is no way that anybody is going to make them do it, now I would suggest.... ^{AND WHEN} ~~IN TALKING ABOUT CREDIT~~ now I'm talking about encumbering their credit, or encumbering the ability of the oil company, let's say to go to a commercial banker, and the commercial banker will say "you have such a large ^{IF} ~~liability~~ ^{with} that pipeline arrangement you have with the State of Alaska, ^{THAT} I won't lend you any more money because I am concerned about that liability." Or to the ^{EXTENT} that a bond rating agency ^{FOR EXAMPLE} would reduce the bond rating of a particular oil company because he entered into an arrangement of this sort. I am suggesting, and I think it is substantiated, that such/would not encumber the credit of ^{an agreement} ~~oil~~ companies in this attitude. With respect to ^{THEIR} ~~their~~ being a footnote perhaps in their balance sheet, because this is a material commitment on their part, ^{AND CERTAINLY} a significant commitment that needs to be brought to the attention of the share holders and other people that certainly would be ^{mentioned} ~~missing~~, but when I say encumber their credit, ^{its not like you take} ~~XXXXXX~~ a play where they say "if you don't ship you have to pay money", or in this case we say "if you don't ship we'll come in and ship the oil for you and pay you". ^{FOR THAT CASE}

_____: Thank you. ^{VERY MUCH}

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AGO 530790

_____ : I have a couple of questions . Going to your point that any agreements should be ^{MADE BETWEEN THE TWO} . . . must be between the two partners, and must benefit both partners, it would seem to me and I . . . this is pretty basic but I am having a little trouble, it would seem to me that as cheap as we can build the line is the most desirable thing both for the State and for the oil companies. Now if the State would build ^{IT} , perhaps they would sell the bonds at . . . if they were revenue or tax free bonds . . . would sell them at an interest rate less than what normal bonds could be sold for. Is that right?

_____ : Yes, sir.

_____ : We would figure the point spread from . . . I think anywhere from 1.5 to 2 points. Is that correct?

_____ : Pretty close

_____ : So this is very general. So that would result in substantial savings, ^{WOULD IT NOT} as far as debt service is concerned.

_____ : It depends on how much of the pipeline is ^{going to be} financed by equity on the part of the oil companies, and how much of the pipeline is ^{oil companies,} going to be openly financed by debt on the part of the pipeline. Because ^{ALL (OR, MILLION?)} if the State would go out and lets say borrow ^{ALL} 3.5 billion dollars, then the State would be paying ^{FOR ARGUMENTS SAKES} lets say 7% interest on that, ^{WILL IT'S} it is possible that the oil companies will not be able to borrow 3.5 million dollars, they will only be able to borrow say half of that, and for the rest they will have to sell shares of stock to the public and also use their own cash flow of retained earnings, to finance this. Well there is a cost associated with that capital which I think with the oil companies is higher than 7%, and there is also a cost associated with the debt which I think the oil companies, ^{FOR} in this magnitude, will be higher than 7%. So in a long-winded way, yes, it would be cheaper for the State to finance it in terms of tax exempt bonds.

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_____: And we're talking about maybe 1 or 1.5 per cent?

YES, SIR.

_____: Now, in the other area, as far as the Federal government is concerned, if the State owned the pipeline, then the State would be entitled as a private company to make the suggested 7% ... the ICC allowance, then a held 7% profit would be taxable if the line were/in private ownership held profit by the Federal government. The 7% would not be taxable by the Federal government if held under State ownership. Now, in millions of dollars, ~~CAN WE~~ ^{BE ABLE} estimate what that saving would be. It seems to me that there would be a substantial piece of money and that that would eventually inure to the benefit of the shipper - the oil companies - as well as the State.

_____: Yes sir, I think you are right on it.

_____: Can you estimate what that figure....

_____: Should have a run..... ^{QUICKLY}

^{WE CAN DO IT VERY} more specifically

_____: ^{WE CAN} Lets do it, ~~it can be done~~ ^{IT'S} ~~very quickly~~ somewhere, but lets say that it costs three billion dollars, and the State lets say in the first year will pay ...well in the first year the whole debt issue, ^{COSTS THREE BILLION} ...in the State, would pay 7% interest on that, so you are ~~talking~~ ^{in interest} 210 million dollars/, and if the oil companies lets say had 100% financing, ^{OR WE} you said that they had a cost associated with ~~it~~ ^{THAT}, of lets just say for argument's sake ^{which I think is} 9% lower than the oil companies would like it, ^{TO} they earn on their assets, you've got 2% difference there, thats essentially 60 million right there, I guess. And ^{ON} of the income tax, thats a year, ...

_____: ^{THIS FACT THE} Let me continue with Federal and State taxes that we calculated, that would be paid by private ownership, in our private ownership base case.

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They are, the first year, 33.73 million dollars in State income taxes; but 158.8 million dollars Federal income taxes.

In the second year, a similar amount 33 plus million dollars, ^{IN STATE TAXES} and again ¹⁵⁶ 150 and a quarter million dollars in Federal income tax.

Moving on to the third year of operation, the Federal income tax and State income tax, ^{5,182} remain roughly the same - 34 million in State, 158 million dollars in Federal.

_____: That's third year? ^{now?}

_____: Third year. Yes sir.

_____: Well, I can have all these figures.....

_____: No, that's not necessary....as my rough figures show that's about 200 million dollars a year in tax savings if the State would own it. Am I right?

_____: You are right.

_____: Now, that's 200 million dollars, ^{how is that} which is a substantial piece of money

going to be distributed? Wouldn't the oil companies benefit in part

because ^{75¢} say for example if it takes \$~~75~~ to ship a barrel of oil from

Prudhoe to Valdez, but you don't have to pay tax on it, you could say, then ^{rough}

in rough figures, say then it only cost them 50¢ a barrel.....is that right?

_____: ^{point is} Correct, I am not sure of your numbers.....actual tax savings are definitely a part of the tariff calculation, the lower the taxes the lower the tariff.

_____: All right, now let me ask you another question: would the tax savings anywhere compare to the 7% profits they would make if they held the title under private? You see what I mean?

_____: Yes.

_____: In other words they would save a quarter a barrel if its ~~100~~

in State ownership, but are they going to make profit at a quarter a barrel if they hold it in their own hands? Is there any way to equate that?

_____ situation: The ~~xxx~~ you just described, yes, you ^{CERTAINLY CAN} just ~~can't~~ equate it

.....it looks like a ^{PROFIT} ~~loss~~. The profit that theoretically the profit ^{ON A} ~~that~~ of 7% - if we're going to use the 7% ^{NUMBER}, with a 3 billion dollar pipeline, the profit is 210 million dollars. That's how much profit they

^{Its} can make. /that simple a calculation, 7% of 3 billion dollars. Now the

profit - if you're going to use the 7%, is 210 million dollars. Equate... ^{AND}

use these numbers and we come up to around 200 million dollars. ^{SC} Well, in

terms of the cash position of the oil companies, its a ^{POSSIBLE} ~~foot~~ ^{BUT IF} ~~foot~~. I could say

something....I'll make it quite clear that this is a "T.S.S." (?)

sort of an opinion and nobody else really has anything to do with it, its

strictly ours. That ^{there} might be a way to make this concept more feasible

and engender the environment in which cooperation might take place, ^{by} suggesting

to the oil companies that under state ownership it might not chose to build its

tariff structure around a 7% return. Say perhaps the State not only would

provide this type of savings but ~~could~~ ^{could} conceivably develop its tariff

structure on a basis/less ^{something} than the maximum. Again I want to emphasize that

this is TEMPLE BARRETT Sloan speaking. As a suggestion for consideration,

if you ever reach the point where you are ^{TRY TO ENGAGE IN} ~~driving~~ ^{driving} this ~~is~~ favorable

climate TO TRY TO COME TOGETHER ON THE VARIOUS ISSUES

_____ ^{in terms} Right, that was sort of what I was thinking, ^{of} each having

a benefit, not one at the expense of the other.

_____ : I heartily recommend that.

_____ : Only one other thing that bothers me - the oil companies of

course would have the right to depreciate the pipeline as ~~xxx~~ an asset, I

assume.

_____: Yes sir.

_____: And that would be a tax of paper transaction ^{BECAUSE} we assume the pipeline is going to be there and carry all the oil out and I suppose ^{WOULDN'T} zero. ^{WOULDN'T} The State wouldn't have that....the State since it doesn't get doesn't pay taxes, it ~~wouldn't have~~ the depreciation quite obviously.

Now, how does that gear into that?

_____: Well, the ~~undivided interest~~ of oil company financing and accounting, ^{exactly} is an art unto itself. And I'm not really qualified to say/how much the depreciation ^{of} the pipeline is worth to a particular oil company, or ~~in an undivided~~ the undivided interest structure what value ~~xxx~~ a particular member of the consortium would place/that depreciation. With respect....lets say that it was a separate entity, ^{A CORPORATE ENTITY,} and not an undivided interest structure, the depreciation would really not make a whole lot of difference to the private ownership on the basis of ^{10%} 7% consent degree limitation. Because that's a cash dividend ^{LIMITATION} figure, and what they're working on on that basis, they can just take 7% cash out of the dividends and that ...and then the depreciation ^{10%} within the structure would not be a significant item at all.

_____: ~~XXXXXXXXXXXXXXXXXXXX~~ Okey.

_____: But thats not in the same place with the undivided interest, ^{BECAUSE} ~~that is~~ ^{THESE} all folded back within the parent corporation, ^{AND} the depreciation may well have some values beyond the.....

_____: All right, now in just ^{the} painting with the broad brush, we've got 200 million dollars here that can be saved in taxes.

_____: Yes, sir.

_____: Isn't that....and if the oil companies are going to share in some of the savings, ^{RIGHT?} now isn't that going to....not withstanding the

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arrangement between the State and the oil companies, isn't that going to result in the oil companies being more competitive in their own area of marketing? I would think that would follow.

_____: You mean to the extent that their costs are lower, that they are more competitive in the market? Yes sir.

_____: So they'd get a substantial advance, I would think.
~~Under the right circumstances I think there are tremendous advantages to~~
the oil companies, both in reduced costs and in reduced financing burdens. (P)

_____: Mr. Rettig is a banker... ^{HERE, I'LL LET HIM TALK} ~~I'm going to continue~~ as I'm getting a cold in my head. ^{HERE}

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

Guilderhouse: _____ referred to establishing the tariffs; and I would suggest it should be a factor in establishing the tariffs. In order to recover the costs.

Rettig: Yes sir, I'm sorry, I just wanted to clarify a point. When I performed an analysis on the income statements of an owner of the pipeline, be it the state or a private secrete, I did in fact include straight line depreciation over a 30 year line for 15% _____ VALUE, in either case.

Guilderhouse: Thank you, I had thought it ^{was} important to make it clearer that we all understood ~~XXXXXXXX~~ the treatment of depreciation in either case.

Eppenback: If I may add _____ Mr. Chairman, the cases showing estimated income to state public ownership which Chairman McVay was eluding you. ^{and shown on chart} ~~page 3~~ and reduce dividen levels 7, 5.5, and 4, so that the committee has this information before us and again to perhaps being a little oversensative to refute any imputation of the state had shown only the worse case or that the governor has made it ^{the} only ~~the~~ worse case, these charts are before the committee and we'll be ready to respond to them at your pleasure.

Rettig: thank you.

Wohlforth: Senator Raider has a question,

Raider: I have a question for Mr. Guilderhouse, under the various proposals here how would the issues of 3 1/2 million involve or would it effect our abilities to issue bonds for normal governmental purposes? That question was asked this morning, but I'd like to have your opinion.

Guilderhouse: Well, mines just an opinion, I happen to believe that ownership of the pipeline will enhance the states ability to issue general revenue bonds. I think that ownership of the pipeline increases the security of the states total income package.

I think, first of all, I think the pipeline is a good business, and because its a good business, or a sound business, and lets say it would be operated in a sound fashion.

The ability to protect the states well head and protect the states royalties and severences, generate lets say a moderate ^{state} surplus or even a large surplus, however

if we're at doubt from pipeline operations to develop other activities in the state, would enhance the states ability the state would be in a stronger financial ~~XXXXXXXXXX~~ position rather than a weaker, financial position.

Holm: Mr. Guildhouse, haven't you assumed that the price per barrel for transportation to the line is the same ~~whether~~ ^{whether} its state ownership or private ownership?

Guildhouse: No sir, I would say in line with the discussions we have there, that there would be some costs savings, ah, in state ownership because of the reduced cost of financing the reduced cost of taxation. That the actual cost of moving under state ownership would be less than the actual costs of moving under private ownership, given equal efficiency in operations.

Holm: Then what relationship do ~~XX~~ these charges have, or these charts upon the wall have to a differential between the rate charged and thus the competitive position of the state operating the pipeline, the oil that passes through that, on the world market as compared with that under private ownership?

Guildhouse: Could you rephrase it sir, I'm sorry.

Holm: Well, under private ownership they will have a certain value on the world market, because it will be certain costs, ah, is state ownership going to put the oil on the market at a better competitive price to compete with Venezuelan Oil, East Indian Oil, any other oil? Or have we built in basically the same end price in Bellingham?

Guildhouse: I'm not really qualified to testify on the world market prices, I had some discussion with a Mr. Whelley, several long discussions, and he states that ~~that~~ ^{Alaskan} oil, I hope I'm not misphrasing him, as I understood him, stated that ~~that~~ ^{Alaskan} oil will probable be a price taker and not a price maker for a long time. So, I can't talk about Indonesian Oil, or Venezuelan Oil, but I am saying the cost associated with the transportation move of the oil to the market is probable given equally efficient operation of the pipeline to be some magnitude less on the public ownership, than private. The actual cost _____ the cost of plans.

Holm: Now these figures predicated upon a specific figure, now I thought they were the same, I thought you were using the same figures, weather under private ownership or the other. If you want to let someone else answer that I can ask that later. May I ask you one other question? You stated earlier major risks of the bond holder was maybe lack of market, ah, isn't it a major risk of the bond holder, to contemplate strike, to contemplate injunctions because of a, a maybe the ^{fisherman} ~~bitterman~~ getting all worked up over some oil spills and so forth, how will this relate to the cost of our bond?

Guilderhouse: To the cost of the bonds? ah,

Holm: What happens, for example if these things occur and the state is in an impossible position of delivering?

Guilderhouse: Well, that is the reason you would establish a general reserve fund. If you remember one of the things I talked about, was that, it would have to be established under conditions of state ownership, A substantial reserve fund that was equal to, lets for discussion sakes, say one year or 18 months of the total operation costs of an interest in amunization costs associated with the pipeline, to provide sufficient income to meet the authorities obligations in the event of a situation such as you described.

Holm: You don't think that will have a depressing effect on the cost of our bond?

Guilderhouse: Well, it depends on how vague, in terms of the interest costs, it depends on how vague you ultimately decide to make the general reserve, I you made it for a 10 year period or a 5 year period which is _____ of course, but it, it depends on how big a general reserve fund you make, and how the market proceeds and risks, you have described occur. I would say that, yea, there are, this is not going to be the cheap st bond that was ever issued. I would say that, given one the size, you have to attract a lot of people,

Farrow: In answer to Representative McVay, You, on one question indicated that this was a darn good business to be in, ah, with that in mind, do you think its necessary for the

state legislature to put the full faith and credit of the of the state on the line to guarantee anything?

Guilderhouse: No sir, I don't think its necessary to put the full faith and credit of the state on the line.

Farrow: Thank you

Guilderhouse: Mr. Farrow,

Farrow: The point you brought up in response to this

1. What representation can you make with respect to the duration the _____ duration Such a Fund would have to be established for, how would you establish it in terms of the senate of revenue? and secondly, how would this enhance the states ability to _____ obligation box? Or would it decrease the states ability to establish a
ah, 20% ah, revenue,

Guilderhouse: May I restate the question to make sure I understood? You're asking essentially 3 questions, How would you go about establishing the size of the general reserve fund? and how much it should be, and then how it would effect the ability to sell the bond.

1) How you go about establishing, it is first, ah, you figure out what the cost, for lets say 1 year cause thats a convenient term, what the interest costs are, what the ^{amort}amortization costs are, and what the operating costs to the pipeline are. Fortunately pipeline is you can get a pretty good fix to what costs are because its not labor intensive, you know, you can really figure out after awhile pretty close to what it cost to operate a pipeline. You know your interest in your amortization, so you say that if, for some reason or another we have a force ~~XXXXXX~~ or the injunction to the strike that the senator mentioned, ah, how long is this liable to last, what is the biggest exposure and how long do we have to pledge to the investment bankers who are representing the investment community _____, How much do they say that you've got to give us before we can sell you bonds? And its negotiated and is sometimes an excruciatingly agonizing process

to come to drifts with how long this is, with the state or the seller of the bonds saying, "well it only needs to be 18 months," and the investment banker saying, "well gee, I can't sell it unless its 3 years," and then you say, "well I'll give you 20 months," for if he can say, I can sell in 2 and 1.5 years. Its this process of evaulation of risks, 'ah, and the likelihood and the probability of risks as well as what the actual costs are that ultimately come in to whats' necessary to sell the bond, and its generally some multiple of what the costs are to pperate the line in case its shut down. Or operate the facilities in case its shut down, and with respect to its impact on the states ability to sell other bonds, I don't see how it would have an adverse effect on it. The ensistance of the general reserve fund will send the context of the pipeline. I don't believe it would have an adverse effect.

McVay: Excuse me, Mr Farrow, are you through? Just one more point, it would seem to me that if ^{Now} ~~and if~~ the state pays off this bond, it aquires an etquity position in terms of a very expensive asset. That would seem to me, to help the general obligation situation. directly or indirectly, would it not? In a concrete way, at the end of five years if you've got 100 million dollar equity that you didn't have five years before, or an asset, or equity unit asset, then that would be helpful for the general balance sheet, would it not?

Guilderhouse: Yes sir, in my opinion it would.

McVay: Would that be an _____? as to how this would improve the G.O. picture.

Guilderhouse: I don't see how the existance of the general reserve funds would _____ contract to the overall financeing of the pipeling. It would be damaging to the G.O.

Havelock: Ah, I'm going to have a ten minute break.

McVay: ^{The State wanted} Like to call Robert Macy, ^{ad 18} _____ Company of N.Y.

who will discuss the marketing of public pipeline issues. Mr. Macy. Mr. Macy, would you' ~~XXXXX~~ please, before you start, ~~XXXXXXXXXXXXXXXXXX~~ just for the record, give us just a brief background of your experience.

Macy: I am Vice Pres. _____ of N.Y., i have been a student over the past 3 years. I have had 4 years of economic investment consulting, for National Company in Washington. Prior to that time _____ for approximately the previous 4 years I was with _____ Company, which I was responsible for annalysing various investment projects.

McVay: Thank you. Macy Mr. Chairman, member of the committee. As a representative of _____ I wish to note that we are pleased to be here to express our views as members of the investment banking group, which is consisting to state in evaulating the fesability of state financing of the oil pipeline project. A project of this unpresedented magnitude obviously poses many unusual considerations, in analyzing various approached to the financial market. The first and most important group of consideration is the identifica-tion of the major risk factors involved. In this category we would include the following major investors concern, 1st) Are there sufficient oil reserves on the north slope to establish an economic justification for long term financing. 2nd) Are there adequate assurances that the pipeline can be constructed within reasonable time and cost estimates. 3rd) Once built, can the pipeling be operated and maintained on a satisfactorally economic basis. 4th) are there adequate assurances that once built, sufficient revenue will be generated, , to cover operating maintanience in debt serviceing requirements _____ that issue. 5th) assuming the financeing would have to be accomplished in stages, what ~~XX~~ assurance do the investors in the earlier stages have that market conditions will continue to sustain the timely injection of funds needed to complete the project. 6th) Are there back-up alturnatives that the state finds that it cannot finance, build, or operate the pipeline on an economic basis. 7th) Does the status of domestic and world oil markets as projected, give satisfactory promise oil for ~~from~~ this source over the life of the issue and at what maximum price? 8th) What additional finance over reserves are there incorporated in the financing plans, to cover unforeseen problems in the future? Few if any of the above

XXXXX

risks can be satisfied by absolute guarantees to the investor. Each, however must be addressed to some degree in the financing plan, and the relative degree to which these risks are secured. We'll determine not only the feasibility of the financing, but also the cost. We understand that extensive economic and engineering studies are available as background data and _____ some investors concern. The sizeable investment already made by the oil companies is undoubtedly as physiological plus. In addition the state could, in theory, take certain steps to provide additional financial reserve to cushion the impact on death servicing of temporary unforeseen problems related to the afore major risks. However, these assurances alone, we believe, are insufficient to facilitate the market, the successful marketing of an issue of this magnitude. Furthermore, from all the suggestions which our group has considered, we know of no feasible plan which does not involve to some degree the cooperation of the oil ^{companies} ~~companies~~ with the state, in arriving at a feasible financing plan. The question is what form of co-operation is necessary and desirable? The first and most obvious to an investor, is to have both the full faith and guarantee of the state and the oil ^{companies} ~~companies~~ behind the issue, however we understand while the oil companies in particular may not wish to pledge their credit in this fashion. An alternative, and one we must recognize as a significant ~~XXXXXXXX~~ jump, in terms of the risk, as viewed by the investor. Is to restrict the liability or financial exposure of the oil companies in any financing, to the state which they have in the AKN oil venture. We have heard several possibilities suggested along each line, including those expressed earlier in these proceedings. Upon consideration, we believe that subject to the conclusion of satisfactory, contractual agreements with the oil company and others pertaining to the construction and utilization of the pipeling, that it is possible that these agreements coupled with satisfactory guarantees by the state, could make such an issue feasible. In conclusion, we ~~XXXXXX~~ believe that if as there appears to be in earlier testimony, there are sound, economic, and social reasons for the state

and the oil companies to cooperate in the financing of this project. ^{now} ~~the~~ establishment of a legislative and organizational framework as presently under consideration by the legislature, should facilitate discussions between the state and the oil companies. The output of such discussions could greatly assist us as well, in providing a more definitive judgement as to whether we believe a state finance oil pipeling is feasible at this time. Thank you

XXXXX

McVay: We'll take, ah, questions in the usual order.

Groth: Mr. Macy, you say that subject to the conclusion of satisfactory contracts it is ~~XXXXX~~ possible, couples with satisfactory guarantees by the state that it might ~~XXXXX~~ work., ah, what kind of state guarantees are we talking about?

Macy: Senator Groth, One of the difficulties I think we all encounter in answering questions like this and one of the reasons ~~XXX~~ why I really outlined what we considered the major risk to the investors in such an issue, is that to satisfy any one of these risks ~~XX~~ there's a whole variety of different guarantees, different methods, that could be used to satisfy the risk element to the investor. I think that perhaps it would be, I think it is pre-mature, if I may say so, to try to dissect one risk, or one method. And say well if we provided this then this would make it feasible, because frankly, I think until the legislation has been passed to set frame. And some feasible plan, or some mode of cooperation has been established with the oil ^{company} ~~company~~. That you cannot come up with sufficient pieces of a plan to satisfy, ^{there is no} to really make any meaningful judgement,

Groth: Mr. Chairman, That's one of the things that troubles me, and has troubled me since this discussion first arose.. Because, ~~XX~~ ah, seems to me, whether we have a bill or don't have a bill, somebody should go to oil companies and make an ^{arrangement} ~~arrangement~~, gentlemen,

are you prepared to sell what you already have, and are you prepared to enter into meaningful negotiations with us presuming we have the power to do so. And it becomes a chicken and egg arrangement that troubles me very greatly. The first inquiry seems to me

I mean we all talk about establishing, buying meaningful negotiations, and opportunities for cooperation, but I'm troubled by the fact that maybe the first inquiry hasn't been made.

McVay: May I recognize that your not the XXXXX person for me to ask that question.

I haven't had any other questions. Thank you

Barber: Mr. Macy, I would like to ^{ask} ~~ask~~ you if you _____ that the passage of this house bill 569, The Trans ^{Authority} ~~Authority~~, is a matter which should be determined prior to negotiations with the oil industry, as to their resection, of state ~~own~~ ownership of the pipeline.

Macy: I believe it is.

Barber: The prime factor in initial negotiation.

Macy: Well I think that it, if I can try to expand a little ^{matter} ~~the~~ _____. I think that,

_____ ~~there~~ perhaps a healthy indication in our system for private companies to exhibit considerable reserve in entering openly in cooperative agreements with public organizations. I think it's possibly, partly due to communication, it's partly due to some misgivings concerning motivations, objectives, goals _____ of interest and what have you. I think the variety of such motivation, on the part of public organizations, is certainly, probably greater than the variety on the corporate side. I think to the extent the state can exhibit through legislation their willingness to cut down and to focus what their motivations and interests are. It's really not only the legislation it's even the hearings and the testimony that we have here that exhibit what the goals and objectives of the state are and this is crystallized, I believe, in this legislation. I think this is very helpful to the corporations in better focusing on in what is involved in this, ~~this~~ this very broad term of cooperation of the State in such a project of this magnitude.

Barber; The saving in corporate tax determination would also very possibly, would it not, be a prime consideration to the oil industry.

Macy: In other words, you're saying if, if we

Barber: Won before I.R.S., and got a favorable decision, ^{that} ~~it~~ would enhance this Trans-Alaska Authority.

Macy: I believe this is the case. I think there is perhaps one additional factor that has to be brought to bear. Let us assume that you have ^{basic} ~~a~~ security. All things being equal, what might be the difference in interest costs between a tax, if it were taxable, or if it were non-taxable? The question here also involves one other factor. An issue of this size is going to ^{have} ~~be~~ have to be marketed very broadly. Some of the institutions which would have to be included in the market, such as life insurance companies, do not have the same tax structures as other institutions to which tax exempt securities might you might say, might normally be, to which they might normally be marketed. Therefore, I think you would probably because of the sheer size of this issue and the marketing problem, have to give up a portion of that differential between a, the normal differential, between a taxable and a non-taxable issue.

Barber: Senator Rettig

Rettig: Mr. Macy, in your studies of this situation, this proposition so far, are you and you as representing your associates and the companies that perhaps you're associated with in this study together this proposal, are you in a position to suggest that we should pass this, in other words, do you feel the chances are favorable that once it is passed that these bonds and various contracts could be worked out? Would you, in other words, recommend that we act favorable on this?

Macy: I would recommend that you act favorable on this. There is an urge to be ^{somewhat} flip in saying that you will never know, or you may never know, if such a financing were feasible until you provide a framework which would allow, I think, for what I consider a more cooperative exchange between the State and the oil companies.

Rettig: You're saying we can't do this unless we do have the vehicle.

Macy: Well, I say I find it highly doubtful that you could do that without the vehicle.

Rettig: Thank you.

Macy: I'm not guaranteeing that you'll be successful.

Rettig: I understand.

McVay: Any other questions - Mr. Farrow

Farrow: Thank you, Mr. Chairman. Assuming that the State goes ahead Mr. Macy, and starts to build the pipeline, despite an outstanding agreement with the oil companies, will this _____, or not?

It seems to me that we'd be able to save the time _____ at this time, There must be some area that you can say how the State has to guarantee its own _____. What areas are we talking about?

Macy: I'm afraid I have to come back to the same answer that I gave to Senator Groh earlier, that frankly, mind you, one of the

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TAPE 15:

page 1

such as satisfactory, reasonable, sufficient ~~and~~ if ~~you~~ ^{undoubtedly} Aside from the risks which I have listed here, there are ^{undoubtedly} others I could list, throw in another dozen; anyone of these risks can be met in a number of ways. To get focused on one ^{WFAK} way to attenuate part of the problem/by looking to the State for certain guarantees, is, really misleading.

I think that if you want a broad-- broader statement, which is highly generalized, the State and the oil companies, if such a plan, vaguely along these lines, were developed, have a stake in the development, exploitation, shipment, of oil to ^{T.H.C.} (27) North Slope. When you put together a prospectus to market this issue, and assuming that you're not counting on external guarantees by the oil companies, I give full credit to the oil companies, you're going to have to ^{BE VERY} focus ^{on} the economics of the North Slope, its oil and its future market, and cost of getting it there. You're going to be focused on what the state has invested ⁱⁿ there. I think perhaps that to the degree the revenues and stake that the State has, and that the oil companies have, that these are areas in which you will undoubtedly be exploring for certain assurances, guarantees, ^{and} agreements. I am sorry, I don't think it is meaningful to be more explicit than that.

^{RETTIG:} I believe ^{that} -----
Mr. Macey, / you have indicated that you feel the chances of working out a suitable arrangement with the oil companies are sufficiently good that you would recommend the passage of HB 569, and would/agree that up to that we should proceed with passing the ^{you also as} ~~on bond~~ ^{or} authorization ~~and~~ measure at the same time? Is that a necessary part of the...at this stage of the game?

^{MACY} ^{THE} : I think this is very useful. ^{the} the acceptance of these levels of financing to which the State to some degree is going to have its name

TAPE 15

page 2

~~for, asked~~

attached, because the legislature is going to go along with this, I think this is very important.

RETTIG,

We have, ~~perhaps~~ perhaps as you are no doubt aware, one of the highest/indebtednesses per capita of ~~bond~~ bond

of any state at this time, and I am aware that many of the bond underwriters

Look at it its on the books already to be authorized.
~~already~~ ~~ALL Ready~~

With the many, many ~~still~~ ^{STILL} unanswered questions in connection with the three and one half billion dollar issue, ~~xx~~ would the very ~~have~~ fact that that is on the books, ~~has~~ any effect upon our other general obligation bonds that we may have to market immediately or in the near future?

MACY: I don't believe so. ~~It is~~ not, as I understand from Mr. Cady's interpretation....what is really involved in the issue here, as I understand it, before any obligation of this type could occur, it requires so many plans enabling enabling legislation...I cannot really see where this would have effect ~~on it~~ ^{on it}.

Thank you.

MCVAE

Any further questions? Mrs. Fisher?

Mrs. Fisher: Mr. AINCY (Meisdig???) IF HB 569 is passed, if everything went right, what time would you estimate the first bonds could be sold? This could be a guessistimate.

AINCY: I would say the first bonds ^{might} ~~could~~ be sold.....the time factor, point of departure, the time after this cooperative agreement is reached with

~~the~~ the oil companies SO IT BECOMES given that that is reached, and that with suitable inputs from the investment community, that this agreement can be brought up to.....the investment bankers judge to be a satisfactory level of investment grade, ^{IF YOU WILL} I would assume that within three

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page 3:

to six months after that, the bonds ^{you could} ~~would~~ begin to sell the bonds. (974)
Now we also have conditions over which none of us have control. It is not only
as I understand it NOT ONLY
it's a question of whether you can sell the bonds ^{AS HOW MUCH YOU CAN} ~~you might be able to sell~~
the bonds, how much ^{OF THE BONDS} you can sell ~~the bonds for~~ ^{AND} at what cost. ^{AND} these are
subject to market conditions, which we have relatively little control over.

MCVARE:

Other questions? Mr. ~~Groves~~ ^{GROH} Grohst?

GROH: One quick one - in the broadest general terms, Mr. Macy,
counsel fees,
what are potential underwriting fees, in connection with the three and a half
billion dollar issue? ^{HA HA} No, just as.....I think the people
of Alaska ^{ought} ~~would like to~~ know. I'd like to know.

MACY ^{I THINK THAT}: This again is something that ^{I WOULD ALWAYS STOP AND} ~~would~~ say is
existing ^{highly GRADED IT IS}
subject to market conditions ^{AND SO FORTH} I would say that you have to
accept ^{THE} ~~that~~ initial issues are going to have a larger underwriting spread,
which is investment banking fee I think you are referring to, than the later
issues because it is ^{A SHEER} educational effort that is going to have to go into the
market. I think that various comments that we have discussed ^{AMONG THE} ~~with~~ members
of the group, I think ^{THAT THE INITIAL} ~~the~~ that the underwriting discount here...somewhere
between 1-1/2 and 2-1/2 %. Now admittedly I have heard of rumors in the
newspapers that somebody is willing to ^{bid} ~~xxx~~ slightly higher than that for
the underwriters service, but ^{I THINK THAT}
this is perhaps a realistic REALITY in today's market.

GROH:

You deal in these figures all the time - would you translate that for me?

MACY: Yes, that is the principal ~~amount~~ amount of THE ISSUE.

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MCVAE: I would like ^{CLARIFICATION} verification on that...are are you....
are you saying 1-1/2 ^{to 2%} of the entire issue, or would that 1-1/2 to 2% say of the first hundred million?

MACY: No, each series, as it comes. Theoretically, at the end of total the total issue, the/underwriting spreads.....total ^{should} 1-1/2 to 2-1/2 % of the total principal amount of the bonds - in this case 3-1/2 billion dollars.

MCVAE: you say seventy million.....2% ^{would be} 70 million?.....

(much hilarity)

HOLM:

M. MACY, I just want to follow that up - would this be the same, whether it was sold by private industry or not?

MACY: Now in general, the underwriting spread for ^A private issue here, on this particular case - I think the alternative you are referring to would be the oil companies (yes) financing - would be less.

HOLM: Approximately how much less?

MACY: This gets very subjective; I'd say that it might run a half percent lower.

HOLM: So we pay a half per cent premium? Why do we pay a half per cent premium?

MACY: I think it is because ^{OF THE WAY IN WHICH} the difference in which corporate municipal or issues are marketed, and the way ^{being} in which public issues are marketed, the relationship between the sale ^{IF YOU WILL, THE SELLERS,} the underwriters and the institution, ^{THEN IT WOULD BE --}

HOLM: Well, ^{A LITTLE BIT} ~~anyway~~, doesn't that narrow that 1-1/2 % spread that was talked about, earlier - I suppose you were here - this narrow that down ^{DOESN'T} to one, and some of the other questions ^{THAT WERE RAISED} took another half per cent ~~out~~ OFF.

MACY : Well, ^{you} we have to understand....you have two things here....
in an underwriting discount, our spread, ^{IF you will} if you will, ^{which} is a one time cost at
the front end... ^{THIS} ~~it~~ comes out and is deducted from the net proceeds ^{OF} ~~that~~
~~the~~ ^{ing.} are offered.

HOLM : So it is just the first year, ^{MACY:} its not an annual thing,

HOLM : No, I UNDERSTAND, BUT ITS

 : ~~I understand, the.....~~

MACY : I think the spread that you're referring to was the spread
in the interest cost, for the life of the issues. ~~(BT)~~

HOLM : For the first year there would be the spread wouldn't
be nearly as great?

MACY : That is correct.

HOLM : Thank you.

BETTIG : Mr. Macy, would you be willing to pay the bond counsels
fee out of that?

BETTIG
(laughter) you don't have to answer that.

Mr. Rose?

Mr. Rose : My question, Mr. Chairman, was along the same line
that you were just asking.....the answer to Senator ^{GROH} ~~Rowe's~~ (A) question.
I am interested in the underwriting fee, but Senator Groh asked about the
counsel fee - what kind of a spread does that represent?

MACY : I am afraid I couldn't GUESS, MYSELF.

Mr. Rose : You have no idea? There is no DOOR OPEN FOR THIS KIND OF THING.

MACY : There may be - I-believe-Mr.

BETTIG : I believe Mr. Macy has indicated he ~~XXXXXXXXXXXXXXXXXXXX~~
is not prepared for that,
not being bond counselor.

BETTIG : Are there any other questions?

CHRISTENSON W: Yes.....where can we get this figure?

RETTIG: Mr. Wohlforth, would you care to volunteer this information?

Wohlforth: ~~I am afraid I am not any improvement as unfortunately I was~~
some
in conversation at my table.

W: Can you rephrase it?

ROSE: Senator Groh ~~asked~~ ^{earlier} about what the normal liquidation bond
fee
counsel/would be ~~RETTIG:~~ what would be the bond counsel's fee for representing
the State in this issue?

WOHLFORTH: Well, again since I didn't hear the question, I imprudently
came to the table

RETTIG: Are there any other questions?

WOHLFORTH: ~~It is the largest or next~~ ^{FINANCED} ~~It would be the largest project. This would certainly be the~~
~~largest project~~ ^{THINK} in the Western Hemisphere and I.....the second largest in the
~~world, to be perhaps "smart alecky" negotiable~~ ^{AGAIN,} an arms length transaction
between those public officials responsible for the public purse, or those

people who are performing services. And again, I ~~think~~ ^{think} its of the magnitude
ON which unfortunately I
where I don't think the committee can begin on meaningful information.

MCVANE: Its not on a minimum fee schedule?

RETTIG: Mr. Macy, do I understand that you have to leave town tomorrow?
Tonight, there'll be a few minutes perhaps shortly, that any members who want
to consult with Mr. Macy, may do ^{so} later.

W: Thank you very much, Mr. Macy, for appearing.

RETTIG: In this hearing we've considered only the various aspects
OF possible State ownership of the pipeline. There are other majors introduced
by the administration ..sponsored by the administration....namely SB 313, 14 and 15
concerning rights of ways, safety standards and pipeline regulations. Mr. Havelock,

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are you ready to proceed?

Mr. Havelock: Senator, the....if I may be allowed a moment of digression
A NON-
to answer ~~the~~ question of Senator Groh earlier - he asked ...he made an inquiry

about he couldn't understand why we hadn't approached the oil companies

To find out
~~about~~ this preliminary question of whether they were willing to.....if I may

answer this in sort of an analogy.....I suppose if possible that I could get

up from this table and go and ask the attractive girl at the end of the table

whether she's willing, and I'm sure she'd tell me to go jump in the lake. *IF I* On

the other hand, if I invited her out *TO DINNER* I might get a good deal more information, *ABOUT*

whether she was willing.....start looking in store windows, I would *AT FURS & DIAMONDS*

probably get a good deal more information! An old negotiator like Senator

GROH
Grethe is probably quite aware of the answer to this. (laughter) This is

Attorney General OLAF HELLIN who will discuss the bills YOU REFERRED TO

GROH: Mr. Chairman, I have a comment....my question is, have
you ever called them?

HAVELOCK: We've talked to them hundreds of hours,

GROH: Did you ever ask them "are you willing to sell?"

RETTIG: *ITS BEEN covered in the papers quite fully.*
According to the papers, quite willing. *(???)*

RETTIG: The answer was "no."

GROH: Then, what are we doing here?

RETTIG: He is still taking them out to dinner!

GROH: *I SEE. Havelock: Before Mr. Helkin starts*

with his
~~as part of the~~ testimony, Mr. Chairman, *I would just like to comment that*
there is a bill that is not before this

committee, *BUT* which will relate to the subject matter generally which will be

testified *TO* before other committees, which is the so-called 20 mill property tax

OK
~~law on the oil~~ pipeline *EQUIPMENT* transportation, which is very much related to the subject

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Testimony of Eric E. Wohlforth
Commissioner of Revenue

March 6, 1972

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

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

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

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

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

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

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

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

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

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

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

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

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

between SEC filings. This dramatic increase in pipeline costs revealed in official documents at the time of Governor Egan's first announcement on State ownership made it urgently necessary that the State finally determine the likely magnitude of pipeline costs. Commissioner Campbell has already indicated the independent study which the State has made through its consulting engineers, Tibbets, Abbott, McCarthy and Stratton, and the foundation for the present estimate of \$3.5 billion. These figures have ^{been} just 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 oil revenues. /

The base case shown to you today in graphic form assumes the total pipeline cost of \$3.5 billion financed 90% by debt at an interest rate of 8%. It conforms to the Alyeska throughput assumptions of full production only in the seventh year of pipeline operation. It shows the same ICC permitted rate of return as shown in the State's projection in July. In the fourth year from the beginning of construction ^{OK} and the first year of production, or 1977, we now show a negative wellhead or no State oil revenues. This was the year comparable to that in which it was earlier shown that the State would capture at least \$164 million in revenues. / The fifth year, 1978 / the second assumed year of operation,

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

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

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

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

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

The next case presented shows the possible economic effect of State ownership of the pipeline. Financing is assumed in the amount of \$1 billion in each of the first two years of construction at 8%, \$900,000,000 in the third year of construction at 6-1/2%, \$250,000,000 at 8% in the first year of operation, and \$310,000,000 in the second year of operation. This case also assumes the same ICC permitted rate of dividend payout as assumed for the private case, namely, 7% which is a cash dividend payout limitation in each year of the projection. In arriving at the State's net cash flow, operating expenses, amortization, and interest on bonds are deducted from the gross income. During the

first year of operation net cash flow to the State through its tariff on the pipeline is \$230 million and royalty and severance taxes of \$15.7 million for a total of \$245 million. Obviously, in State ownership no federal or state income taxes are calculated on pipeline income. In the fifth year from beginning of construction or the second year of operation net cash flow is \$228 million which together with royalty and severance taxes of \$17 million produce a total of \$245 million. In the sixth year from the beginning of construction and the third year of operation net cash flow amounts to \$227 million through the tariff and total royalties and severance taxes amount to \$123 for a total of \$350 million. In the 15th year cash flow is reduced to \$183 million by reason of the fact that the pipeline has depreciated but total royalties and severance taxes amount to \$297 million for a total to the State treasury of \$480 million.

It is emphasized that this case makes almost identical assumptions to that for the private case described above. It should be emphasized that the net income shown to the State is computed after debt service on State bonds. To avoid a speculative argument on the possible differential between interest rates on the State's debt which may be tax exempt versus taxable interest on the private borrowing we show all but \$900,000,000 in State bonds at the same 8% rate. The main differences, of course, lie in the fact that the State is not subject to federal income tax and will receive no state income tax from pipeline operations.

since it is the owner. The timing of the bond issues for both private and public ownership is the same although the term of the public bond issue is shorter indicating heavier debt service loads and the State of course is financing the pipeline 100% on a debt basis.

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

JOINT HEARINGS ON PROPOSED PIPELINE LEGISLATION

MARCH 6 THROUGH MARCH 9, 1972

WITNESS REGISTER

	<u>NAME</u>	<u>AFFILIATION</u>	<u>REPRESENTING</u>
1.	H. A. Boucher	Lt. Governor	Administration
2.	Charles Herbert	Commissioner, Nat. Resources	Administration
3.	John E. Havelock	Attorney General	Administration
4.	Bruce Campbell	Commissioner of Highways	Administration
5.	Eric E. Wohlforth	Commissioner of Revenue	Administration
6.	Larry Eppenbach	Department of Revenue	Administration
7.	Joseph R. Henri	Commissioner of Administration	Administration
8.	H. M. Temple III	Temple, Barker & Sloane	Administration
9.	Charles Kates	Hawkins, Delafield & Wood	Administration
10.	Tom Gildehaus	Temple, Barker & Sloane	Administration
11.	L. E. Crowley	Salomon Brothers	Administration
12.	Robert Macy	Kuhn, Loeb & Company	Administration
13.	John E. Havelock	Attorney General	Administration
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JOINT HEARINGS ON PROPOSED PIPELINE LEGISLATION

MARCH 6 THROUGH MARCH 9, 1972

WITNESS REGISTER

<u>NAME</u>	<u>AFFILIATION</u>	<u>REPRESENTING</u>
1. Charles E. Spahr	Aleyeska Pipeline	Standard Oil of Ohio (SOHIO)
2. W.J. Williamson	Aleyeska Pipeline	Law Professor U. of Houston
3. Harry R. Jones	Aleyeska Pipeline	Attorney specializing in State & Interstate commerce. Houston, Texas
4. Donald W. Markham	Aleyeska Pipeline	Washington, D.C. Attorney
5. Edward L. Patton	Aleyeska Pipeline	President of Aleyeska Pipeline
6. Joseph R. Cortese	Aleyeska Pipeline	Attorney Ohio, specialist in law re Powers of State & local govt
7. Raymond B. Gary	Aleyeska Pipeline	Investment Banking, Underwriting & distrib of securities.
8. George A. Seymour	Aleyeska Pipeline	Mobil Pipe Line Company.
9. Thomas R. Broussard	Aleyeska Pipeline	Atty. Spec in taxation, Legal Dept. ARCO
10. Edward L. Patton	Aleyeska Pipeline	Aleyeska President. See 5 above
11. Joseph R. Cortese	Aleyeska Pipeline	Same as 6 above.
12. Richard M. Donaldson	Aleyeska Pipeline	V-Pres & Gen Counsel of SOHIO
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JOINT HEARINGS ON PROPOSED PIPELINE LEGISLATION

MARCH 6 THROUGH MARCH 9, 1972

WITNESS REGISTER

	NAME	AFFILIATION	REPRESENTING
1.	S. C. SANDUSKY	DIVISIONAL MANAGER	MARATHON OIL COMPANY
2.	DON DICKEY	GENERAL MANAGER	STATE CHAMBER OF COMMERCE
3.			
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1 IN THE HOUSE

BY THE RULES COMMITTEE BY
REQUEST OF THE GOVERNOR

2 HOUSE JOINT RESOLUTION NO.

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 SEVENTH LEGISLATURE - SECOND SESSION

5 Proposing an amendment to the
6 Constitution of the State of Alaska
7 provisions regarding the use of state
8 funds for the debt of public
9 corporations.

10 BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

11 * Section 1. Sec. 7, art. IX of the Constitution of the State of Alaska
12 is amended to read:

13 SECTION 7. DEDICATED FUNDS. The proceeds of any state tax or license
14 shall not be dedicated to any special purpose, except when required by the
15 federal government for state participation in federal programs, or when
16 dedication is provided by law, for the purpose of securing the payment of
17 bonds and notes of a public enterprise or public corporation of the state
18 or a political subdivision of the state. This provision shall not prohibit
19 the continuance of any dedication for special purposes existing upon the
20 date of ratification of this constitution by the people of Alaska.

21 * Sec. 2. Sec. 8, art. IX of the Constitution of the State of Alaska
22 is amended to read:

23 SECTION 8. STATE DEBT. No state debt shall be contracted unless
24 authorized by law for capital improvements and ratified by a majority of
25 the qualified voters of the State who vote on the question except that the
26 State may guarantee by law bonds and notes of a public enterprise or a public
27 corporation of the State created or empowered to construct pipelines for the
28 transportation of oil or gas or both and may by law authorize such public
29 enterprise or public corporation to mortgage any State lands or properties

1 and royalties or rents, issues and profits therefrom as additional security
2 for its bonds or notes, whether or not guaranteed by the State. The State
3 may, as provided by law and without ratification, contract debt for the
4 purpose of repelling invasion, suppressing insurrection, defending the State
5 in war, meeting natural disasters, or redeeming indebtedness outstanding at
6 the time the constitution becomes effective.

7 * Sec. 3. The amendment proposed by this resolution shall be placed
8 before the voters of the state at the next statewide election in conformity
9 with sec. 1, art. XIII of the Constitution of the State of Alaska and the
10 state election laws.
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PROPOSED AMENDMENTS TO HOUSE BILL NO. 569

Page 2, line 26:

After the word "interest." strike the words "It is also declared to be in the public interest for the state to guarantee the principal and interest on bonds issued to finance the facility."

Page 19, line 12:

Delete all of AS 44.58.260.

Statement of Charles F. Herbert
Commissioner of Natural Resources

In 1964 the State of Alaska selected 1,593,705 acres on the North Slope, between Naval Petroleum Reserve No. 4 and the Arctic Wildlife Range. The land selected was considered to have good potential for petroleum but none suspected that it would contain the largest oil pool ever found in North America. On the map, the lands north of the heavy green line are those selected in 1964 and the orange-shaded area covers the Prudhoe Bay oil field. I want to emphasize that not all of the land within the shaded area will be productive of oil or gas--in fact, there are a number of dry holes within the area shown as the oil field.

Although millions of dollars had been spent in an unsuccessful search for oil on Federal lands southwest of State lands, the first lease sale of North Slope lands by the State was moderately successful and provided revenue at a time when it was needed badly. Greater interest was shown in subsequent lease sales even though drilling on State lands had been disappointing. Finally, on what was said to be a "last try" for oil on the North Slope, ARCO announced a major discovery in July, 1968. The State then selected an additional 2,852,880 acres south of the original North Slope selection. This later selection, for which tentative approval by the Bureau of Land Management has not been received, lies between

the green and brown lines on the map. Note that over half of the area in the later selection is covered by leases. These are Federal noncompetitive leases which had been issued prior to State selection. Some have expired recently and many are due to expire within the next few years, unless oil or gas is found in productive quantities.

With oil interest at fever pitch, the State sold much of remaining tentatively approved North Slope lands at a lease sale on September 10, 1969. The total of bonus bids received at that sale is the largest ever recorded anywhere.

Bonuses received from the sale of State leases on the North Slope:

<u>Date of Sale</u>	<u>Acres Leased</u>	<u>Bonus/Acre</u>	<u>Total Bonus</u>
Dec. 8, 1964	476,147	\$ 9.20	\$ 4,379,729.91
July 15, 1965	403,000	15.25	6,145,472.59
Jan. 24, 1967	42,397	34.87	1,478,777.23
Sept. 10, 1969	<u>412,548</u>	<u>2,181.66</u>	<u>900,041,605.34</u>
	1,334,092*	\$ 683.65	\$912,045,585.07

* This figure includes some offshore lands and some duplication caused by forfeiture of leases and subsequent re-leasing.

Bonuses on future sales of leases on the North Slope are most difficult to estimate. Certainly, there is little incentive to purchase leases in the area until such time as construction of a pipeline is assured. About all we know is that the State does own, or will own, land that can be offered for competitive oil and gas leasing.

We estimate that the following land may be offered at some future date:

Unleased land on which the State now has tentative approval	200,000 acres
Selected land, less valid Federal leases - at least	1,000,000 acres
Offshore lands between Pet. 4 and and the Arctic Wildlife Range	300,000 acres

Since Alaska now ranks second among the states in proven oil reserves, and will probably outrank the leading state, Texas, when more active drilling is resumed, Alaska can look forward for very many years to substantial income from oil and gas royalties and severance taxes.

The Prudhoe Bay field alone has a proven reserve of 9.6 billion barrels of oil and 26 trillion cubic feet of natural gas. To the west of Prudhoe Bay, the Ugnu field has oil but there has not been enough drilling to permit a reliable estimate of reserves. Wells in the Ugnu field are much less productive than those in the Prudhoe Bay field but they should add materially to North Slope production. Other potentially productive structures are known so we think that an estimate of 20 billion barrels of oil from State lands on the North Slope is justified.

In addition to production from State lands and offshore lands on the North Slope, oil and gas will be produced from lands that may be selected by Native Regional Corporations and from Federal lands that are or may be leased. We expect that someday Petroleum Reserve No. 4 will be developed, and there is some possibility that the very attractive Marsh Creek anticline in the northwesterly portion of the Arctic Wildlife

Range may be drilled. The highly regarded Canadian publication, OILWEEK, estimates that the Alaskan North Slope will produce 50 billion barrels of oil and many trillions of cubic feet of natural gas. Most certainly, oil and gas pipelines from the North Slope will be busy for many years.

In all existing leases on the North Slope, royalty is fixed at 12-1/2% of the wellhead value. However, leases issued prior to 1969 provide for a royalty of 5% of the production from a lease on which a discovery of a new field is made. Only one lease in the Prudhoe Bay field is entitled to the reduced royalty and that privilege expires in 1978, ten years after the date of discovery.

All existing North Slope leases have a term of ten years, or as long as production is maintained. Leases may also be extended if committed to an approved unit agreement. Unit agreements, which are formed by pooling of interests of all lessees on a geologic structure capable of, or believed to be capable of, producing oil or gas, carry specific drilling requirements which must be approved by the Department of Natural Resources if on State land, or by the U.S. Geological Survey if on Federal land. Prior to 1969, leases on lands to which the State had only received tentative approval were issued as conditional leases and the lease term did not begin to run until the State received patent to the land. With the exception of the leases sold in the September, 1969 sale, North Slope leases are conditional and the term of lease has

not begun to run.

The wellhead price of oil or gas, on which royalty and severance taxes are based, is stated in each lease as the highest of (1) the price actually paid by a purchaser at the well, (2) the posted price by the Lessee in the oil or gas field, or (3) the prevailing price paid to other producers. Since nearly all Alaskan oil is sold on the West Coast of the United States, the wellhead price is determined by the field price at the point of delivery on the West Coast, less transportation charges. Since these charges are variable among producing companies there has been enough confusion in the Cook Inlet Basin to cause a lawsuit between the State and one of the producers. Since this matter is now before the court I cannot comment further, other than to hope that clear guidelines for the determination of wellhead price are established either by directive from the court or by general agreement.

All oil and gas produced from State lands on the North Slope, other than offshore lands, is subject to a payment of 2% of the gross value (i.e., wellhead price) to the Alaska Native Fund, until such time as \$500 million has been paid into that fund from all sources of State income subject to such payment. Although provision for payment to the Alaska Native Fund effectively reduces State royalty on a standard oil and gas lease to 10-1/2%, the payment is treated in State accounts as an obligation against the State treasury and so does not enter into estimates of State income from minerals.

After deduction of royalty from wellhead price, the remaining value is subject to a State severance tax based on the rate of production from each producing well. The tax on oil is:

3% on the first 300 barrels per day

5% on the next 700 barrels per day

6% on the next 1,500 barrels per day

8% on all production over 2,500 barrels per day

The severance tax on natural gas is 4% of the wellhead price, regardless of the rate of production.

Derivation of State income from royalty and severance tax is:

Assumed wellhead price of oil	\$ 2.00
State royalty @12-1/2%	0.25
Taxable value of oil	<u>1.75</u>
Severance tax @ 7% (best estimate)	0.12

Total State income then would be \$0.37, or 18-1/2% of the wellhead price, a percentage that is probably applicable to oil production from the North Slope, regardless of wellhead price. For natural gas, State income is 16% of the wellhead price.

3/6/72

INTRODUCTORY STATEMENT BY LIEUTENANT GOVERNOR

MARCH 6, 1972

I HAVE BEEN ASKED BY GOVERNOR EGAN TO DELIVER HIS MESSAGE TO THE PEOPLE OF THE STATE OF ALASKA IN HIS ABSENCE.....AS LIEUTENANT GOVERNOR I HAVE HAD THE OPPORTUNITY TO WATCH OUR CHIEF EXECUTIVE DEAL WITH THE AGONIZING REALITIES THAT DELAY IN PIPELINE CONSTRUCTION AND SPIRILING COSTS HAVE RESULTED IN.... AND WHILE APPRAISALS THAT DO NOT VIEW A PORTION OF OUR FUTURE TOTALLY THROUGH ROSE COLORED GLASSES ARE DISTASTEFUL TO SOME.... I HAVE NEVER SEEN OUR CHIEF EXECUTIVE SWERVE FROM HIS DUTY TO OUR STOCKHOLDERS.....THE PEOPLE OF THE STATE OF ALASKA

THE FUTURE OF OUR STATE IS A BRILLIANT ONE....NO ONE KNOWS THIS BETTER THAN OUR GOVERNOR WHO HAS DEVOTED OVER THIRTY YEARS OF HIS LIFE IN SERVICE TO ALASKA AND HER PEOPLE....THERE HAVE BEEN ROCKY SHOALS BEFORE AND OUR SHIP OF STATE HAS NAVIGATED THEM.... THEY WERE NOT OVERCOME BY WISHFUL THINKING...WE NEED NOT BE AT ODDS WITH OUR PARTNERS IN THE FUTURE...THE OIL INDUSTRY...WE RECOGNIZE YOUR CORPORATE RESPONSIBILITIES....I AM SURE YOU WILL RECOGNIZE AS GOOD CITIZENS OUR RESPONSIBILITIES...AND IT IS IN THIS SPIRIT THAT GOVERNOE EGAN HAS ASKED THAT I READ THIS MESSAGE INTO THE RECORD.....

SCHEDULE OF JOINT HEARINGS ON PROPOSED
PIPELINE LEGISLATION

COMMITTEES:

SENATE COMMERCE COMMITTEE, RON L. RETTIG, CHAIRMAN.

HOUSE STATE AFFAIRS COMMITTEE, RICHARD L. MCVEIGH, CHAIRMAN.

LOCATION: GOLD ROOM, BARANOF HOTEL

BILLS TO BE CONSIDERED:

SB 313 - Relating to lease of rights-of-way.

SB 314 - Relating to safety standard for oil and gas transportation.

SB 315 - Creating Alaska Oil and Gas Transportation Commission.

SB 294 - Creating Alaska Leasing Board.

HB 569 - Establishing Trans-Alaska Authority.

HB 570 - G. O. bonds, \$3,500,000,000.

MEETING SCHEDULE:

Monday, March 6, 1972	2:00 p.m. to 6:00 p.m.
Tuesday, March 7, 1972	8:00 a.m. to 11:00 p.m. 2:00 p.m. to 6:00 p.m.
Wednesday, March 8, 1972	8:00 a.m. to 12:00 p.m. 1:30 p.m. to 6:00 p.m.
Thursday, March 9, 1972	8:00 a.m. to Completion

A special section will be reserved for other Members of the Legislature.

Testimony of Lawrence Eppenbach
State Investment Officer

March 6, 1972

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

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

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

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

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

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

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

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

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

under conditions of public ownership.

Under conditions of private ownership, a very different case develops. Here in the initial year a total of about \$37 million should accrue to the State. Where does it come from? \$3.2 million of it only comes from the North Slope in the form of gas royalty and production tax payments. This is gas that is assumed to be shipped in a trans-Canadian gas pipeline. The remaining \$34 million comes from state income taxes. In the 7% dividend case displayed here there is no positive wellhead value for oil during the first two years of operation under private ownership. In this case, for there to begin to be some positive wellhead for oil during the first two years, the dividend payments must be no greater than $4\frac{2}{4}\%$ and even if the dividend were lowered to zero the State's income from royalty and severance tax of approximately \$53 million would be less than one third of that estimated as recently as last year.

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

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

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

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; *those are State \$* 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 ^{items} ~~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 ^{as I mention}. Nonetheless, so far we have not jeopardized any State activity essential to health and safety. These painful adjustments herein noted were recommended in spite of the fact oil was projected on stream in July 1976; now another year's delay - or more - seems probable. The consequences are obvious.

Our budget book for Fiscal Year 1973 projects a growth rate of 6% compounded annually through 1976, and 8% thereafter through Fiscal Year 1981, 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 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 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 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. 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. 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% (see Exhibit C). Now an increase of 1% equals a huge cut in all programs, and the elimination of many. /

The dollar crunch is graphically portrayed in the following paradigm. Under the private ownership operating budget column, increasing annually at 1%, the available dollars are recorded. Contrast 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 billion less dollars to spend over the next ten years. We would be able to authorize 365 million fewer dollars for capital improvements.

(Graph on following page)

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