

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 86/2

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

AS A SAFE HAVEN FROM THE TEST OF WHETHER THE BENEFITS AND BURDENS OF OWNERSHIP HAVE BEEN TRANSFERRED, THE REGULATIONS PROVIDE THAT THE TRADE OR BUSINESS WILL NOT BE MET IF THE OUTPUT "IS SOLD TO A SUBSTANTIAL NUMBER OF UNRELATED CUSTOMERS UNDER A RATE SCHEDULE OF GENERAL APPLICATIONS PROVIDED THAT NO SINGLE CUSTOMER PAYS ANNUALLY A DEMAND CHARGE OR GUARANTEED MINIMUM PAYMENT WHICH EXCEEDS 2-1/2% OF THE AVERAGE ANNUAL DEBT SERVICE." THE ILLUSTRATION UNDER THIS EXCEPTION DEALS WITH A FACILITY FOR SUPPLYING ELECTRIC ENERGY.

IN OUR OPINION, THE MINIMUM SHIPPING AGREEMENTS CAN HARDLY BE SAID EITHER TO BE TERMS OF SALE CUSTOMARY IN THE INDUSTRY OR NOT TO HAVE THE EFFECT OF TRANSFERRING THE BURDENS OF OWNERSHIP TO THE COMPANIES. MR. GARY HAS ALREADY EXPLAINED WHY THE BURDENS OF OWNERSHIP (IN THE FORM OF THE PLEDGE OF COMPANY CREDIT) ARE OF NECESSITY PLACED ON THE COMPANIES. EARLIER TESTIMONY BY THE ADMINISTRATION HAS STATED THAT SOME OF THE BENEFITS OF OWNERSHIP WILL BE PASSED ON TO THE COMPANIES AS WELL. THEREFORE, THE TEMPLE PLAN WILL NOT FIT WITHIN THE EXCEPTION.

THUS, IT IS OUR CONCLUSION THAT IT IS EXTREMELY UNLIKELY THAT A FAVORABLE RULING COULD BE OBTAINED FROM THE INTERNAL REVENUE SERVICE THAT INTEREST ON THESE PROPOSED BONDS WOULD BE TAX EXEMPT. ALTHOUGH RULINGS, ONCE OBTAINED AND ACTED UPON BY THE RECIPIENT, ARE SELDOM, IF EVER, RETROACTIVELY REVERSED, IT SEEMS UNLIKELY THAT CONGRESS, IN VIEW OF ITS POSITION IN 1968, WOULD NOT ACT TO NULLIFY SUCH A RULING BEFORE ANY COMMITMENT HAD BEEN MADE IN RELIANCE ON THE RULING. IN FACT, LEGISLATION WOULD PROBABLY BE

INTRODUCED AS SOON AS ANY APPLICATION FOR A REVENUE RULING BECAME KNOWN WHICH WOULD CAUSE THE IRS TO SUSPEND ACTION ON THE RULING REQUEST.

~~TWO ADDITIONAL MATTERS SHOULD BE MENTIONED.~~ IT HAS BEEN SUGGESTED THAT IF THE STATE COULD OBTAIN THE TAX BENEFITS UPON WHICH THE ADMINISTRATION'S PROJECTIONS ARE BASED, THESE BENEFITS WOULD BE PASSED ON TO THE OIL COMPANIES. THE MAGNITUDE OF ANY DIFFERENTIAL IN INTEREST RATES¹ HAS BEEN DISCUSSED EARLIER BY ADMINISTRATION WITNESSES AS BEING QUITE SMALL OR NON-EXISTENT. BUT EVEN IF SOME TAX SAVINGS WERE PASSED ON TO THE OIL COMPANIES BY REDUCED TARIFF, WHETHER ORDERED BY THE ICC OR OTHERWISE, THE BENEFIT TO THE COMPANIES WOULD STILL BE SUBSTANTIALLY REDUCED BY THE INCREASED INCOME TAX PAYMENTS ON THE HIGHER PROFITS RESULTING FROM LOWER TRANSPORTATION COSTS.

SECONDLY, THE OWNERSHIP BILL IS DESIGNED TO PROVIDE FINANCING FOR SEVERAL FACILITIES SEPARATE FROM THE PIPELINE IN AN EFFORT TO TAKE ADVANTAGE OF CERTAIN EXEMPTIONS FROM THE INDUSTRIAL REVENUE BOND PROVISIONS OF SECTION 103(c).

WHERE AN OBLIGATION MEETS THE TESTS OF AN INDUSTRIAL DEVELOPMENT BOND, THE INTEREST MAY STILL BE EXEMPT FROM TAX IF THE PROCEEDS ARE USED FOR CERTAIN FACILITIES LISTED IN SECTION 104(c)(4). THOSE FACILITIES ARE:

- "(A) RESIDENTIAL REAL PROPERTY FOR
FAMILY UNITS;
- (B) SPORT FACILITIES;
- (C) CONVENTION OR TRADE SHOW
FACILITIES;

- (D) AIRPORTS, DOCKS, WHARVES,
MASS COMMUTING FACILITIES,
PARKING FACILITIES, OR STORAGE
OR TRAINING FACILITIES DIRECTLY
RELATED TO ANY OF THE FOREGOING;
- (E) SEWAGE OR SOLID WASTE DISPOSAL
FACILITIES OR FACILITIES FOR
THE LOCAL FURNISHING OF ELECTRIC
ENERGY OR GAS;
- (F) AIR OR WATER POLLUTION CONTROL
FACILITIES, OR
- (G) FACILITIES FOR THE FURNISHING OF
WATER, IF AVAILABLE ON REASONABLE
DEMAND TO MEMBERS OF THE GENERAL
PUBLIC."

YOU WILL NOTICE THAT SECTION 1 OF HB 570 LISTS SEVERAL OF THESE EXEMPT FACILITIES. HOWEVER, FOR MOST OF THOSE FACILITIES RELATED TO THE PIPELINE IT IS UNLIKELY THAT THE EXEMPTION WILL APPLY. THE PROPOSED REGULATIONS PROVIDE THAT "TO QUALIFY UNDER SECTION 103(c)(4) AND THIS SECTION AS AN EXEMPT FACILITY, A FACILITY MUST SERVE OR BE AVAILABLE FOR GENERAL PUBLIC USE, OR BE A PART OF A FACILITY SO USED, AS CONTRASTED WITH SIMILAR TYPES OF FACILITIES WHICH ARE CONSTRUCTED FOR THE EXCLUSIVE USE OF A LIMITED NUMBER OF NON-EXEMPT PERSONS IN THEIR TRADES OR BUSINESSES."

THE BULK OF THE FACILITIES ASSOCIATED WITH THE PIPELINE ARE FOR THE USE OF A LIMITED NUMBER OF PRIVATE COMPANIES. HOWEVER,

THIS RULE DOES NOT APPLY TO POLLUTION CONTROL FACILITIES.

IN CONCLUSION, THE REQUIREMENTS OF GUARANTEES BY THE OIL COMPANIES OF THROUGHPUT TO THE PIPELINE NECESSARY FOR SUCCESSFUL MARKETING OF STATE BONDS TO CONSTRUCT THE PIPELINE, AMPLY DESCRIBED BY MR. GARY, WILL MAKE THE INTEREST ON SUCH BONDS SUBJECT TO FEDERAL INCOME TAX. FURTHER, IT IS QUITE POSSIBLE THAT THE STATE'S INCOME FROM OPERATION OF THE PIPELINE WILL BE TAXED BY THE FEDERAL GOVERNMENT. THUS TO THE EXTENT THAT TAX EXEMPTION IS ESSENTIAL TO THE ATTRACTIVENESS OF THE OWNERSHIP BILL, THAT BILL IS UNLIKELY TO SATISFY THE STATE'S REVENUE NEEDS. IN THE MEANTIME, IT CREATES A CONTINUING CLOUD OVER THE PRIVATE FINANCES NEEDED BY THE COMPANIES IN ORDER TO PLACE THE TRANS ALASKA PIPELINE IN SERVICE ~~AS SOON AS POSSIBLE.~~

SENATE BILLS NOS. 294 AND 313

RIGHT-OF-WAY LEASING

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

IV. OTHER PROVISIONS OF THESE BILLS ARE UNCONSTITUTIONAL.

A. Court Jurisdiction.

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

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

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

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

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

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

B. Penalty Provision.

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

C. Regulatory Jurisdiction.

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

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

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

D. Forfeiture.

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

E. The Option To Purchase.

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

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

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

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

F. The Savings Clause.

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

V. CONCLUSION.

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

SCOMM

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

McVay: The floor is open now for questions of at this time, I don't know if Mr. Donaldson wants words of introduction, o.k., the floor is open now for questions of Mr. Markham.

Rader: Mr. Markham, you mentioned that the majority published of the return was 5.6. So that we could advise ourselves of that type of thing, where does that type of information come from.

Markham: It isn't published, it would have to be derived from the information that is filed with the ICC.

Rader: The next question I had was, if my memory serves me correctly and it may not, but it seems to me that several years ago you had an expert here on from the Miller administration from the ICC who gave us, lead us to believe that certainly the Alyeska interest would be, Alaskan interest, pipeline interest would be grouped with the other interest of the pipeline companies for purposes of both calculating rates of returns and also dividedds. As I understood your answers yesterday, you believe that to be clearly erroneous.

Markham: Only half erroneous. I think there is some confusion perhaps between the percent degree and the computation that is made here and the way the commission uses the 8% return. It is undoubtedly true that for purposes of determining compliance with the ^{percent degree} ~~percent degree~~ they look at the entire financial results of the company, because of that 7% dividend. However in determining whether or not the 8% maximum allowed, under the commissions rules, have been exceeded, the commission may and I think would, in a rate ^{case} break the line down into appropriate operating divisions. I don't think there is much question on it, but what the interest of the owners in the Alaska line would be treated as a separate operating division for purposes of determining ^{whether} the 8% had been exceeded.

Rader: Do you know of any instances where...

Donaldson: The question of combining ~~a~~ figures and data as far as Alaska and other ^{PIPE} lines of the ^{owner} ~~six~~ companies in other States has come up a couple of times. On Markham's answer on the way the ICC would like to handle it gives you one part of the picture in response to that question. In case there was any misunderstanding of the response of the ^{yesterday} owner companies [↑] in our session, let me say again that not only would the ICC probably handle it that way but there are a good ~~many~~ many reasons for our purposes and political requirements of Alaska why we can see that the figures for TAPS should be segregated for study and comments or whatever regulatory comments, or whatever regulatory aspects come from those numbers. We in effect, here, give you the assurance that those figures will be separately maintained. How this is done again is a question of mechanics, we can't guess today just what is the best way to do it. It was you Senator Rader, I think, that made the suggestion that possibly put it into a separate corporation. That would be one way of doing it. There are several others, I understand, so the question is not whether but simply what the best way of doing it is. I wanted to speak to it again so that no one here would have any doubt or reservations on the treatment of it.

Rader: Mr. Markham, would you analyze for me whether or not the State should ^{have any concern} ~~be concerned~~ about the fact that we would ~~work~~ (?) with the other operations for purposes of dividend distribution, a percent decrease. ^{it does} ~~it does~~ ^{rather} ~~it does~~ occur to me whether or not we have an interest, ^{just} ~~would not have~~ ^{on} how that might effect us.

Markham: I don't really see why it should be a concern in view of the fact the ICC does not rely on the ^{current} ~~present~~ decree for regulatory purposes, that is the Department of Justice under the Elkins Act. As ~~a~~ far ~~a~~ as maintaining a reasonable level of rates, ~~a~~ on the line in Alaska ~~and quite~~ I am quite ^{confident} ~~confident~~ that the Commission will look at the operations of that line as if it were a separate operating

division, you will segregate the valuation, you will segregate the ~~operation~~^{operating expense and} revenues and so on and determine whether or not the 8% limit, which is the one currently prescribed by the commission has been exceeded. So I don't really see why you people need to ~~be~~^{concerned} be concerned about the ~~concern~~^{concern} decree beyond this, that if it is another check on the companies themselves in fixing their rates, they are going to be just as certain as they can, that they are not going to exceed that limit in addition to the limitations imposed by the Commission through its regulatory process. You really have a double governmental check on the earnings level that will operate on this line.

Rader: Just one further question . Is your thought that ^{the} Alaska operation be segregated, a recent opinion of yours or do you base that on some decision you have made or decided for a similar decision has been made.

Markham: Well I mentioned yesterday that I have personally been involved in two cases in recent years ^{involving} ~~at~~ the rates on a single line. One of many lines operated by pipeline ~~companies~~ companies. These cases didn't go to hearing, they were contested cases, but they didn't go to hearing, they were disposed of in my judgment on the basis of the financial results of that line primarily. And I see no reason why the Commission wouldn't do the same thing here, it's the realistic way to do it, it's the ^{realistic} ~~simple~~ way to do it, and these people are just too darn busy I think, to go out and make work for themselves, by trying to ^{at} look ^{is} the entire operation of the 7 companies when the problem/only the rate here in Alaska. I could add, I can't say to any case in which they have ever undertaken to fix the rates for an undivided interest line, no there is no ~~president~~^{president} on that.

But I think that there are enough ~~analyses~~^{analyses} analyses in the rate decisions of the Commission so that you can be reasonably ^{confident} ~~confident~~ that they are going to do it the simplest

realistic way and that obviously is to look of the results of this one line.

Rettig: Mr. Markham or Mr. Donaldson, I believe that it was Mr. Jones yesterday that indicated that a requirement by the State for record ~~an~~ keeping and recording, would not conflict with ICC or constitutional requirements, do I interpret that as meaning that if the State did require ^{separate} ~~separate recording~~ reporting, ~~reporting~~ for the Alaska pipeline it would ^{present no} ~~present no~~ no problems for the owners.

Donaldson: I have talked with Harry Jones about this subject; ~~he~~ actually ~~he~~ his departure was the fact — a friend of his was quite gravely ill.

He apologized for not being able to... the subject of our discussion, in essence it is a perfectly proper exercise of State authority to acquire information. The only limit that your suggestion might be appropriate ^{had} ~~if~~ ~~against~~ the requirements were so burdensome or heavy and someone was standing at their elbow, and ^{at the time} they wrote a letter or received a ^{obviously} report, it would be the kind of harrassment that nobody would intend. But it is a very broad power. The second part of your question and you talk about separate system and accounts. We're used to dividing ICC's extensive information under a well established system in the past. It would be quite burdensome to create a different type of system so that you would have to run two systems of accounts. I think probably the direction of Harry's suggestion was that if you understand how broad the information was given the ICC and there may be some supplementary information, thats fine. But not totally a different system.

Rettig: I didn't have in mind requiring the maintenance of a separate accounting system or different chart of accounts separate from that required by the ICC but merely the elements that go into it as they, it might to Alaska could certainly be

kept separately.

Donaldson: George Seymour, who will be the next witness is prepared to give you quite an example of this and what information is involved.

McVay: I think Mr. Markham and Mr. Donaldson, ~~thrust~~ (?) requesting is that ^{if} Alyeska makes money the State of course can make money, what's to keep Alyeska with its supporters who are world wide ^{oil} companies from laying on ~~lower~~ ^{It's not} on Alyeska. That is what we are trying to figure out. ~~was mentioned~~ that we wanted to set up burdensome accounting procedures or anything like that but how can we maintain the integrity of our own line as far as accounting is concerned. That is the... ~~thrust~~.

Donaldson: I can certainly understand your question, perhaps I should have extended my comment in anticipation of, the first place if you have the kind of information you have been referring to, and if this notion of burying somebody's elses burdens somewhere else was a fair charge. With the information that would be segregated as to Alaska, I think the State attorney's would be well armed and corrected promptly the type of procedures that Mr. Markham used yesterday. The first thing is to get the knowledge. To me knowledge and power ~~and~~ are an effective regulatory theory in themselves.

Holm: Mr. Markham, we heard some talk about how long it's going to take for the ICC to come to a conclusion, I've heard 2 and 3 years and some delays, what kind of a time frame would be involved if the state were to object to the proposed rates that had been filed with the ICC and then we objected to the rates or the rate of return of the companies or really what I'm after is what minimum time could we expect this if we were really pushed. **AGO 530953**

Markham: The minimum time would involve suspension of the rates before ~~it~~ they ever took effect if the commission felt that the States objection to them ~~would~~ were

well taken. Or if there were a sufficiently serious question concerning the lawfulness of the rates and this was raised before the rates became in effect but after they had been filed, remember I mentioned the other day there is a 30 day filing requirement, now if during that 30 day period the State were ^{to} raise an objection to the rates which ~~would~~ the commission felt was probably well taken, they ^{could} ~~would~~ ever suspend the rates before they took effect and prevent the rates from going into effect for a period of 7 months while they conducted an investigation into the lawfulness, held a hearing and reached a final decision. Now that is the minimum time period.

be
Holm: So there would be some rate in effect during this period of time.

Markham: It would be the old rate.

Holm: Well there may not be an old rate. If we start out and we say look Fred, 50 cents is too high ...

Markham: If the Commission were ^{to} suspend an initial rate that would mean that the carrier could not operate & until it ~~fix~~ filed another substitute rate that the Commission felt was sufficiently reasonable on its face so that it did not suspend it. In other words the carrier could be prevented from operating until a final rate of satisfaction.

Holm: Obviously we don't want to keep them from operating but if we are going to make an objection, is it conceivable that we would arrive at that there would be a conclusion that the rate setting arrived at prior to the pumping of any oil at all.

Markham: No I don't think so. This is not an area which the commission would be likely to issue but would amount to a declaratory ~~order~~. In order to get an ~~advance~~ advance decision from the commission I think that would be the only

available procedure and I doubt that the commission would intervene.

Holm: Then as I understand it the y would file a rate and this rate would be for a in effect/while during some pumping before the ICC would have any facts upon which to make a different ^{decision} ~~or~~ any decision as to whether these rates were indeed ^{legitimate} ~~legitimate~~ or proper.

Markham: Well, let me back up again. If the commission, the commission could suspend the rate and prevent it from going into effect. So that it would be in suspense until the investigation was completed. If the commission decided that the question was ^{not} sufficiently serious to warrant suspending the rate ^{even} they could nevertheless immediately start an investigation/ before the rate had become effective and under the commission's procedures you get moving pretty rapidly in submitting evidence in these cases. In the case of a changed rate, in other words other than initial rate, the carrier has the burden of proof, the carrier has to come forward with evidence in support of that rate and the time periods allowed by the commission are pretty limited for those purposes. So you will have the machinery in operation perhaps even before the rate takes effect as far as determining ^{whether or not the rate is recent,} ~~what the rate is~~.

Holm: You ~~can~~ have been pretty well involved with these hearings, are we talking about 2 to 3 years before it's finally settled?

Markham: Ordinarily ~~no~~ no. If the hearing is handled ~~on~~ on modified procedure you are talking about months instead of years. Now it is possible that ~~then~~ if it develops into a great big investigation which you have people intervening and all sorts of interests coming in and raising ^{fairly} ~~fairly~~ questions it can get stretched out and the proceeding involving a year or two. But this is not the normal thing in a rate case.

McVay: Mr. Donaldson, *I think wanted to add something,*

Donaldson: Let me have the *;* answer as well as, this is not a new problem. Every time you start a new line you've got to make some guesses to what the rates are going to be. There is a considerable amount of experience out on that guess *accumulated* over a big many years. And the companies don't bid by money, what *the ultimate rate* ~~at~~ will be. Really what they are trying to do is to figure out what the probable rate will be, come as close to it as they can, not take advantage of the situation. They probably also ~~bid~~ *err* on the low side, you see. They try to make a good guess and if they guess wrong, not only do you have the procedures of *err* but to the extent that there is any excess and there is a *procedure I understand* so the remedies are there, the important thing is the attitude of the companies attempt to follow in making a real good guess. It hasn't been a problem, you understand, it is a darn good question and I want to respond to it.

Holm: *you said* *usually* on the low side, is it to your advantage to have a low tariff. It appears that in any of the other means of transportation they *usually* ~~are~~ *err* on the high side and have to get knocked down. Now are you saying that in the oil transportation business you ~~are~~ *err* on the low side..

Markham: It is not to our advantage ~~are~~ *to have* a low tariff. It is a reflection of the ~~respect~~ respect of the regulatory authority. What you are trying to do is figure out where they come, and come as close as you can *on the bottom side* ~~figure~~ of it.

Colleta: Mr. Donaldson, based on your last three remarks you have now an *anticipated* ~~anticipated~~ tariff,...

Donaldson: No sir we don't. And the reason just in brief as Mr. Spahr referred to yesterday when he was speaking of all the unknowns. You have to know really

what the cost in the line will be. You've seen that our costs have trended up, we have had more information in delays, taken in the total, environmental requirements have been added to the construction and we just couldn't guess what ~~w~~ it will be.

Colletta: I personally couldn't accept this answer. Its a *gigantic* project and based on that your initial concept had to have a starting point and it has been a continuous revision as the changes have occurred. Now I'm certain that someone must be anticipating and adding these provisions, there has to be a point when you normally decide that it is no longer feasible.

Donaldson: I didn't mean to imply that we haven't worked with numbers. I was trying to express what is involved in is we don't have any great confidence in any set of the numbers we get today. The assumptions that make a great deal of varying in the tariff numbers anybody can calculate, turn on the fact of what you think the line will really cost before you ~~find out~~ *it is built.* Secondly when to start. Third what rate of *proof* will it have. If you have where the ~~numbers~~ numbers uses 600,000 barrels a day you run the same numbers just changing that one figure to a million 200 thousand barrels a day, you can swing from a ~~very~~ negative wellhead price to a positive wellhead price very easily. I am ~~h~~ not trying to be evasive but there is a real problem in *guessing* and we try to get some field, everytime we read the mail from anybody who ~~has worked with it~~ *is working on this line*, and say we think you ought to build it this way, the numbers change, you've got ~~to go back and do it~~ *to go back to do it* over again.

Colletta: Is it normal practice when a line is in the planning stage prior to being constructed that you anticipate its full capacity, are tariffs generally set this way, for example on the Alyeska line has a capacity of 2,000,000 barrels a day, would that number be taken into consideration ~~to~~ to establish the tariff ~~wh~~ rather than

the amount of ^{oil that} ~~oil that~~ going through it.

Donaldson: Well, you're looking at your costs to begin with. When you say the line has the capacity is 2,000,000 barrels a day, it doesn't when it starts ~~from~~ ^{sure} ~~it~~ the same 48 piece of pipe but as you add pumping stations that piece of pipe becomes more efficient and can handle more volume. But Mr. Spahr ~~think~~ again I think was referring to yesterday was, it was our guess that the best economic risk for the companies to take was to design the line so that it could be expanded from a million two, to the two million level at the very modest instrumental additional cost. They only built it to a million two to start. If you wanted to add that other 800,000 barrels you get a very expensive expansion. We don't hang up on the 2 million figure, you are looking at what ever you have got into the line at the point. Let's say it is a million 2, and the pumping stations and facilities that that embodied, ~~that's~~ that's the cost you start to work with. Then if you only have 600,000 going through that facility you can run the computer and possibly come up with a very high tariff. It is a question as to ~~what~~ what your facts are not whether 2 and 2 still makes four.

Colletta: Mr. Chairman, based on that when do we change the tariff on the line?

Colletta:

~~XXXXXX~~ If the tariff is set at a million 2, then 30 days ~~from~~ from now you start pushing 2 million barrels through, when do we change the tariff?

Markham: I would assume that the tariff would be fixed on the basis of the contemplated throughput for the foreseeable period and if the throughput should increase to the point where the costs ~~is~~ are brought down, the tariff would be brought down and the new tariff...

Croft: Mr. Donaldson, Mr. Spahr used the figure for the total cost of the line

as 2.3 billion dollars. I think that is the most recent public figure, is that correct?

Donaldson: I don't think he used that figure.

Croft: What figure is ^{the} current Sohio ~~estimate~~ estimate of the total cost of the project at a given capacity.

Donaldson: Ed Patton can probably give you the number on that ; I can report that last December when we met with the representatives and the administration in New York on these same subjects at quite an extensive conference. They of course asked us this same question. What's the best number. We had to tell them that the number that we were working with then , a 2 million line capacity ^{that was} ~~is~~ the frame of reference, and on the time frame that we were looking at there, it was about 3 billion dollars. My recollection is that that did not include any factor for ^{lost} interest on investment capital, it did have some ~~delay~~ time in but again those numbers changed. The point is not what the specific number is Senator Croft but that we are all talking the same general ball park in g big numbers.

Croft: ~~Three billion dollars~~ Assuming the three million dollars cost, assuming ~~the~~ Mr. Spahr's assumption that the line will be on production by mid or late 76, and 2 million barrels a day, what do you anticipate will be the tariff you will seek from the ICC under that set of circumstances. .

Donaldson: I personally don't know the answer. We don't expect 2 million barrels a day.

Croft: Who does ~~no~~ know the answer.

McVay: As I understand the witness has answered the question. . .

Croft: I am asking, will they present any witnesses at these hearings that will be able to tell us your anticipated tariff under ^a given set of circumstances.

Donaldson: Well, we hadn't come prepared to do that; I think what we can do

this is an important thing, is to... if you would give us a set of circumstances, we can give you some estimate as to what that means. That is an assumed situation and really we didn't come prepared for that sort of thing ~~just~~ ^{if} ~~Croft: If you would give us a set of circumstances~~ didn't occur to us that it was the problem here.

Croft: You didn't think that we would be concerned about that.

Donaldson: No sir, that is not the point.

~~Croft: Mr. Donaldson,~~

McVay: Mr. Donaldson, the ~~Senator~~ ^{later date} Senator is concerned about that perhaps at a given the set of circumstances to you, then maybe you could give them a printout, in writing,

Croft: Yes, for example ~~the~~ take the case assumptions that the administration has in its computer ~~perhaps~~ printouts, the 24, use your figures and your summary of the environmental impact statement that was submitted ⁱⁿ ~~at~~ August 1971 as far a surplus capacity, ~~the~~ use a cost of 3 billion or 3.5 billion, in your calculation, use whatever life expectancy figure you think is reasonable, ~~but~~ set out the assumption and provide us with the information.

McVay: ^{initially} it would be in the interest of the operating companies to have as high a tariff as possible, is that correct?

In other words going back to Mr. Holm's question, most carriers the advantage is always ^{the way} ~~with~~ of competition, that sort of thing to have the lowest tariff.

But in this case, I ~~think~~ can see where if you have the patience to have a high tariff, because that again reflects against the wellhead price.

Donaldson: There is no guarantee that you can collect the tariff ; Sohio can make your oil unmarketable. There is no guarantee that you are going to profit ~~from~~ on any pipeline this is why it is not a utility and simply say because you 've got a line

and because there is oil there you can set a high tariff and expect to collect it doesn't fit with the economic facts of life. What you do when you start up a facility as I understand it is try and *particularly after you get it all strained* to work out all ~~the things~~ [?] so that you can use the facility and market the oil, cover your costs, service your debts and hopefully make some profit. All this sounds evasive when you try to answer ^{a question} ~~something~~ like this, it is a real guessing game until you know the facts of *life are and the* ~~cost~~ cost of your pipe in the ground .

Croft: Let me go back...this is ^{a fundamental} ~~probably not~~ .

the wellhead price determined by backing up from the refinery, the expenses involved in the finished product, is that correct? o.k. Now if you put a high tariff on the transportation from Prudhoe to Valdez , say, lets just use...

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

is another dollar. You've got a \$2.50 product. You back it up with wellhead price you've got a zero result which means, then, that the State doesn't share.

DONALDSON: You really back it off on a market PRICE OF CRUDE OIL IN
~~The market where you're offering your oil not in your refining product~~
~~It's a pure mathematical assumption.~~ .. You're not in the
 business to produce oil for a zero volume at the wellhead. I would guess that
 on the set of assumptions that the Governor was speaking to last week he came
 up with a calculated ^{negative} wellhead price. Nothing wrong with the mathe-
 matics ^{ON THESE} assumption. You don't do business that way. You have to
 figure out some way ^{PARTICULARLY IN A} to start up, and get her going, and I am not expert
 on this field, and don't presume to be. I have heard Senator Croft's questions
 and I think maybe we can just see if we can work it out in that TEMPORARILY

MCVEIGH: Right. Well, O.K. We'll close this up. But you can see what we're ~~concerned~~
 concerned with.

DONALDSON: Sure.

MCVEIGH: All right. Are there any more questions? Senator Thomas.

THOMAS: Mr. Chairman. Just a quick one. On the matter of jurisdiction, if
 the State were to take some of this royalty in oil and process it right here
 in the State, would that not put the State back in regulatory position legally?

DONALDSON: Insofar as the oil was intrastate in its shipment to the extent that the
 bulk of the oil would be moving through the TAPS facility it is the STIPEND
 of Interstate Commerce that part of the _____ would remain in the
 Federal jurisdiction area. To the ^{EXTENT} ~~event~~ you had an intrastate shipment, ^{THIS} ~~there~~

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is no question about it, as Harry Jones said yesterday, _____

STATE DEPARTMENT DEPARTMENT regulations.

THOMAS: Then I wonder, in that case, if we were able to regulate that part, the interstate part, would that not have a great influence on the rate for the interstate EQUIPMENT ?

DONALDSON: I can't answer questions I don't know. Do you have any comment on that?

MARKHAM: There would be THIS limitation on the State's jurisdiction over even the intrastate rate. THAT IS THAT IT could not fix the rate in such a way that it resulted in a burden on the interstate movement. Specific provision in the Interstate Commerce Act dealing with this type of situation arises constantly in the railroad & MOTOR CARRIER field. The State would have initial jurisdiction, without question, to regulate the intrastate rate, but it could not do it in such a way as to impose a burden on the interstate portion of the transportation.

MCVEIGH: Mr. Huber, then Mr. Young.

HUBER: Mr. Markham, I understand that your field of expertise is the pipeline area where we are dealing with Federal Government regulations, particularly ICC. Is that correct?

MARKHAM: I denied yesterday being an expert, but let's go on from there.

ITS YOUR AREA OF EXPERTISE
HUBER: I have a small question on a -- a small question on fairness of rates.

~~I WANT TO EXPLORE~~
Now (coughing) I want to explore another area that we haven't been exploring that appears to be in your expertise, and that is I wonder if you would reiterate to us the relationship with pipelines, gas and oil pipelines, which ones are required under what conditions to be common purchasing AS WELL AS common carriers. I WANT TO TRY TO GET THAT GROUND WORK Laid AT THIS TIME.

MARKHAM: You just got got completely outside any area of expertise I have. I don't know the first thing about common purchaser ARRANGEMENTS. That is

primarily in the gas pipeline field about which I know very little. Ordinarily, I would think that there could be some real constitutional problems ^{involved} and ~~all~~ in trying to turn a commentary oil pipeline also into a common purchaser. Beyond that my knowledge of the subject ^{fails} fades.

MCVEIGH: Mr. Huber, I don't want to discourage questioning, but try to limit your questions within the scope of what we're doing here. I think I don't know what "common purchaser" is, either, but I have a feeling it's a marketing ^{TERM AND WE ARE NOW IN THE} tariff ~~_____~~ production and transmittal stage.

HUBER: Mr. Chairman, it is A TERM, NOT A MARKETING TERM, BUT IT IS A TERM OF ~~_____~~ the fairness of the method of transportation of a common carrier. This is what it amounts to. And it is beyond the questioning but I don't want to get beyond the witnesses' expertise of the other places TO GET THIS. Are you, I wanted to find out just what area the Prudhoe pipelines, in your opinion, are required to do this. ^{you} We do agree that the Prudhoe pipeline ^{can terminate} ~~(cough)~~ a part of the Outer Continental Shelf, would be required to be a common purchaser as well as a common carrier.

MARKHAM: I couldn't agree because I simply don't know.

^{ALL RIGHT} HUBER: One other question that's having to do with rates. And we're still trying to determine here whether the State should be owner and operator of the line. Then I understand ^{FROM} ~~some of~~ your testimony so far today, "Should the State Be the ^{operator} ~~owner~~ of the Line?" A rate of 7%, on the total value of the line, or

about 210 million dollars a year wouldn't be anything unfair FOR THE STATE REAPING THAT AMOUNT OF HARVEST OFF THE LINE IT WOULD BE ~~even~~ a fair system.

^{VIE-A-VIE} Markham: I don't think we can assume, I think the assumption has been made, that because the ^{con} ~~recent~~ decree, which applies to the shipper, owner oil co. ah, permits 7% dividends that this would automatically provide both a limit and a allowable return for state operation. I don't think that you can assume that any more than you can assume that if the ~~question~~ of the reasonableness

Tape #29

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had been a whole lot of risks it might have been closer to YOUR 7th.

Second point is, these are pipelines running through terrain where there
to
is a lot of experience and it's not too difficult to lay pipe. The risk terrain

here that we have is essentially more, and, ah, as investor or as A Familiar

whether it's the state or loner companies, there ^{IS} isn't a reasonable argument

higher risk ^{ought} to be rewarded to whoever steps up and does the job AND

those comments be ^{MIGHT DESERVE SOME} ~~serious~~ in discussion. and I think they add to the picture, ^{I'M NOT SURE.} of the

^{SENATOR HAS A} McVEIGH: ~~Retting do you have any questions. Neither Mr. Donaldson nor~~

~~XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX~~

Retting: ^{WHEN} Neither Mr. Donaldson nor Mr. Markham, ~~but~~ this is ONCE FUNCTIONING

were going to have 7 different tariffs is that correct? Ah,

Markham: Yes, ^{IF IT} that operates as non-divided INTEREST LINE

Retting: ^{NOW,} In ~~XXXXXXXXXXXX~~ responding to the request for an estimate of the tariffs

at this time, this would involve again the 7 different tariffs, would it not?

If it were possible, in attempting to do this at this time ^{DO} ~~to~~ you Run Around of

Dept. of Justice problems in discussing these matters ^{which} with may in the end,

combine themselves ~~XXXX~~ into a particular rate.

Donaldson: Let me, ^{Don't Give} answer that question. I'm not sure I can either, ^{EXCEPT TO SAY THIS,}

We don't, ^{AT STANDARD OIL OF OHIO AND BRITISH PETROLEUM,} ~~XXXXXXXXXXXX~~ discuss tariffs with any other members of our project

for just that reason. When we get down to the rate procedures, tariff questions

and ~~XX~~ this sort, we will make our independent filings ^{with} to the ICC. At that time

& it will all be out on the table and we'll see how our work compares with any

body else, but this is a subject that we just don't do. and I'm not sure that

any such thing as a ANTI-TRUST expert, but most of the time I TAKE PART OF IT BY
^{I'VE BEEN PRACTICING IN CLEVELAND, ITS BEEN IN THIS FIELD AND WE STAY AWAY FROM IT}

EXTRACURRICULAR. The ? defender cross questions for computable numbers,
^{IS AN INDIVIDUAL COMPANY AND, EXAMPLE}

you would almost have to respond, what are own ideas would be. And, ah, it is an

interesting exercise ^{BECAUSE} given the case a set of assumptions ^{INSTRUCTIONS}, the computer will run

and give you a number. The question is, not whether it works, but what the assumptions

AGO 530966

and, ah, I think for (enough) time with some discussion of the
company to negotiate or
representation (enough), you should be clear that you will not do it. ?

Rettig: Thank you. Going back to the problem of using the various elements for establishing tariffs, It was mentioned a couple of days ago, I think that it was about 3 to 4 years before the ICC got around to establishing the value ^{in connection} with the Cook Inlet pipeline Co.. Recognizing that initial cost is an element of valuation in fact ^{it ~~ph~~ perhaps} ~~its progress~~ is the only reliable one, upon the immediate completion of ~~a pipeline~~ of a pipeline. Is the matter of evaluation a difficult one at the beginning, certainly the evidence is open, its there its established upon the completion is it not? And, ah, getting around to evaluation, my ICC rediance, unimportant, is it not? It's already established.

Markham: It's my understanding that the people who are familiar with the valuation process can estimate valuation even before its determined by the commission, quite ^{accurately} ~~accurately~~. The bargain there is very small, and certainly in the case of a new pipeling, or valuation of the term, as you suggest, very largely on the initial cost on the actual investment, ah, the determination of an estimated valuation would be relatively simple, could be done quite readily and would be I would guess 97 to 98% accurate.

^{Putting it another way,}
Rettig: So you undoubtably, immediately upon the completion of the pipeline the cost is known, is that correct?

Markham: That is correct.

Rettig: Wouldn't it be difficult to argue with that figure as the actual valuation of it? At that point.

Markham: Except conceivably for some depreciation that might have taken place on some elements during the construction period, or something of this sort. There couldn't be much argument.

Rettig: Thank you

McVay: Senator young,

Young: I'm not sure, ^{whether} I want to ask any questions or not. For they've been asked while I've been waiting to be recognized. Mr. Chairman, it's early in the morning

Yesterday it was established that the intra-state are your feeders or witnesses use the grounds of the cold, etc. Now I've been trying to find an example of a pipeline ^{similar} ~~simber~~ too (or 2?) that's proposed in AK, I think AKN's have a unique psychological hang-up, that they're the first ones involved in something of this magnitude. And if I remember correctly, the little 36" pipeline from West TX to CA, ^{Texas Gulf} that's owned and operated by the Pacific Gas and Elec. Co., as ^a ~~XXX~~ separate owner and operator. When they established they, there must be a consorting with a, or is a climate, which either one it is. Consorting with companies that utilize this line in shipping gas and I know that you said that you didn't know anything about gas lines, and if there is a consorting group do they through with establishing new tariffs, or how does this work? Is there any correlation between the two is what I'm trying to find out?

(Markham: I'm not familiar with the lines, however ^{committee} ~~to~~ ^{Donaldson} some extent because one of the projects we're also working on as some of the people in the room know is the North West Project Study Group. Considering a gas line from Prudhoe down the McKinze River to service most the U.S. and even part of Canada. From that work I've learned that gas lines normally want to operate as a contract carrier instead of a common carrier. And that the people involved in moving the gas are really approaching it from a different standpoint, they want their gas moved, as new gas reserves are found usually you have enough leadtime, so that the line can be enlarged or looped to handle the additional energy to be moved, it is a totally ^{different} world in its legal structure. The regulation of rates and tariffs and so-forth here is under a different agency, a better power of commission. And, ah, essentially it is quite a different subject than the one we have here. AGO 530968

is of
If this has roused some interest there will be opportunity on the door to give you more information, and representatives of this study group in particular have planned to be in AK from time to time working (crutch) and people from the administration on some of the technical environmental aspects as well as the financial and other aspects of this type of department. I believe certainly that it is a kind of a separate question from the budgetary aspect.

Young:

~~XXXXXXXX~~: There is no correlation between gaslines ~~XXXXXX~~ and the oil lines?

Donaldson:

~~XXXXXXXX~~: Not to my knowledge, not at this particular point.

McVeigh: I believe the Senator did wait a long time, judging from these questions. Do we have any more questions? Mr. Rose.

Rose: Thank you Mr. Chairman. Mr. Markham, I have to admit that to the very high praises of the ICC ~~if~~ ^{disfor} somewhat, ^{of the} give some comments on that matter over a number of years from my own observations with dealing with the ICC myself, do you know of any specific example where the ICC has lowered ~~the~~ pipeline tariffs.

Markham: Has done what? I don't----

Rose: Do you know of any particular instance where the ICC has lowered pipeline tariffs?

Markham: The decision that has been referred to repeatedly here both in the state testimony and I mentioned it yesterday, the 1940 decision, was one in which the commission made a general investigation of tariffs throughout the crude oil industry and established 8% as the maximum allowable return for crude oil lines. Now it did not, in the initial case as I recall issue an order requiring reductions. This was just before the war. What it did was to make a tentative decision and then after the war the subject was reopened, the commission had a rehearing, they found that the carriers had reduced their rates, in response to the earlier decision and found that no further action was required then a few years later, I don't recall whether this actually resulted in a reduction, but in a case started on a complaint by the railroads, the commission

examined the allowable earnings for petroleum products and established 10% as the allowable for products. I don't recall whether there was an order actually issued requiring a reduction of the rate in that case, but certainly the establishment of those ceilings has had the effect of requiring the carriers to limit their earnings in exactly the same way the 7% consent decree has had that effect.

Rose: Does the determination of maximum allowable profits. The question was, do you know of any particular instance where the ICC has, in fact, ordered a reduction in ^{specific} tariffs.

Markham: I would have to say, ^{that} again the effect of the the 1941 was to cause a reduction in rates, now I don't think there was ^{ever any order actually} an actual order issued in the case.

Rose: Right, you know of any specific instance where the ICC has ever made a calling that a particular carrier has been assessing excessive profits?

Markham: The 1940 case was certainly such a case.

Rose: ^{I thought that was} Does ~~that give~~ a determination of how much was the maximum profit ^{was}. And was there a finding that excessive profits had been assessed?

Markham: There were findings as to what profits were being made throughout the industry and some of them exceeded the 8% at that time.

Rose: And that was 42 years ago.

Markham: That was 42 years ago but its been mighty effective in controlling ^{the} ~~earnings~~ ^{ceilings}

Rose: 32 years ago I'm sorry, I'm getting older faster. Do you know of any instance Mr. Markham, where the ICC has ever holded a refund on the basis of at ^{no} ~~XXXX~~ time have they ever ^{ordered} ~~XXXXXX~~ a lower tariff or at that time they have ever ordered a refund, am I right?

Markham: There has never been a reparation case brought involving pipelines as far as I know

Rose: Are you vaguely familiar with a group known as the Corporate Accountability Research Group?

Markham: I'm afraid I'm not.

Rose: And the group

McVeigh: ~~XXXXXX~~ He said he didn't know Harold.

Rose: I understand, but perhaps if ~~XXXXXXXXXX~~ indicated where the group appeared that perhaps he might remember... *perhaps... that.... they exist.*

McVeigh: This is not a seminar, lets keep that in mind.

Rose: But anyway, I'm not familiar with it ~~XXXXXX~~. ^{frankly} HA HA HA I have been furnished and I discussed it yesterday with Mr. Collins. With the statement I have got from Mr. W. ^C Moore Jr. I testified before the sub committee of priorities Economy ^{Government} Gov. Authority & economic committee. Jan. 11, 1972

And at that ^{at time} he indicated on page 3 of that statement that ICC applications also makes it possible for pipeling ^C owners to install this regulatory rate, Etc...

I assume that this individual knows more about it than I do ^{let} are you familiar with that testimony sir?

Markham: I;m not familiar with ^{it} ~~it~~ I knew there was such a testimony. --- I would like to comment however on this reference ~~XXXXXXXXXX~~ ^{to} abdication. I talked about it a little bit yesterday, It seems to me that the ICC is a little bit like, ah, a parent of a large family, Some of the children are running off and getting in ^{trouble} ~~trouble~~, some of them are fighting among themselves, some of them are falling down and hurting themselves, some of them are doing their jobs and behaving themselves. Now the 4th group of children don't require the same kind of attention ^{that} ~~as~~ the 3 other types do. A good parent I shouldn't think would spend much time slapping around the 4th ones just for the sake for exerting parental control. But I wouldn't regard that as abdication.

Rose: Bruce Rosa the Deputy Ass. Attorney Gen. at the same hearing also indicated or stated ^{that there is} ~~indicated~~ possibility of regress for outside shippers who resort to ICC regulations. In need of ^{this} Anti Trust Div. of the Dept. of Justice.

Markham: I would disagree with the statement regardless of who he is. I don't think there is any serious doubt about the ability of anyone to get a fair hearing if he feels that he has a complaint ^{against} about shipper rates. Now, no one can guarantee that you're going to get regress, but you will get a fair hearing. No one can guarantee that ^{you are going to collect if you} you will go to court in a law-suit but you can be sure ^{that} under our system of govt. of at least getting a fair hearing.

Rose: If they give you a fair trial before they hang you.

Rose

~~XXXXXXXX~~: Thank you Mr. Chairman

McVeigh: Mr. Donald ^{can} did you have some ^{thing} /... I noticed (pause) You don't have to respond if you don't want to.

Donaldson: Mr. Moore, that you referred to, did testify at those hearings for Senator Proxmire. He is an associate of Mr. Nader I believe and approached his investigations with a certain ^{frame} of reference we might not always agree with. The only response I want to make is one that Don Markham has already indicated. I don't view business as basically bad. The supreme court has said that there ^{is} nothing unlawful ^{XXXXX} because your co. happens to be ^{big} ^{Rose} big. I think we ^{ought} ^{to} agree with you ^{Sir} Senator [>]

Donaldson

~~XXXXX~~ I'm sure you do. Perhaps I ^{ought} ^{not} to stop there because really that kind of ~~XXXXXXXXXXXX~~ question isn't material to the hearings here. I have to be able to go home and look my kids in the eye at night. These things don't worry me except as the bias ^{comes out in some of these ???}

McVeigh: Are there other questions? That's fine Mr.

Donaldson: I wasn't referring to you personally sir. You raised a fair question and I gave you a response to Mr. Moore's

McVeigh: Mr Barber,

Barber: To Mr. Donaldson, while this question has been nibbled at, I am sure it is in the back of everyone's mind. Whether it has been stated clearly and concisely or not is beyond my recollection. Is there a point of no return financially when this project due to increased escalation costs will reach a ~~point~~

point where it isn't financially feasible to bring the north slope oil to market.[?]
By that I mean the current market prices on the west coast and the rapidly
escalating construction costs of the pipeline where it has gone from 1.5 billion
to 3.5 billion in ⁴ months.

(cough)
Donaldson: Let me ask a couple of questions let me respond to them. On project
costs, the costs haven't jumped that fast that much. There is a misunder-
standing, I think perhaps I can set that straight. Last December when we
went with the members of the administration and their question, of course, What
do think this is going to cost?, They had a document that had been furnished
by Aleyeska indicating a total cost on the information ^{submitted} ~~submitted~~ of about 1
billion dollars, We ^{I think} straightened out a misunderstanding that 1 billion dollar
~~xxx~~ figure really was the total cost of the project, it was not. And if we
researched ^{very} very quickly for them and confirmed it. We learned that the 1
billion dollar figure was the cost of selective information that ^{had} been requested ^{by the state}
at one time on certain ^{categories} ~~categories~~ of cost and we've responded with information
on the ^{categories} ~~categories~~ requested, but it was not the total cost of the project.
Someplace along the line, the label on the document ~~xx~~ that it was only a
partial ^{submission} ~~submission~~ had gotten lost, and I don't know ^{where it} ~~what had~~ happened and if it
was really anybody's fault, but the idea of a 1 billion dollar figure sort of
hung over us since ^{when in} ~~when the~~ fact that it was only a partial ^{trend} ~~thing~~. The costs,
however, as you know ^{have} ~~tend to~~ go up as these additional requirements are laid on.
Any project, I suppose, has a point of no return, happily, we are not there yet.
The thing that concerns us

Donaldson: the whole thing is, the sooner we get her going the better. At the end of the testimony that we will present as industry members here, I have- been asked to give a concluding ~~remarks~~ ^{remark} suggesting really where we are and what the State of Alaska and what ~~would~~ ^{MIGHT} appear to us really ~~completed~~ ^{contribute to} moving this along. In a sense ~~it might~~ ^{these remarks might be} presumptive, they are not meant that way, ~~IT'S NOT OF~~ ^{real concern} we present this, but I think after the testimony fully is laid out these ideas will become clear. Yes sir there is a ~~xxxxx-xxxx~~ point.

Barber: Well, Mr. Donaldson, you ~~missed~~ admit there is a point so you know what the point is so I will wait with great anticipation your concluding remarks.

Donaldson: I don't know what the point is, but as costs go up and crude oil prices don't move as fast, what you can see any set of numbers ~~is a~~ ^{closing of} that ~~RANGE~~ ^{rate} That's the thing you ~~we~~ should worry at all.

~~Barber:~~ Well, I can't ^{SAY} see the point is there. 

~~BARBER:~~ THANK YOU

McVay: Can I ask a question. Do you estimate (semi-points) what delay costs per year. In other words, ~~were~~ ^{if ARE} you ~~used~~ to dealing in figures inflation is 2% or 3%, the cost of living goes up 1%, ...

Donaldson: _____ He can give you that number.

Senator Palmer: This is line with what Rep. Barber was saying, Mr. Chairm-an, for the Chair to Mr. Parker or Mr. Donaldson.

The State is not of course interested, I believe this would be correct in saying, in producing oil that ~~has~~ ^{has} a minus or a zero well-head value. From your comments earlier, I believe a suspect this will hold true as far as the industry is concerned also. But, I ~~expect~~ the points might be a little different. You might be willing to produce the oil that has a value somewhat lower than the State would be interested in producing that same oil. From the standpoint that you ~~will~~ ^{Perhaps} be making profits from the other portions of the industrial involvement. Can you speak for that at all?

Donaldson: Yes, Sir. I can speak very much to the point of that in a pretty short answer. Each function of our business has to carry its own weight as to profitability. One merely cannot subsidize the other. ~~This is the~~ ^{This is the} way our company looks at it, I can't really

speaking for all other companies, but this is so. You don't stay in a business very long if ~~you~~ it can't pay its own way, and you can't see at least ~~an~~ a turning point and work its way out. The idea of subsidization ~~is~~ through a number of functional levels from the well-head to the gasoline pump in the service station is an idea that is often played with - we just don't look at it that way.

McVay: Any further questions? You gentlemen will take a ten-minute break now. Yes, Mr. ^{Markum} ~~Martin~~, you may be excused.

McVay: Mr. Seymour, before proceeding, we have been here now, this is the third day, and everyone is getting (the fourth day) understandably everyone is getting tired. It is not the Chair's intention^{ion} to limit questioning; however, it is the Chair's intention to keep the questions on the point. As I said this morning, we are not here for the purpose of a seminar, we are here to find as a fact finding body, and I'd ~~want~~ like the questions to be germane and try to stay within the field of the expert. There will be a certain amount of cross-examination permitted, but cross-examination will not be permitted, so let's, as tired as we are, try to get on with it and ~~wax~~ wind up these things as fast as we can. ~~Next witness is George~~

Our next witness is George Seymour is the manager of the PART INTEREST pipelines for Mobile Pipeline Company, Common carrier pipeline affiliate of Mobile Oil Corporation. He has been a Director and a Vice President of Cook Inlet Pipeline Company since March, 1970 ~~with~~ ~~xxxxxx~~ Staff responsibility for the operations of that Company. George is a professional engineer. He has been engaged in pipeline engineering and management through Mobil for some 24 years. He will address the subject of pipeline economics and risk factors ~~and~~ and financial report.

Seymour: Prepared Statement^{of}: This morning, at this sitting, I just plan to speak to pipeline financial reporting. And, I'd like to review the type and format of pipeline industry financial reporting, which could very well serve the needs of the State of Alaska in connection with the TAPS project. (Go to prepared statement from here)

Seymour: Deviations: I regret that I don't have enough copies for the whole room, there is extensive reproduction required and the page numbering is not as good ~~xxxxxx~~ as it should be. We have typed in because of page size problems, the page number opposite the title of the particular page.

~~A~~ ^{PAOE 2} ^A Page 2: Parágraph 2 insertion: Now I might say that the pipeline companies follow the uniform system of accounts for pipeline companies, which is this booklet which is prescribed by the Interstate Commerce Commission for our use. It's a public document, available for sale from the Superintendent of Documents in Washington. This is our accounting Bible in the industry. And, you will note ⁴⁵ ~~45~~ we review these forms that they follow very prescribed methods of accounting and each ~~xxx~~ item of cost and capital investment is specifically numbered and we do not deviate in any way from this system. ~~xxxxxxx~~ (Continue prepared statement-)

^{PARAGRAPH 5} ^{Page 2} ^{XB} Page 2: ~~Last page~~ insertion: Again we are using a Cook Inlet Form P as an example. And, if this Form were used to report on TAPS by any of the owner companies, there would be, or could ^{very} ~~well~~ be additional pages completed, many more probably. Continue---

Continuation after Page 3: As to revenue the schedule could set out TAPS revenue separately and if further detail would be desired by the State, as schedule that summarized such data could be prepared. Any necessary additional operating information desired by the State could also be provided on this or a similar page. The State would also be interested in the valuation of TAPS carrier property. As you know, the Interstate Commerce Commission determines the company's original valuation and traditionally brings it down to date each year. A copy of a company's valuation report which set out valuation of property located in each State is sent to each state by the ICC. In addition, because of the magnitude of investment in TAPS we expect that the ICC will determine the valuation of tax facilities separate from the valuation of owner ~~xxxx~~ companies other carrier facilities. This information would also be provided to the State of Alaska by the

ICC. To summarize, we have reviewed schedules, or samples of schedules which could be used to report required TAPS financial and operating information to the State. The TAPS owner companies have previously stipulated it was their intent for range to provide the State with complete financial and operating statistics on TAPS. Information of the type we have just reviewed which seems to be consistent with the TAPS owner companies have offered to furnish appears adequate to fulfill the State's total need for corporate financial and ~~operating~~^{what} operating data. Now I realize there's a great deal of information given to you here and I'm sure you may want to review it. I think we will agree there's a good deal more data in this form than is ever presented in an annual report of a publicly held stock company. I'd be happy to answer any questions that I can.

McVey: Do you have questions for the witness?

Croft: Mr. Chairman, Mr. Seymour, I note on Section 108, page 5, that Cook Inlet pipeline is a joint stock company, not an undivided interest.

Seymour: Yes, that is correct

Croft: So its a different operation in that regard than the TAPS line would be.

Seymour: Cook Inlet's operation is certainly different from that standpoint. Yes.

Croft: Secondly, do I understand the figures correctly that the capitalization of the Cook Inlet pipeline is \$4 million? That their net earnings for this particular year were in excess of \$5 million?

Seymour: Yes, Sir. That is correct.

McVay: Any other questions? Thank you very much, Mr. Seymour.

Donaldson: Next witness is Edward Patton, President of Alyeska who I am sure needs no introduction to this committee

Patton: Prepared Statement. After Page 1, Although it is not a part of my prepared statement, which will be handed out to you, I would like to comment on some remarks made by Mr. Gilderhouse the day before yesterday. In part of his testimony he eluded to the fact that it would be a basic requirement of the State ^{of} in ownership case that Alyeska agree to an executed contract calling for guaranteed construction and oper-

ating performance. This is a subject that I can address with some familiarity . As recently as 1966 when I attempted to negotiate a lump sum contract (those are the words used by the Speaker of the House) for a project at that time involving about \$140 million the perspective contractors indicated their inability to accept this bid because there had not up to that time ever been a lump sum contract of that magnitude. And the perspective contractors did not have the financial resources to undertake that kind of risk. We are now talkin g about a facility costing about 20 times as much as that 1966 contract, and the State or the State's representatives are implying that we should take on this lump sum obligation and it has been said in a manner which would imply that taking this on does not require the full faith and credit of the Oil Companies. This just cannot be. For me as President of Alyeska to agree to a lump sum contract, I would first have to add a contingency to the cost and estimate to be sure that I had covered all of the unforeseen possibilities~~xix~~ in the history of ~~the~~ ^{this} project indicate there have been many. And then I would have to add a profit which ~~has~~ ^{Not} is ^{now} under contemplation becuase if we are going to expose ~~the~~ the owners of Alyeska to the risks then they deserve a profit, and I might add that the fourth _____ paragraph in this contract would be somet-hing that~~xix~~ has not been seen up to ~~xx~~ now. It will have to involve environmental contengencias and prospective lawsuits in addition to the normal forces of nature, ~~Acts~~ Acts of God, Acts of Government and so forth. Yx Continue prepared Statement.

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

VALUES AND HAVE TAKEN THE
these Bills
FORM OF REVENUE MEASURES. INDEED, IF ~~THEY~~ ARE REALLY REPRESENTATIVE
OF THE ATTITUDE OF THIS LEGISLATIVE BODY, I CAN ONLY FORECAST THAT BUSINESS
AND INDUSTRY WILL BE DISCOURAGED FROM INVESTING IN ALASKA. SB-313,
FOR EXAMPLE, WOULD ESTABLISH AN ANNUAL CHARGE OF 1/20 OF GROSS PIPELINE
REVENUE PLUS \$656/ACRE. WITHOUT HAVING TO ESTABLISH PRECISELY WHAT
GROSS REVENUE WILL BE OR WHAT THE EXACT AMOUNT OF STATE LANDS WILL BE,
THAT FORMULA EQUATES TO AN ANNUAL CHARGE OF SEVERAL THOUSAND DOLLARS
PER ACRE. WHAT MAKES IT EXASPERATING IS THAT WE ALREADY HAVE A SOLID
HISTORY OF FEE TITLE ACQUISITION ALONG THE R.O.W. AT A FRACTION OF THAT
PER ACRE.

SB-294 IS EVEN MORE EXPENSIVE. AN EXAMPLE I HAVE SEEN
RESULTED IN A RENTAL OF OVER \$11,000,000/YEAR, OR BETWEEN \$7,000 AND
\$17,000/YEAR/ACRE (DEPENDENT UPON THE ULTIMATE STATE MILEAGE). NUMBERS
LIKE THESE WOULD, OF COURSE, COMMAND GREAT RESPECT IN DOWNTOWN

LOS ANGELES. OBVIOUSLY, IF ANY FORMULAS LIKE THESE PASS THE LEGISLATURE, IT WOULD BE IN OUR INTEREST TO ACQUIRE FEE TITLE TO ALL OF THE STATE MILEAGE INVOLVED.

SOMEONE HAS ADVANCED THE ARGUMENT THAT THE "LOWER 48" LEASING
* FORMULAS AVERAGE OUT TO A R.O.W. COST OF ABOUT 4% OF THE COST OF AN AS-BUILT LINE, SO ALASKA SHOULD DO AT LEAST AS WELL. IT'S A RATHER WEAK ARGUMENT BECAUSE CONSTRUCTION COSTS IN THE REMOTE AREAS OF ALASKA ARE AT LEAST 2-3 TIMES ^{THOSE OF} THE "LOWER 48" AVERAGE, WHEREAS THOSE REMOTE AREA LAND VALUES ARE PRACTICALLY NEGLIGIBLE COMPARED WITH "LOWER 48" LAND VALUES. IN EFFECT THE SB-294 FORMULA SAYS THE MORE DESOLATE AND FOREBODING LAND IS, THE MORE ONE SHOULD PAY FOR IT. I DON'T ^{really} AGREE ^{with that}.

MR. CHAIRMAN, YOU HAVE ASKED ME "WHAT CAN ALASKA DO TO HELP?". I HAVE ANSWERED THAT QUESTION IN A NEGATIVE SENSE TO THIS POINT. ^{but} ALASKA HAS ALREADY HELPED. THE CONCERNED STATE AGENCIES HAVE CONTRIBUTED GREATLY TO THE WILDLIFE AND ENVIRONMENTAL STUDIES, AND THEY ARE WORKING TOWARD MEANINGFUL AIR AND WATER QUALITY STANDARDS. YOUR UNIVERSITY ^{STATE} ~~THE~~ BEEN OF IMMEASURABLE HELP IN THE SOLUTION TO MANY OF OUR PROBLEMS. I THINK THIS LEGISLATURE CAN ASSIST NOT ONLY THIS PROJECT, BUT THOSE TO COME IN THE FUTURE, BY CONTRIBUTING TO STATUTES WHICH ARE EASILY UNDERSTANDABLE, WHICH ARE EMINENTLY LOGICAL AND FAIR, AND WHICH ARE NOT SUBJECT TO CHANGE BECAUSE OF POLITICAL OR MONETARY EXPEDIENCY. NO ONE IS GOING TO MAKE MAJOR INVESTMENTS IN THIS STATE WITHOUT ASSURANCE THAT THAT INVESTMENT WILL NOT BE REGULATED OUT OF EXISTENCE.

ALL OF YOU KNOW OF OUR INTENSE FRUSTRATION. ANYTHING WHICH MIGHT RELIEVE THAT FRUSTRATION WILL BE HELPFUL. WE WANT TO GET GOING, SO WE URGE YOU -- IN FOOTBALL LANGUAGE -- TO GET OUT THERE AND BLOCK FOR US. THANK YOU.

ELP/n1
3/3/72

E. L. PATTON

LARGE PIPELINE RIGHT-OF-WAY LEASE RATES

STATE OWNED LANDS

(All Rates Shown Are for Single Payments for
Life of Project Unless Otherwise Indicated)

	<u>Basic Approach</u>	<u>Rate</u> <u>\$ Per Acre</u>	<u>Rate</u> <u>\$ Per Mile</u>	<u>Rate</u> <u>Other</u>	<u>Remarks</u>
Arizona	Negotiated	10-12			10-year Period Perpetual Lease May Be Negotiated During Primary Term
California		400			Annually
Indiana	Standard Rate		3200		
Louisiana	Standard Rate		3200		
Michigan	Standard Rate		3200 320		Developed Areas Undeveloped Areas
Minnesota	Standard Rate		320		
Montana	Standard Rate		200		
New Mexico	Appraisal	15			
Texas					
General	Standard Rate		480		10-year Period
University	Standard Rate		1120		10-year Period
Washington	Negotiated	10			
Wisconsin	Standard Rate		320		
B.L.M.	Standard Rate		5		

ELP/nl
3/6/72

Tape 31, Page 1

Mr. McVeigh: Thank you, Mr. Patton. We have questions from first Senatorial Committee, State House Affairs Committee, House Finance Committee. Mr. Croft, did you have questions? Mr. Huber?

Mr. Huber: Very short one for Mr. Patton. I think I want to refer to the, the area about the leasing bill 294 and when you mentioned about the possible ~~interfer-~~
~~ence~~ of routings. I don't believe any member of this legislature wishes to add anything to the routing of the proposed Alyeska Pipeline. But ~~too many~~
~~are said~~ ^{does go further} ~~than this~~ and did you mean to apply your remarks ^{also}
~~off~~ to the gaslines and other things of the future, particularly the gas lines?

Mr. Patton: I don't want to get involved talking about gaslines because I don't know anything about them, but I think any any legislation which departs from from sound engineering considerations and that's what this legislation reads. It's inadvisable.

Mr. Huber: ^{There is} ~~You'd be concerned~~ ^{issues} ~~with~~ over the prolitheration of pipelines since you know the most current ^{plans} ~~fashions~~ on gas pipelines is through Canada all the way and there is some concern in ^{the} ~~your~~ ~~Statement~~ using a common corridor or common corridors as much as possible. And that's the ~~only~~ reason I asked that.

Mr. McVeigh: Any further questions? Mike Miller.

Mr. Miller: Just one ~~question~~ ^{question}. We 've heard previously that the pipeline hasn't passed the two million barrels, although at the

present time, the prudent reserves don't indicate a real need for that.

Could you give us an estimate/^{either} in dollars or percentage how much more Alyeska is willing to invest in the two million capacity, forty-eight inch pipeline as compared to what would have invested if they had taken into consideration only the proven reserves?

Mr. Patton: Well, you're touching on some areas that are owner responsibilities, but I'll endeavor to answer as much as I can of that question. The investment level that we are now talking about the difference between the one point two million barrels per day case and the two million barrel per day case ~~is to me,~~ ^{relatively} depends ~~partially~~. So obviously for a ~~low to be~~ low cost you get a large increase in capacity, about a forty to fifty percent increase.

Mr. Miller: Thank you very much.

Mr. McVeigh: Mr. Patton, we've heard that one pipe, I believe, one point two million barrels per day is what's being planned now for maximum production. Is that correct?

Mr. Patton: No, I don't think that is correct, Mr. Chairman. The actual situation in my contract with the owners right now is to design and procure materials but we have suspended procurement because of the recent delays that we had to okay and procure materials for the 600,000 barrels per day gauge. We had further instructions from the owners to design the one point two million gauge but not procure any material at this time. We have no instructions at all on the two million barrel gauge.

Tape 31, Page 3

Mr. McVeigh: So then that that really the two million barrel figure is used a lot in the conversations about the pipeline, but that's, that's high then or at this stage at least unrealistic, is that right?

Mr. Patton: I don't exactly know what you mean by unrealistic because in the time trend that we're talking about we could have the the two million barrel gauge engineered and material available to build it in order to fit in with the [?]transitor placed on it by Interior in the operation of the line. So it's not unrealistic, we could, we could be ready to go with the maximum gauge easily within the time trend that we have facing us.

Mr. McVeigh: Thank you. Any further questions?

Mr. Merdes: I have one.

Mr. McVeigh: Senator Merdes.

Mr. Merdes: Mr. Patton, using your best judgment on the facts that you have before you now, when do you estimate that the pipeline, when I say when, I mean the time frame, making certain assumptions and I say this in the backdrop of Senator Stevens remarks in the joint session of the legislature as to a time schedule of construction dependent on certain facts. What is your best judgment as to when construction will get undertaken, using certain assumptions?

Mr. Patton: Well, they're all assumptions. You have to recognize that. The first assumption is that the Interior Department will issue the Impact

Statement next week. That would put us into the Washington, D. C., District Court for six to eight weeks or possibly two months later. We would expect to stay in the various court houses in the Federal judicial system for the remainder of the year. Then we would hope to get the validated permit and probably begin construction about a year from now. Or April of 73. If those things happen, we would expect to finish construction, hopefully in the fall of 1975. But those are all assumptions. We've had assumptions that appear to be just as good last year, year before that, year before that. I emphasize that.

Mr. Merdes: One final question. Is there any possibility of say constructing a road with a bridge across the Yukon onto your agreement with the State Highway Department or is everything contingent upon a permit?

Mr. Patton: Well, I think everything is contingent upon the permit. If it's not, I can't see any of the owner companies laying any more of their money on the table until they have the permits. I wouldn't do it with my money.

Mr. McVeigh: Thank you.

Mr. Barber: Mr. Patton, I understand that on the North Slope there will be permitted no gas boring like there has been done in Cook Inlet. Are your time frames for your six hundred thousand barrels throughput, your one million two hundred thousand barrel throughput and the possible two million barrel throughput daily coupled with the construction of the Canadian gas line in any way?

Mr. Patton: Well, they, ^{they} ~~we~~ have a degree of freedom that gives us the maximum and that is the reinjections of the gas and that is what's planned in the early days. There's not any flaring plant.

Mr. Barber: At what point does it become engineering unfeasible to pump the gas back into the ground?

Mr. Patton: Well, I think...

Mr. Barber: In the ^{of} realm / millions

Mr. Patton: I don't, I don't really know. It's the producer's job. I don't think you're talking about being engineeringly infeasible; you're talking about the economics of the thing, and I'm not privileged of those numbers.

Mr. Barber: In other words your engineering time frames are in no way coupled with the construction of the Canadian gas line.

Mr. Patton: That is correct.

Mr. McVeigh: Any further questions? Mr. Cullate. Excuse me.

Mr. Patton: I have some points that were raised yesterday and today that I thought you were going to ask about and one of them a while ago was escalations. Do you want me to address those points?

Mr. McVeigh: If you care to, yes. We'll be with you ^{as soon as} when you're through.

Mr. Patton: Well, the escalation, now you can assume the labor and materials are going to escalate at the rate that the oil well as it off phase two, which is five and one half percent. You talk five percent of three billion dollars is one hundred fifty million dollars a year. Now historically, the so-called technical stipulations put on by Interior if escalated at three, four, five hundred million dollars a year, we would expect them to taper off as they run out of ideas on how to tighten up the security, but if you had to guess right now what the escalation would be in another year's delay, affording people another year of time to think about this, I would, I would guess that we're talking about three hundred million again. One hundred fifty of that would be in labor and materials and the other half would be in what might

Tape 31, Page 6.

likely happen as more engineers and scientists work at this project. Now, this doesn't address the cost of mine. The ^{cost of the} money is not Alyeska's problem, it's the problem of the owner. Mr. Holm, I believe it was Mr. Holm this morning, who raised the question of what is the point of no return. There are at least seven different points of no return. The point of no return was reached by the Holm Oil Company eighteen months ago. It will be reached in my opinion in separate steps by individual oil companies, depending upon their, what they think they have in the way of oil up there and what their financial resources are and what alternate investment opportunities they have to make. And because there are at least seven different numbers and they are all private numbers within the confines of one company, I mean one company, just one of the seven, to each of the seven, you can bet that none of the seven are going to tell any of the other seven what that drop-out place is. So you can't quantify that number. There certainly is one, but, or seven of them.

Mr. McVeigh: Is there anything else you want to know? Mr. Collate.

Mr. Collete: Mr. Patton, I'm a little confused and I quite don't remember, could you possibly comment on what the contract hearing on Alyeska Pipeline Service Company is. Is it a construction contract?

Mr. Patton: Right now it's a construction contract, but there is being worked an operating contract. The intention of the owners is to have us design, construct, operate it, maintain the pipeline, as Mr. Spahr said in his opening remarks.

Mr. McVeigh: Any further questions.

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Mr. Rader: Mr. Chairman.

Mr. McVeigh: Yes, Senator Rader.

Mr. Rader: Is that construction contract a fixed fee contract or a contingent fee contract or a cost plus contract or what type of contract is it?

Mr. Patton: It's a cost plus contract. Well, it's not even cost plus because we're not earning a profit, it's just straight cost. We are reimbursed with every cost to build a line.

Mr. McVeigh: Any further questions?

Mr. Rader: Would it be feasible for the State to enter into a cost plus contract with you and audit the costs as you go along?

Mr. Patton: Well, you're talking about if the State had the financial resources.

Mr. Croft: Yes, of course -- financial resources

Mr. Patton: If the State had the financial resources and the owner companies agreed, they wanted to make Alyeska available for that, the answer is yes.

Mr. Croft: I've just been handed a copy of your remarks. I don't care to ask you about the remarks, but there's an appendix which you didn't mention in your oral testimony and it lists large pipeline right of way lease rates on State-owned lands for various states. Under the remarks section there is reference for example, in Arizona to a ten year period that a perpetual lease may be negotiated. As to Texas, general and university land remarks indicate a ten year period. There's no indication of any renewal or right

of renewal. And under the Bureau of Land Management there is no indi, there is nothing under remarks to indicate the duration. Could you explain whether the absence of remarks indicates that the period of duration is indefinite?

Mr. Patton: Well, the parenthetical under the heading says it that all rates shown are for single payments with a life of the project unless otherwise indicated. The BLM is for the use of the life of the project. The State of Arizona regulations indicate in the regulations that the first period of the lease is only ten years, but that during the initial period, you may negotiate a perpetual lease. In the case of the Texas ten year period, there is a long, long history of never having failed to renew a lease automatically. Furthermore, there is not a great deal of State land involved in Texas, so you have the alternative of end-running the State's land. And furthermore, you are talking about relatively minor investments in those areas. You are not talking about a three billion dollar investment. I think the big difference is that you are putting up regulations, which is to reason. Posed the threads that I have mentioned and you don't yet have any corp interpretations or long history of how you are going to, are going to enforce those regulations. This is the big difference. We're talking about the State of Texas that has a fifty year history of pipelining, and is essentially a audiner.

Mr. McVeigh: Any further questions, Mr. Patton, oh, Mr. Culetta.

Mr. Culetta: Mr. Chairman, Mr. Patton, based on the assumption, not really the assumption, the fact that you're a construction contractor and in essence e
than of 1000

an operator, doesn't this mitigate the undivided interest, will, will Alyeska be responsible to ICC for the tariff regulation or do we have seven undivided interest holders. It has been stated that there will be seven tariff.

Mr. Patton: I have nothing to do with the tariff or the regulations. We would simply operate the pipeline as the owner's agent.

Mr. Culetta: As the owner

Mr. Patton: The owners plural

Mr. Culetta: agent

Mr. Patton: As the owners' operating agent. We would have nothing to do with collecting the money.

Mr. Culetta: So, would I be correct then in assuming that in the event of a tariff discrepancy, which of the company's would we file against?

Mr. Patton: Well, you're just, I'm not an expert on this. Not my area.

Mr. McVeigh: Any further questions. Thank you, Mr. Patton.

items requested that statements be passed out in advance as to the oral testimony of your witness.

: We're, the next witness, the next witness

: We're going to get the statements now

: We're going to go through until 11:30. There will be, I understand/a ^{which is planned} roll call in the House at 11:00 o'clock, but

there will be no counts. Members wishing to make roll call, I will have a brief pause at ten minutes to eleven so that they can leave.

: Thank you.

: Is the mike on now?

Mr. Donaldson: The next witness and the last witness to testify on the subject of regulation and right of way is Joseph Cortese, general partner in the law firm of Squire, Sanders & Dempsey in Cleveland, Ohio. Joe is specializing in the area of law concerning the powers of state and local governments, in ^{tax exempt bonds} ~~fact~~ belongs to Mansing. Later this afternoon he will again return to the witness chair to discuss with you some of the legal aspects of the state ownership. If we can defer any questions on that subject in his later testimony, we would appreciate it much. Mr. Cortese.

Mr. Cortese. Thank you. Chairman. Ladies and gentlemen of the House State Affairs and Senate Congress committees. Ladies and gentlemen of the Legislature. It is certainly my pleasure to be with you. It's taken a bit of time to get to the table, but I've been fascinated by the presentation to the committee and the questions you have, particularly alert questions of this committee. It is also my first time in Alaska, and I hope to have occasion to return, but other occasion than this. My function is to testify to the legal aspects of the right of way leasing bills, Senate Bills 294 and 313. I think it is a rather unhappy function on my part because necessarily I must give you my candid views of those bills which resolves in my advising you of my opinion that the legal undercunning of those bills are indeed faulty. I certainly don't mean to be disrespectful, but it's difficult to convey those views clearly without being direct and confine them to the point. I want

to emphasize that in expressing these legal views, I do not in any way or in any degree whatever question the sincerity and the honest effort that have gone into the drafting of these bills. I necessarily must disagree with the legal judgments. Regarding these right of way bills, Senate Bills 294 and 313, my comments will be applicable to both bills because they go to the very legal essence of the bills rather than to necessarily detailed aspects. We have heard on Tuesday as I recall from the Attorney General's office, that use a paramount, parallel matifore by the Attorney General, that the two bills are sort of engaged to be married sometime next week. That's provided, apparently, that the dowry can be negotiated. It would be premature, obviously, to try to comment on the issue of that marriage. It may be possible that the marriage won't be consummated. However, here again, assuming that any substitute bill or amended bill would be built on the essence of the two right of way leasing bills before our-your committees, I believe that the comments that I will make, you will find they're relevant also to any such amended or substitute bill. What I must say to you in the first instance is that the basic premise of these two bills is that the State in its capacity as a landowner having control over land necessary for the pipeline, can impose terms and conditions on the pipeline proprietors that it concededly could not impose in its governmental capacity. Examples, it is acknowledged that the State in its exercise of its police power, its direct regulatory capacity, could not impose regulations upon rates, upon certificates of convenience, for certificates to instruct, or on the method of rendering service of the pipeline, but it has been contended, too, this

committee and other committees of the legislature and the joint impact committee, that this regulatory function which could not be performed directly in the exercise of your police power can somehow be garnered by the exercise of your position of landowner and contractor of the use of that land. I must say to you that this basic premise is wrong. It directly conflicts with the decisions of the United States Supreme Court. For example, in the case of Frost against the Railroad Commission of California, decided in 1926. The United States Supreme Court held that a California statute, which sought concessions from a motor carrier as to methods of operating its business as a condition of the use of state highways, was in violation of the United States Constitution because such condition would constitute a taking of the carrier's property without due process. Let me quote briefly from that case as an illustrative principal. The Court said: If the state may compel the surrender of one constitutional right as a condition of its favor, it may, in like manner, compel a surrender of all. It is inconceivable that guaranties embedded in the Constitution of the United States may thus be manipulated out of existence. Likewise, the attempt of a state to regulate how an interstate telegraph company may select its customers or special services is void where even where^{it} posed as a condition of the use of its streets, for the state may not use its constitutional powers to achieve the unconstitutional result of interfering with interstate commerce. This is the principal of the Western Union Telegraph case decided by the United States Supreme Court in 1918. Quoting from that case: It is suggested that the State gets the power that is to regulate the manner of business of this telegraph company from its power over the streets which is necessary for the telegraph to cross. But if we assume that the plaintiffs

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in error under their present charters could be excluded from the streets, the consequence would not follow. Acts generally lawful may become unlawful when done to accomplish an unlawful end, and a constitutional power cannot be used by way of a condition to attain an unconstitutional result. As the following will further show, a state may not use its control of land to prohibit, attempt to regulate, interfere with, or unduly burden interstate commerce, nor to exact waivers of constitutional rights. If the use of state lands is necessary for interstate transportation, the state cannot withhold the right of way, it cannot exact more than reasonable compensation for such right of way, and it cannot invade the field of federal regulation or unduly burden interstate commerce as a condition of making available the use of its land. I must interject at this point. These conclusions I am expressing here are not so in my conclusions. Two of my partners and two of my associates

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Mr. Cortese: This problem, also the group-of officers of the respective companies, pipeline companies and --- ----- has the problem, we are agreed on the conclusions that I expressed. The State of Alaska may not withhold the necessary right-of-way, or it may not withhold the means of transporting the oil and gas in interstate commerce. The State of Alaska through its oil and gas leases has granted to the lessees the right to develop, produce, process and market oil and gas. This is what is granted in the lease. The oil and gas can only be marketed feasibly by means which utilize state-owned lands. Under these circumstances, the State may not withhold its lands from the lessee. This principal follows from the commerce clause of the United States Constitution, as you heard in some detail by previous references the commerce clause from the Constitution, Article 1, Section 8, Clause 3 reverses exclusively to the Congress of the United States the power to regulate interstate commerce. No State may enter into the field of regulating interstate commerce.

In Oklahoma v. Kansas Natural Gas Company, decided by the United States Supreme Court in 1911 the State of Oklahoma had adopted the statutes designed to prohibit the interstate shipment of natural gas from within the State of Oklahoma to outside of the State of Oklahoma. The technique used to so prohibit such shipment was to take cognizance of the fact that natural gas could not be shipped out of Oklahoma feasibly only by a pipeline. Certainly it could be put into tanks somehow and conveyed somehow certainly some alternative was physically possible, but practically and economically, no it was not, this gas had to be transported out of Oklahoma by pipeline or it would not be transported at all. Taking cognizance of that, the State of Oklahoma said "No Interstate Gas Pipeline may cross a state highway. It sought thereby to use its control of that land,

those state highways, to preclude interstate shipment of natural gases.

The Attorney General, Mr. West, for the State of Oklahoma argued that the Kansas Natural Gas Company was misguided in its legal premise that Oklahoma somehow had to give it the right to cross its highways. He argued that the gas company may have a right to engage in interstate commerce, but it does not have the right to the means of engaging in interstate commerce. So obviously if the gas company had the right of way it could engage in the interstate commerce of shipping gas out of Oklahoma, but the State of Oklahoma could withhold from it, he argued, the power to cross its highways. The Supreme Court rejected that argument, concluding that "if Oklahoma had that kind of power then Oklahoma had the power to stultify interstate commerce contrary to the United States Constitution."

If I may quickly read from the opinion of the court I think you could see the cogent analysis that necessarily follows from what the State of Oklahoma *sought to do*. At this late date it is not necessary to ~~save~~ ^{STATE CASES} ~~FACE~~ to show that the right to engage in interstate commerce is not the gift of a state and that it cannot be regulated or restrained by a state, or that a state cannot exclude from its limits a corporation engaged in such commerce. To attain these unauthorized ends is the purpose of the Oklahoma Statute, the state through the statute seeks in every way to accomplish these ends and all the powers of the state is conceived to possess ^{ARE ENCASED} ----- in all the limitations upon such powers are attempted to be circumvented. The use of the highways is forbidden to them, interstate pipeline companies, and the right of eminent domain are withheld from them, and the prohibitive strength which these provisions are supposed to carry is exhibited in the fact that the boundary of the State is a highway. If it cannot be passed without the consent of the state commerce to and from the State is impossible. The situation is not estimated by appellant (Oklahoma Attorney

General), and he says: 'If the appellees had the right of way they might engage in interstate commerce, but their desire to engage in interstate commerce is a different thing from the means open to them to procure a right of way.' And it is further said, that, (by the Attorney General) the confusion of the right to engage in interstate commerce with the power to forcibly secure a right of way is the basis of appellees' case.' There is here and there a suggestion by the Attorney General for the State of Oklahoma that the State not having granted such right the alternative is a grant of it by the Congress, which, of course, had not been done in the State. But this overlooks (cut) the affirmative force of the interstate commerce clause, the affirmative force of the interstate commerce clause of the Constitution. The inaction of Congress is a declaration of freedom from state interference with the transportation of articles of legitimate interstate commerce, and this has been the answer of the courts to contentions like those made in the case at bar.

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

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

The same Oklahoma statute was also considered in the same year in a case decided just a month before the Supreme Court decision, by a separate case *Haskell v. Cowham*, decided by the 8th Circuit in 1911. There, the court stated in under similar circumstances /.

"No state may by means of its police power, or its proprietary power, take

note, or its proprietary power, over highways or by means of any of its other powers, erect and maintain impassable barriers against interstate commerce along its borders or through its body in the face of the grant to the nation of the power to regulate interstate commerce; for all the powers of the state are subordinate to this power of the nation and to its will that such commerce shall be free."

Not only would the withholding by the State of a right of way to the lessees constitute an undue burden on interstate commerce, and I might interject here "I am not suggesting that the State is purposing to withhold the right of way I am ascertaining the legal principle of the basis for other reasoning that will follow." Not only would the withholding by the State of a right of way to the lessees constitute an undue burden on interstate commerce, but it would also constitute a deprivation of the lessees' property without due process of law.

A succinct statement of this principle is found in that same Haskell case cited above: "But an owner who by virtue of his ownership of land or of mining leases thereof has the vested right to draw by means of wells and pumps natural gas from under the surface is the owner of valuable property which the state cannot take from him without just compensation and the state laws and acts of its officers which prevent him from taking it from the land and selling it and conveying it out of the state in interstate commerce, while they permit withdrawal of gas by others in intrastate commerce, necessarily violate the national Constitution (1) because they take his property without just compensation and (2) because they substantially discriminate against and directly regulate interstate commerce."

The right of the lessors of the North Slope oil and gas to transport it in interstate commerce without obstacles or burdensome conditions imposed by the State is expressly apparent in view of the fact that the State invited them to

bid competitively for and purchase of oil and gas rights from the State, including, as stated in the leases, the right to "market" such oil and gas.

The point to be emphasized in our consideration of House Bills 294 and 313 is that their factual premise is inconsistent with their legal premise. Factually, they assume that the only practical way of getting the oil out of Alaska is by a pipeline and that pipeline must run across State controlled lands. If that were not the fact there would be no point to the bills, with effect to this pipeline, for the price and conditons they exact would be avoided by ^{THE} use of other lands. Thus, the premise is that the pipeline owners must contract with the State for right of ways. On the other hand, the legal premise is that the State, through its proprietary capacity, can achieve by right of way contracts what it could not achieve in its governmental capacity because, it is claimed, the contracts will be entered into by voluntary bargaining. It has been claimed that a state as proprietor can legally obtain unusual contract terms because others may contract with it on its terms or may forego contracts with the state. ^{THE} ~~That~~ legal theory is planly irrelevant where interstate commerce would be thwarted and property right lost if the private parties declined the state's terms. I want to emphasis that distinction and that conflict in the factual premise and legal premise of both these bills because as I said the factual premis is that one must have the right of way ^{FROM THE STATE} in order to get this oil out of the state, and the legal premise is that the state can exact any contract terms it desires in making contracts in disposing of rights to use its land, because anyone who voluntarily enterd into such contracts with the state or declines to enter into such contract with the state, that obviously is not the fact, ^{situation.}

I would like to interject here, since I am sure I will get the question, whether this is manifest from the presentations that have been made to the legislature

in connection with the drafting of these bills. I do make reference, I had not intended originally to do so, but ^{IT IS APPARENT} from the questioning that has gone on previously that substantial reliance is being based upon the 80 page memorandum of Prof. Witherspoon. I would like to briefly quote from that memorandum at page 30 on this legal premise that I referred to, on page 30 of those of you who have it before you may examine the portion ^{that} I will quote, this is the major heading on the CONSTITUTIONAL BASIS OF THE STATES POWER TO ENACT THIS LEGISLATION the sub-heading "The states power to dispose of its property and to contract" and under that the essential legal premise ^{AS STATED} as follows, "Since the other party to this disposition or contract does not have to enter into these transactions and is perfectly free to do as it chooses it has no justifiable basis to complain concerning the conditions or obligations placed upon it as part of the considerations for the state entering into the transaction, as a legal premise an expression of utter freedom. On the other hand at page 60 of the memorandum we get down to the factual premise involved, and under the heading of "The essential feature of the proposed litigation" Leverage. which is followed with four points of leverage. The quotation ^{that} ~~which~~ I direct your attention to is "by choosing to exercise it's, the states, property control and disposition power and contract power the state has chosen a method which gives it initial leverage relative to the oil and gas industries. These industries and their pipeline elements must be able to lay their pipeline over state land in order to move the crude oil and natural gas they produce in Alaska to markets outside the state. They must be able to lay their pipelines over state lands."

Instances of the Federal Government asserting conditions and requirements in ~~its~~ ^{the} exercise of its contract functions are beside the point, those are infact instances where private parties may fore go contracts with the Federal government

without the loss of property rights, and it can hardly be claimed that the Federal Government is unconstitutionally restraining or burdening interstate commerce since the Constitution places the power over ^{such} commerce in the Federal Government. Reference has been made to the Federal governments requirements for EEO, Equal Employment Opportunities conditions in its contracts. I have personal experience with that, in that a leading case on the subject was one that I participated in Entitled Wayner v. Cauhega County Community College. This involved a Cleveland plan a forerunner of the Philadelphia Plan. That contract and requirement was contested by a contractor who lost the bid because he would not comply with it. We defended that contract requirement of the Federal Government.

We defended it through four levels of court including the U.S. Supreme Court in a period of two and a half years. We were successful in defending it, but in defending it we had to establish that the Federal Government was not thereby forcing a discrimination against the presumed white majority. That the equal protection clause of the U.S. Constitution was not being violated by the this Federal ^{contract} requirement, I ^{say} ^{site} this as an example of nevertheless having to test contract requirements against Constitutional inhibitions.

The very facts ⁱⁿ of premise of House Bills 294 and 313 that the pipeline owners must get ^{the} right of way from the State makes it apparent under the ^{U.S.} Supreme Court Cases that such right of way cannot be withheld and cannot be used by the State to achieve results which are otherwise prohibitive.

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

The State may properly charge rental for the right of way, even ^{where} ~~when~~ there

is no other practical way to conduct the interstate commerce but by use of the state land, but the Constitution requires that such rents be reasonable and not discriminatory and bear a true relation to the actual value of the ~~land~~^{LAND}. The leading case on this point is St. Louis v. Western Union Telegraph Company, 148 U.S. 93 (1893). In that case, the City of St. Louis imposed an annual rental of \$5.00 per pole, within the city, upon the telegraph company. The telegraph company opposed in court that charge claiming (1) that the city could not impose any charge^{ment} because of its engag^{ment} in interstate commerce and (2) that any such charge of \$5.00 was excessive. The court held that ~~a~~^{the} rental charge could be imposed, but that it must be reasonable in relation to the value of the land, in expressing its conclusion~~s~~, after careful analysis, the Court said that:

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

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

The Court said "The court cannot assume that such a charge is excessive,

and so excessive as to make the ordinance unreasonable and void; for, as applied in certain cases, a like charge for so much appropriation of the streets may be reasonable. If within a few blocks of Wall Street, New York, the telegraph company should place on the public streets 1500 of its large telegraph poles, it would seem as though no court could declare that five dollars a pole was an excessive annual rental for the ground so exclusively occupied;" bear in mind this was 1911, "while, on the other hand, a charge for a like number of poles in a small village, where space is abundant and land of little value, where space is abundant and land of little value, would be manifestly unreasonable, and might be so excessive as to be void."

The discenting opinion would have taken judicial notice of the fact that a \$5.00 per pole charge in the city of St. Louis was ^{not} unreasonable because it said it was known to the discenting judges ^{was} anywhere there were many areas of St. Louis where the occupation of space by a pole was not worth \$5.00 a year. But, what is important to note in this case is that the court speaks in terms of reasonable compensation in relation ^{ship} to the value of the land, the raw value of the land occupied.

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

Land value is most frequently determined in eminent domain cases where just compensation is based upon the value of the land taken. It is held that land value is determined by what the owner gives up, not by what the taker gains. In United States V. Miller, decided by the Supreme Court in 1943, the party whose land was being condemned argued that the land should be valued in

relation to the specific purpose for which it was to be used, a railroad right of way. The United States Supreme Court rejected this contention, ~~and~~ stating as follows:

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

The point here is that the value of this land to be determined for purposes of reasonable rental, which is the limit of what can be charged without inhibiting or burdening interstate commerce is the value of the land to any normal person or any general user who might want to use it, and not the special, peculiar value of this particular user. I should further emphasize that in all the discussion about having the rent gauged to the profitability of the land, it is not profitability of the land that has been really talked about, what they are talking about under these bills is profitability of the pipeline. Under ^{where it is} these conditions ~~I would~~ ^{assumed} private capital will build that pipeline. The defect of the real formula of Senate bills 294 and 313 is that they bear no relationship to the value of the particular land involved. And are not limiting^{all} to the land itself, but seek to use some measure of gross revenues for the profitability of the pipeline built with private capital. This clearly goes beyond what the Supreme Court has said could be reasonably charged and would constitute a prohibitive burden on interstate commerce. Furthermore, since these unusual charges are wholly out of keeping with general practice in other states, as Mr. Patton has indicated, and in the state of Alaska as well and are largely addressed to this pipeline project they might

also be viewed as violations of the prohibitions against the discriminations against interstate commerce and as constituting discriminatory taxes upon interstate commerce. Or simply discriminatory practices to the extent that they are considerably in excess of any thing that might be gauged as reasonable relationship to the value of the land, they should be viewed as taxes, and yet there are taxes imposed on those who must pay -----.

Other provisions of the bill are unconstitutional. (a) Court Jurisdiction

The Bill provides the lessee shall agree to the jurisdiction of the state courts ^{with} ~~regarding~~ ^{to} the interpretation of the lease ^{the} for resolutions concerning disputes concerning the lease. We are uncertain ^{as to} of the intention of this provision. If it is merely to obtain service of process on ^{the} pipeline companies, the lessee, ~~we~~ ^I suggest it is entirely unnecessary, since the pipeline company is already in this state subject to service of process and has a statutory agent. If it is intended merely to say that the law of Alaska shall govern the interpretation there is no objection to that. I submit that would be the natural thing since the lease ^{would be} ~~is~~ entered here, but if that is the purpose more appropriate words could be used to say so, however if this provision is intended to require the lessee to seek relief only in State Courts and to prohibit it from invoking in appropriate circumstances the aid of Federal Courts including the removal of cases to Federal Courts where appropriate it is clearly unconstitutional as stated by the ^{U.S.} Supreme Court in Pearl V. Burke Construction Co. decided in 22. "The principle established by the more recent decision of this court, is that a State may not in imposing conditions ^{upon} the privilege upon foreign corporations doing business in a state exact from it a waiver of the exercise of its constitutional right to resort to the Federal Court or thereafter withdraw the privilege of doing business because of its exercise

of such right, whether waived in advance or not. Such requirements for waiver
of Federal Court or use of the Federal Court ^{if} ~~is~~ imposed by the police power would be
unconstitutional even a voluntary agreement having this effect would be void.
Roberts case cited here, District Court, North Carolina.

We also note, ^{and then I} will summarize the rest of this, that the penalty provision
of these particular Senate Bill 313 is in our view unconstitutional as
saying no standard and ^{of} being contrary to the due process requirements of the
Federal Constitution in that it would require the lessee to agree in advance to
any penalty that the Commissioner might choose to access.

C. Is an important regulatory Jurisdiction, both of these bills which seek
to require the condition of the lease, that the lessee consent to regulatory
jurisdiction of some regulatory body of the State of Alaska. I would point out
that as has already been testified by previous witnesses that quite obviously
the regulatory area pertaining to interstate commerce is preempted by the
Federal Government, whether excersized or not, and that an attempt by the
State, ^{by} indirect, such as in the Western Union Case, that ^I ~~was~~ cited earlier
Where the State of Massachusetts sought to acquire the telegraph company
to render stock quotation service to whomever the State of Massachusetts said.

That determination was to be made by the telegraph company was considered to
be ^{inadequate} ~~higher~~ to the Federal Constitution and paramount of interstate commerce
even though the state sought to seek sought to impose that

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Cortese (continued): b re submitting then to the ICC. Any forced agreement that comes to terms with the state on rates has implicit within it a veto power of the state over rates and would clearly be an invasion of the area preempted by the Federal government. State cases where municipal corporations have a function in rate making as part of their franchising power are not applicable for there the state law permits that function. The federal law does not permit any such primary function in the states with regard to rate making for oil and gas pipelines engaged in interstate commerce. The federal law provides only for the proper state participation as a party in the proceedings of the federal regulatory agencies but not as a prior regulator. Cases previously cited to the impact committee on this point, the Armour Packing Company Case, the Chicago Great Western Railway Case, are in applicable. There is no attempt by any state there to assert regulatory rate making functions. Surely there were rate contracts involved, contracts by shippers with the railroads, surely the court held in one case that the contract was invalid because it interfered with the regulatory power in that tariffs were raised after the contract was made and the contract rate could not stand because all rates had to be the same, could not be discriminatory, therefore, if the contract rate was forced up to the tariff rate. This works both ways and I want to, or ought to, emphasize to the court this Armour Case, excuse me, to the committee, that this Armour Case makes it clear that you can not have a long term contract on rates that is sustainable. Either minimum rates for the purpose of protecting bond holders of state bonds, and I don't mean to get into a detailed discussion of that at this point, nor maximum rates for purposes of protecting whomever the state thinks ought to be protected, because the regulatory process of the ICC will control that and not the contract. I point out in the memorandum which has been given to members of the committee that the forfeiture provisions of 313 are, in our judgement, unconstitutional, that the option, the purchase provision, of course, is forced upon the companies in order to obtain a lease of

for the right of way across state land would be an unconstitutional burden on interstate commerce. It would be a deprivation of their rights, in a sense, that it have just compensation determined in an orderly judicial process. I also point out in the memorandum that the savings clause referred to earlier of 313 to the effect that it does not operate in any area that would be preempted by the federal law and would not operate, that the bill would not operate to the extent that the transportation can not be constitutionally regulated by the state. Either leaves very little or nothing of value in the bill, but in any event, that the bill is so permeated with such provisions that it would probably be declared unconstitutional in its entirety. The problem is that the basic premise of the bill, that the state can exact any conditions it desires by virtue of its land owner position is constitutionally unsound. In conclusion, we have not attempted to deal with every provision of SB's 294 and 313, and we do not mean to imply that provisions not discussed would be valid. Rather, we have shown that the basic legal premise of these bills is wrong and would produce unconstitutional results in vital respect. We do not doubt the authority of the state to provide for the leasing of rights of way over the public ^{demand} demands for this pipeline project and others, to obtain reasonable rental therefore, and to provide for reasonable conditions and terms relating to the protection of the states land and properties to the extent not inconsistent with, or preempted by ^{it} federal authority, however, the state knows that SB's 294 and 313 are not proper vehicles for such purpose for they are permeated with unconstitutional provisions developed from an unsound legal premise. I should add that obviously we have found no case precisely involving the same facts. To our knowledge, this sort of legislation has never been attempted before but we have sought to bring to the attention of the committees our judicial authority which are as close in point as we were able to find. We think that they establish legal principals which are applicable and from which would probably be concluded that the basic premise of these bills is constitutional unsound.

We do not have a --- bloc case but we thank the authorities present.

McVay: Let me interrupt for just a moment. The House is adjourned until 1:00 so members here don't have to worry about the 11:00 session. Number two, we are to vacate at 11:30 and it is 11:12 now, again point of the rule, that I don't want to stifle any questions. It would be nice if we could get through with this witness by 11:30, attempt questions now Mr. Rose.

Rose: Mr. Cortese, did I hear you state ~~then~~ that the owners must be able to lay this pipeline across the state lands, that's, of course, for the purpose of getting it out the state to market, is that right?

Cortese: Yes sir.

Rose: I notice that you did not address yourself to the question of public ownership, in other words, of the state becoming an owner in respect to carrying which could provide the carriers and then the owners would be able to carry the products across the state. Would you care to comment^{up} on that? ~~at~~

Cortese: Yes sir. That is a subject area that we had planned to get into this afternoon. That is, the area of state ownership, the testimony as it has already been previewed will indicate that our best judgement is that there is no practicable possibility for the state to finance and construct this pipeline, so that it is not ^{viable} ~~applicable~~ alternative. secondly. I should point out to you that in my judgement the state does not have the power to preempt or monopolize this field of activity. It is true, for example, the state may monopolize the liquor business. This is because the federal constitution, the 21st Amendment, expressly gives the power for full control over the liquor business, and in cases dealing, challenging the state and its control over the liquor business as interfering with interstate commerce the courts have indicated that (what for) the 21st Amendment the state could not so interfere with interstate commerce but by reason of the 21st amendment it may ⁱⁿ ~~with~~ respect ^{with} ~~to~~ the liquor business.

^{It is investigated that}
Rose: A Even ~~provident~~ state ownership/assuming their financial capability.

Cortese: Are there legal impediments?

Rose: Are you suggesting that there is a legal impediment in that assuming financial capability if the state ^{should} ~~can~~ do it.

Cortese: Yes, I ~~would~~ ^{permits} will get to that effect, this afternoon. It time

McVay: Mr. Harris.

Harris: Mr. Cortese, if the state enacted legislation, or adopted regulations seeking to secure jobs for Alaskans on this project, and this was challenged in court as unconstitutional, what, in your opinion, would be the court's decision?

Cortese: I have not examined that question and I could not give you a conclusion that would be meaningful to the committee. I suspect, however, that the question Harris had would be, in some part, does the requirement have any particular burden or accessive burden on interstate commerce. As Mr. Patton has already testified, there is no question that this would be an intention of the oil companies to maximize utilization of native ^{talent} ~~help~~ and Alaskan talent. I couldn't give you a legal conclusion on that, Sir.

McVay: Mr. Barber.

Barber: Mr. Cortese, in connection with legal premises quoted by you with respect to the unconstitutionality of these two bills under question, would your premises likewise hold to a pipeline across the State of Alaska which would meet a Canadian gas line going to the continental United States?

Cortese: I hadn't thought about it previously but I can't think why not sir.

Barber: In other words, you would hold the Canadian line to be interstate commerce even if the item under discussion, the TAPS itself, is within Alaska 100%?

Cortese: Oh yes, there has been ample testimony ^{I think} on that by Mr. Jones in particular that the flow of the product, whether its oil or gas you're speaking of course about a huge stream of oil from the north through Valdez to the lower forty eight, and that quite obviously being interstate commerce and I gather from reading Professor Witherspoon's memorandum, that at least in three places he similarly concludes that this would be interstate commerce.

Barber: In other words, you hold the ^{Canadian} line to be of the same type or synonymous with tanker^{or} operations from the port of Valdez to the lower forty eight?

Cortese: I would think so, continuous flow of commerce, regardless of the particular technique or vehicle employed.

Barber: Even when it goes over a foreign country?

Cortese: Oh yes.

McVay: It is interstate and foreign commerce.

Cortese: Thats true, the commerce clause relates to commerce among the states and with foreign countries.

McVay: Mr. Groth . . Mr. Holm.

Groth: One of the primeses of the SB 294 and 313 are that to the this leverage position and Witherspoon memorandum. You can also gain jurisdiction over the federal lands by voluntary contract. Do you concur with that?

Cortese: Even jurisdiction over the

Groth: The point is that portion of the pipeline, according to Mr. Witherspoonth, is on federal land. It could be, in part, regulated by the state on the basis of ~~the~~ getting voluntary agreements with the oil companies for the right to go over the state land.

Cortese: Well, I see your point. No, I do not agree with that at all. This particular feature we are talking about, fifty miles of state owned land with another ninety miles under^a selection that has been ~~attentively~~ excepted and another fifty, I believe^{that}, has been selected and frozen there has been no action on it. Fifty, fifty, fifty

Groth: Lets assume its even two hundrend.

Cortese: Assuming that its two hundred.^{that} The fact ~~at~~ that the bill seeks to exert jurisdiction over eight hundred miles under a two hundred mile lease manifests its attempt at regulation rather than having anything to do with the leasing as such of state land, the utilization as such of state land, and quite clearly in my mind, displays that the bill's attempt, as is manifested by all that has been said about it, is an attempt^{to} boot strap the state into regulation of an interstate carrier which the U.S. Supreme Court has said repeatedly simply cannot be done.

Groth: Just one other question Mr. Chairman. Some four or five places in the 82 page memorandum, page 66, 71, 75, 76 and various other places, it is not necessary that you look in it. The concept is expressed that there is a possibility that the state now ought to go to the Department of Interior and say, Gentlemen please give us the permit so that the state would thereby gain jurisdiction over that other 600 miles for purposes of discussion. What is your view as to the likelihood ^{of} ~~that~~ the Interior, at this stage of the proceeding, consenting to such an arrangement?

Cortese: I don't think that I could express any opinion on ^{that} ~~it~~. It has certainly been a long, long process. One would certainly hope that one does not have to start all over again. So far as likelihood on the judgements, practices of Interior on that score is concerned, I really couldn't comment in a way that would be useful to the committee.

Groth: Thank you.

McVay: Mr. Holm.

Holm: Yes, Mr. Cortese, you cited a quotation out ^{of} the lease where you said that, if I remember right, that the lessee had a right to market. Where is this quotation found, where can we get this? Is that the actual language, the right to market?

Cortese: Not right to market, I'll read it to you sir. This is the standard form of lease of the Department of Natural Resources of the State of Alaska, form #DL 1. This is the revised October 1963 version. There is also a revised April 1971. ^{version} I think the language is the same in both. Reading from the first ^{line} ~~line~~:

"Born in consideration of a ^{Cash} ~~tax~~ bonus and the first year's rental, the receipt of which is hereby acknowledged, and the rentals for all disconvenents and divisions herein contained on the part of the lessee to get paid, kept and performed, and subject to the conditions and reservations herein contained, lessor (that is the state) does hereby grant and lease upon the lessee (thats the oil companies)

exclusively without warranty for the sole and only purposes of (leases for the sole and only purposes of) exploration, development, production, processing and marketing of oil, gas, and associated substances produced therewith, and of installing pipeline and structures thereon to find, produce, save, store, treat, process, transport, take care of, and market all such substances and for drilling water wells and taking underground and surface water for use in its operation, for housing and boarding employees, its operation thereon, the following described tracts of land in Alaska."

Whereupon there are spaces

Holm: And you interpret that word marketing you extend that to a right to cross state lands?

Cortese: No I don't depend upon that. What I am indicating to you is that the lease itself contemplates, of course, the marketing of this oil when it is obvious that it can be marketed only by crossing the state lands, let me emphasize that the Oklahoma case had nothing to do with the state selling the natural gas because natural gas is bought privately and yet, that the owner of the natural gas, Kansas Natural Gas Company, had a right to cross state highways to get that gas out of state.

McVay: Gentlemen we have to adjourn. We will be back at 3:00.

BREAK

McVay: Ladies and gentlemen, the hearing will reconvene. Mr. Donaldson do you want to call the next witness. I think that I should say that the previous witness will return, speaking Mr. Holm of your question. He has another presentation.

Donaldson: The next witness we have to present is Mr. Raymond B. Gary, general partner in Morgan, Stanley and Company, and the Manager and Director of Morgan Stanley and Company, Inc. He has been with ^{this investing} ~~that~~ banking firm since 1955. I might say just a further word of introduction. His investment banking firm has

*Joe would you come up, Joe. I wonder if you would come up & finish the ?
Mr Holm asked of you before the break should you rather wait?*

dealt extensively in pipeline financing, and has raised some very very large sums of money for a variety of clients. We think he is uniquely qualified to testify on the subjects being considered by the joint committees and he will address his remarks to the finance issues on all the bills being heard here today, rather than piece meal his testimony, we thought this might save some time and . . .

Gary: Thank you. Mr. Chairman and members of the committee, we appreciate the opportunity to appear before you. Our firm shares with all of you the concern about this pipeline and any delays in its construction and ^{we} would very much would like to see come through in the interest of the state and the oil companies and in the country's national interest. There are elements of balanced payments on this oil and we are aware of that too ^{including national bankers} . . . First a few words about Morgan Stanley.^o We are investment bankers in the business of underwriting and distributing securities of industrial corporations, transportation companies, finance companies, public utilities, pipelines, airlines, and governments. Since our firm was formed in 1935 we have managed or co-managed over sixty billion dollars worth of securities and that includes two billion of pipeline financings of some 56 issues for 18 pipeline companies. We've also managed the largest debt offering ever, public sale, of debt ever done - that was \$1.6 billion of debentures with warrants attached for the American Telephone and Telegraph Company. We've also done the largest private financing ever done for construction projects - that was the Churchill Falls (Labrador) Corporation, its a hydroelectric project under construction now in Labrador. So you'd think that qualifies us to talk about these large sums of money. I'd like to say something about pipeline financing in general to start off with, if I may. There's two ways it's customarily been done. First is "project financing" ^{and the} where the pipeline assets are owned and operated in corporate form. The second is, as the case here, "undivided ^{joint} human interest systems".

The financing is the same, in a sense - it's a question of who's on center stage. When it's project financing the pipeline itself is on center stage and is spot-lighted by credit of the oil companies. Undivided joint interest financing, ^{and} the oil companies are in center stage, but everybody recognizes the pipeline to be a part of their system. In terms of the first, project financing, the corporation is formed to construct the pipeline and operate it. The financing is secured by pledge of unconditional oil company credit in the form of completion and thru-put agreements. These represent unconditional applications of their credit. What they say is, "you'll either ship or pay" and in any event you'll pay over to the pipeline company the amount of money that will keep it in funds sufficient to meet all its obligations on their bills payable. They're effectively guaranteed. Customarily we finance 90 per cent of pipeline costs. The reason why we do that -- first, why do oil companies want to borrow 90 per cent? It's strictly a matter of consent for you to be all heard about, which dictates use of leverage because the return on equity capital is limited. The reason lenders are willing to loan 90 per cent is they have the oil company credit there and they are not taking any risk of failure on the pipeline--they're not taking a business risk, they're taking a credit risk, if you will, on the composite credit of the several shipper-owners, but they're not taking a business risk because ^{no matter} what ~~ever~~ happens they get paid, whether it breaks down or is interrupted or any event of "force majeure". There is no "force majeure" outs. I take ^x we all know what we mean by "force majeure" but those are events of God, they're major catastrophies--events out of the control of anybody. Nevertheless, I should also add that when you do a pipeline financing you still have to put your backstop by oil company credit--you still have to demonstrate to the lenders that the pipeline itself is an economic and viable operation. You prove to them first that there's enough crude in the area that the pipeline's serving to support its life. We submit an engineering report or an engineering study to show that it can satisfactorily operate and offer an

opinion of an engineer to the effect it can be built, within the cost and the time, and he looks at the other end, delivery end and where the market for the crude is and satisfy yourself that there is an adequate market for the crude when it comes out the other end. Then, in addition to all that, once the lender is satisfied that its a viable and worthwhile investment, then he has the backstopping behind him. I might say a word here about the notion of "modified thru-put agreement". I don't know many, and in any case even for a modest sized pipeline financing that have been borne in the past, I don't believe there's ever been a case of a "modified thru-put agreement". It's not appropriate to the situation. Oil companies build pipelines to serve their own transportation needs, primarily and it's natural for a lender to say, ^{to him} "Well, you're building for your own purposes--you backstop it with your own credit." It doesn't do a lender very much good to have a mortgage on pipeline because if the oil company isn't using it, there's not much the lender can do to get any value out ^{of it}. In fact, we don't put mortgages on pipelines very much anymore. Now, George mentioned pipeline financing, and in this case the oil companies themselves own, as you've heard at some length, undivided joint interest in the systems. They do this financing of pipelines owned in this fashion are done just as any other item in the corporate or corporations capital expenditures budget, it's done through their working capital earnings cash flow and issuance of securities which reflects their entire equity/debt mix, so that its gone through ^{the} total capital structure. The end result of the financing is that they've permitted themselves the risk of building a system and their return is a -- comes to them from the transportation income, if any, of the pipeline. This is just as real a use of credit as any other, it substitutes for other investments that an oil company might have made--other uses of its credit that it might have made and therefore we say they are entitled to get a profit. Now, let's turn to the financing of TAPS, for a moment, we're talking here about an amount of money for a project that is

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