

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 86 / 2

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_____ planned financing and the whole scheme for a period of 15 years. The project is the largest hydroelectric project in the world. It will be when it is completed - will have been - ten years in construction. The project's cost is estimated now at some \$930 million. The financing consisted of the combined offering both in the U. S. and Canada of the ~~equivalent~~ equivalent in U. S. dollars ~~xxxxxxxxxxx~~ of \$550 million in First Mortgage Bonds. In addition to that ~~wx~~ there was a bank loan of \$150 million U. S. Equivalent. Jr. Financing of \$100 million in the form of general mortgage bonds which are actually sub-ordinated to the first mortgage bond. And in addition there ^{will} ~~would~~ be some \$150 million of retained earnings during construction period as a result of partial operation during the construction period. That financing of \$550 million, the project is \$900 and in order to do it we have to obtain ~~d~~ from the largest lending institution in the Country, the largest amount of commitments they had ever made to a single man. At that stage. Since then there has been one larger, which I will come to if you are interested. Although I might say those commitments in that case were for ^{\$125,000} ~~\$25,000~~ million ^{on offer} to Metropolitan Life and Prudential Life. The largest amount they had at that time in any single name would be private placement was many times larger than the nearest that had ever been done before, which was, I believe, the pipeline financing. This financing is 3 to 5 times as large depending on how you ~~compute it~~ ^{compute it} so we are already talking about straining the environment capital saving of the company here. We strained _____ for Churchill Falls. In this case its very fortunate that the oil companies happen to have chosen to do ~~it~~ an undivided ^{joint} interest form. ^{Because} It ~~is~~ possible for each of them to come to market in a discreet amounts for in different names and at different times through the construction period to meet their needs so that it will not be such a strain on the market as it might have been had it been done in project form and then ^{it would} ~~come~~ to the market for \$3 billion, which is an amount which we feel may be in excess of the amount of money that ^{can} ~~may~~ be raised in a single offer. Despite the size, we think it ^{could} ~~can~~ be done absent the ~~legis~~ ~~legis~~ legislation you are talking about this week. Which to our way of thinking raises some severe AGO 531017

impediments on the ability of oil companies to raise these amounts of monies. I think we might now turn to how this legislation affects financing and after that I'll finish up ^{up} talking about the State's ability to finance this amount of money. _____. I'm going to pick five areas, there are more. The basic general theme is that some of the elements in this legislation prevent threats or they put clouds over the ability of the oil companies to finance. And I might point out that to the extent you do that, or it is done, and the Interior Department has already done it/ ^{in one respect} it hurts both you and the oil companies, because anytime you put a cloud over a project, you make it less attractive for some lenders and when things get less attractive for lenders, they ask for increased interest rates. And pipelines' economics are sensitive to interest rates especially when you raise 90% of the costs. They are very sensitive./ ^{So} we're concerned about them, and we think you ought to be. The first is the limitation of the lease for five (5) years. This has been covered by a number of people before, but I'd just point out to you that customary pipeline financing, you're always able to save the lending. The pipeline has the undisputed right to use the leased right-of-way for the expected economic ^{OR} physical life of the system. And, in no event, for a period shorter than the indebtedness. Now, in this case, lenders would regard this five-year lease limitation as a major infirmity impairing the liability of the system. And, I think there is some doubt that they will lend longer than five years, in this case. Or, if they did, I think we've got to realize what might happen here. Your interest is in keeping this well head price up, but the quickest way I know of putting it down is to force the oil companies to depreciate this property in five years. You ought to be thinking in terms of a longer line, as long as possible, ^{ON THIS} so that the term of the bonds can be stretched out which results in spreading the burden of financing over the longest possible period rather than the shortest possible period. If anybody's interested later, I might go over the affect of depreciation on these and on with the pipeline operations. We, for years, have been trying to stretch out maturities of pipeline bonds, the past thirty years which some people say is about as long as you

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can go without affecting interest rates. In order to match it up with the ICC depreciation which has been getting longer and longer. . well, anyway, I guess that's enough on the lease. Loss of ownership is the next area and this is the most curious, I guess. If the prospect hanging over the oil companies that the ownership of this pipeline could be taken away from them at some time in the future almost nullifies any justification for making the investment in the first place. If an oil company's used its credit, it's foregone its use in other areas. The threat that the profit on it or control of it even would be taken away in something that would be a real cloud over this project and would make lenders shy, not shy, it would make them walk away from it. At this stage, I'd point out another area in which why this has got to be pinned down. These seven oil companies are all common carriers. Somebody tendered to them voluble to ship, they have to share their space, and, if you will, back out some of their own oil if they happen to be full, and the system goes. Proration . . . now, having built the system, if they've got to share this space with others, they're entitled to a return on that, and if lenders think that there is going to be some denial of return to the oil company, they're going to down grade its credit, and they're going to not lend. Regulation . . . I guess I don't need to cover too much. There's been alot of that this morning. I'd just point out again, this is another one of those areas where you could scare off lenders. If they think that the thing would be regulated in such a fashion that the oil companies cannot earn a profit, they are going to penalize the oil companies either in the form of a higher interest rate or/simply not lending. They'll say, we'll lend something else. And they see opportunities all the time. So, I don't think that one needs to be covered too much anymore. Now, there's another kind of a little problem in here that is proposed by this threat of taking the pipeline away from the oil companies that has not been covered before. I might do that in a little detail. The prospect, if you will, from the standpoint of the oil companies is that they find themselves in a position vis-a-vis with the State of Alaska, heads you win, tails I

lose. They borrow the money to finance the system, they build it, they pledge their credit, they take these enormous risks that are insurant in this situation, and then someday down the road it can get taken away from them. One of the things that they would be doing, normally do, is borrow as long a term as possible. And in the long-term bond market, and you borrow at long term, you do it from institutions who are covering long-term liabilities and investing at long terms, and they exact a penalty or redemption of ^{penalties} / if you have to pay off your bond early, say out of the proceeds paid to the oil companies by the State of Alaska and condemnations proceeding. Now in this case, just the fact that the threat's there is going to make them think about it and worry about that early redemption. The reason they do it is that they're protecting themselves against being paid off early at a time of low interest rates. They go into one of these things and they set a rate that's appropriate at the time of the credit involved and make their plans on this basis ^{and} to enjoy the income at the interest rate that, whatever's negotiated at over a long period of time. If they think they're going to get paid off early, at a time of low interest rates, they ask for this redemption penalty to guard against that contingency. Now, in this case, it's a threat to lean over, that may, even if this Legislature doesn't do it, they still read the newspapers and they see well, the State's thinking about it. Well, there are people in the State that are thinking about it. They'll say, well, it might happen. So, against it happening, they say we're going to have a big redemption premium if you pay me off early. ^{Now,} / I don't know how big that would be. It could be as high as 10% in the earlier years. Now, that's a figure to be borne in mind that if you're talking about \$3.5 billion dollars worth of debt, 10% redemption premium is an additional cost of \$350 million dollars, and that's substantial. It might be unnecessary. Now, finally the whole question of uncertainty is one that is terminating this whole picture, at the moment. The uncertainty of how these hearings are going to turn out, and what's going to happen on this legislation, among other things. There's one rule in finance that you learn very early, when there's

uncertainty, it adds to the cost. Now, the uncertainty here ^{is delaying} ~~delays~~ this project; it's delaying financing by companies that might be in the market now to pawn some of the expenditures they've made in the past. They can't go into the market if they don't know whether or not they're going to own these facilities. I might also say, we're in the time now, relatively better interest rates, and by that I mean better for the borrower, relatively lower interest rates than we've seen in some years, and there're a number of bankers and economists who are of the opinion that that, this present, relatively happy time is not going to last too long, that interest rates will go up, and I point out to you again that pipelines are sensitive to interest costs. Just a 1% rise in interests costs, say from 7% to 8%, or 8 to 9, by the time the financing is conducted, adds to the operating costs of the system \$35 million dollars during the period which the maximum amount of debt is outstanding. And that comes back and hits you in that well head price, because, of course, a tariff must carry the burden of the debt. Now, I'd like to finish up with the abilities of the State to finance this staggering sum of money. I might point out that another thing that hasn't come out yet is that if the State does it, which we don't think it can, but it's not going to be 3-1/2 billion, it'll be more, because among other things, the State's estimates, as I understand them; there was some confusion on this, but as I understood it, it did not include interest during the construction, so that would be added to the base figure, whatever it comes out at. The State's bankers have been talking about a reserve fund of or it should be talking, I should think, two years of debt service. There is interest on interest and interest on the reserve fund because that would have to be raised. And you're possibly looking at raising as much as a billion dollars more than, in fact, the oil companies will have to raise. Well anyway....The tax exempt market is ^a big one, but our firm's of the opinion for this amount of money that even if it could be raised, and there are some doubts about that, but for it to be raised at all, you would have to tap every reservoir of capital in the country to the maximum extent. Now, this would include, and the biggest of those reservoirs, of course, are the life insurance companies that are

not ordinarily life insurance companies and pension funds I should say that are not ordinarily borrowers of tax exempt securities in the first place, because they get almost no benefit from them. For that reason, the cost isn't this number that's been banded about, it's the rate at which life insurance companies loan their money to credits of this kind. Now, this theory's been advanced that one of the ways the State can secure a borrowing of this magnitude is to dedicate to its oil income, now, its prospective oil income. I'm not talking about the existing royalties and severance taxes which could not ^{SUPPORT} ~~afford~~ this amount of debt. I'd only point out at this stage, that from the purposes of security or adequately securing a bond offering, the royalties and severance taxes from the North Slope at any rate are not, they're not bankable assets. There're not valuable assets to add security in a completion undertaking because their realization are completely dependent upon the completion of the pipeline. So they don't, they would add security if it were in operation and those amounts would be falling, but not much, because the back ^{stoppage} ~~stocking~~ that's needed here is against those that have had some forced _____ that result in shutdown of the pipeline. That's the thing that lenders worry about. They have confidence in the oil companies that they can build it technically and that they can evaluate the economics, but it's all those other events that they worry about and the reason they ask for / ^{their} back stocking, and the back stocking is, if you will, it's somebody financially capable of paying interest and debt service during periods that nobody can foresee but you still worry about - an earthquake, a shipping strike, a tanker spill that results in an injunction against operation of the pipeline, so it's shut down. Now, when it's shut down those royalties and severance taxes aren't flowing so they don't add much security to this borrowing that we're talking about. So, we reluctantly come to the conclusion that the State on the basis of its present resources cannot, CANNOT finance the construction of this pipeline. In our view, if it can be done at all, it has to have the unconditional back stocking of the oil companies, I'm not talking about a modified truth of it here, I'm talking about

the full faith and credit of the several oil companies. I might say here, at this point, the only area in which there's some disagreement in our office, there's some that think it would take the joint and several back stocking to do well. It's not a question of going to something weaker than the normal truth of the thing but it's a question of meaning perhaps something stronger. A word about the plan proposed by Temple, Barker & Slone. If that plan doesn't have a completion undertaking, it doesn't do any good to say, well, the State will pay this on a contract basis because there still isn't completion. That isn't a completion undertaking by someone financially capable of discharging that undertaking. The State doesn't have the assets to perform that and just consider, if you will, the prospect of maybe the State selling one or two issues in the tax exempt market and then that market getting exhausted. It has a way of doing that. It doesn't take too many repetitive offerings before underwriters say stop, we can't do anymore. And those are issues of 115 and 200 million dollars. There're considered gigantic in that market. And then what happens, so the pipeline's half under construction, all this money has been committed, who is going to pay the bond holder back. So that that plan effectively does involve the full ^{courage} / and faith and credit of the oil companies if you would expect that they would go ahead and still complete the project if the State failed to be able to pay. Again, it's a sort of a never, never land because it can't happen in the first place. To get people to commit to even the first issue of bonds, you've got to convince professional investors that the last issue will be sold. They've got to see the end of the tunnel. And the only basis upon which they would do partial issues would be having a completion undertaking by someone who is financially capable of doing it. If the bond market runs out of money, they can put the money up whether its out of their equity or whatever it is, on their own credit, and that's the strength that you look to to get this done. Now, that is indeed an encumbrance of the credit of the oil companies. And I might point out, there was a remark made during the day about this plan that didn't encumber the oil companies. Well, if it doesn't encumber the oil companies credit, it's no good as securities. I might just give you another few facts here, and then I'll quit. There isn't the underwriting

capital in this country to do an issue of 3-1/2 million dollars worth of borrowing. The largest bond issue ever underwritten was managed by our firm from a telephone deal last a year ago January of \$500 million dollars. That's the largest underwritten deal ever done in history. It strained the capital of this country to the point and the investment bankers in this country to the point where the calendar had to be lightened around it so people could take these commitments, and the next largest deal ever done was the common stock offering which we did for Standard Oil Company of New Jersey early in 69
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some, /about \$400 million dollars, and that one strained the capital resources of the industry. As I said before, the telephone offering that the ventures with warrants had to be done on a dealer managership basis simply because it could not be underwritten. So, again, you've got to bear that in mind when you talk likely about the State doing an issue of \$3-1/2 million dollars worth of bonds. There isn't the underwriting capital around to do it. Other aspects of this plan, obviously also entail very considerable delay. There's the delay of ^{this} /legislation getting passed, the delay of constitutional amendments. That agreement which was talked about, that satisfactory voluntary agreement which was talked about, I don't know how long that would take to negotiate, but that would be a long time. The delay adds costs. We've seen, all of us, how the cost of this pipeline is escalated in the last three (3) years while it's been waiting for its approval in Washington and it's going to continue to do so. Construction costs in this State are recognized to be very high. Construction costs all over the world are escalating in a year. There is going to come a time when the continued delay of this thing is going to hurt, and it's going to hurt both you and the oil companies. Now, one more point. The question has also been raised and we discussed it with the State officials when they were in New York of the State's capability of raising the amount of money to take over this pipeline at some time in the future. Presumably, some time in the future after it has become a going concern and demonstrated first that it works and doesn't sink into the ground. This is very problematic. We'd think that there'd be a host of things you'd have to know. You'd have to know first if there's more crude than there is now proved. You'd have

to take a look at the economics of the system with the party involved. You'd have to look at the economics of the market on the West Coast of the United States, the technical operating experience, market conditions at the time, general levels of interest rates and all sorts of factors, and if every single one of them turned out very favorably, and I mean a variety of factors that I haven't even mentioned, and there'd been no serious mishaps. . . all of these things turned out perfectly, well, then we'd think that maybe it's almost conceivable that the State might over an extended period of time raise a substantial amount of money. I wouldn't say 3-1/2 billion, because I don't know. To do so, even then, with all those things perfect, economics beautiful, discoveries all over the place so that the system was obviously full and about to be moved and everything else favorable. I still think that the State to raise the amount of money then would have to pledge all of its royalties/^{and} severance taxes to the detriment of the State's credit for other purposes, whatever highways, or schools and hospitals. It's generally the a good rule to finance, not to encumber any of your assets to / borrowing purpose, because you're detracting from the _____ of the whole, but as I say, that's terribly problematic and I don't think any bank will do the judging _____ that can be done. That's about the end. I might say that we wouldn't consider it sound. We say that in order for the State to raise the money to do this, it would have to pledge all these valuable oil income assets, but we don't think that's a very good idea for the State to do as banking ~~as~~ it buys alot of governments, national governments and these kinds of things simply because at the event of a forced _____ occurs then, after this stuff is hot and the pipeline does get shut down, whether its by whim of the Interior Department the reserve becoming unproducable for one reason and another, then you have the State up to here in debt, strangling in debt without the royalties being realized and that's trouble. Now, I don't want to end on a sour note. I'll just say that I hope the State will clear away these clouds from this financing and let's all get to it.

Mr. McVeigh: Senator Rettig has some questions.

Mr. Rettig: Mr. Gary. . . .

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

Rettig: ... more able to secure the unconditional throughput agreements from the oil companies and everything should run smoothly, the guarantees would never have to be called upon. What would this do to the oil companies in the event they wanted to seek financing for something else. What is this guarantee without standards from an investment standpoint?

Gary: How many years are we talking about?

Rettig: Well, we're talking about 25 years I ^{suspect} ~~suppose~~. The operation has continued smoothly for 10 years or 15 years.

Gary: This is a very interesting question and there has been a lot, we've talked about it in our office for months and we've talked about it with our oil company clients. There are a lot of people who ~~say~~ ^{about this financing} say, will throughput agreements, they aren't ^{credit} they are operating agreements, they are shipping agreements; if you don't happen to ship for some reason you pay. And, the only time you pay out on your cash efficiency power graph in a throughput agreement is when there is something drastically wrong with the operation, either crude has dried up, it has happened to pipelines, ^{that I know about} or maybe the market has dried up or the economics of the operation have ^{changed} ~~decreased~~ so that the pipeline is no longer an important operation. This ^{is happening} ~~has happened~~ in this ^{continent} ~~continent~~ where the is drying up; ^{major} production is now being sought in the Gulf Coast area, some of the smaller pipelines up there have limited economic lives so by and large in this country pipelines have been well planned and thought out, ^{is that} it is not very often that oil companies or, but it does happen, have to pay up on the ^{cash} ~~tax~~ efficiency provision of the ^{agreements}, and that's ^{simply} hangup enough money for the pipeline company to pay off the debt. So operating experience is then, is not then an actual drain **AGO 531026** on ^{their credit} ~~either~~ side. That's fine as long as you are talking about a 50 ~~xxx~~ or 75 million

dollar pipeline, ^{where} and often several owners each own a moderate percentage of ^{owning only} ~~THESE~~ ~~dollars~~. I have known pipelines that has 17 owners in it, the leading owner ^{that has} 9%. Well let me use an example to help. The pipe line ~~has~~ 17 owners in it, and the whole financing is \$35,000,000 and the largest interest in it, I believe is held by a subsidiary ^{OF GULF around 9%}, I don't think investors worry much about the Gulfs ~~THROUGH-PUT~~ commitment on that pipeline. This pipeline, it is so large that ^{no one} ~~knows~~ is going to regard the throughput agreement as any other than a guarantee of debt. They are going to think its a percentage interest of the pipeline multiplied by the 3-1/2 billion or what ever amount ^{debts} outstanding, that ^{added} onto the balance sheet, rating agencies will do it, certainly investors will do it, its not going to be overlooked. There is a lot of talk about off balance sheet financing if you will not being charged up. Thats not true any more. Investors know about ^{they understand it} it, ^{rating agencies} do. I've talked to both of the major rating agencies ^{I would tell you how much} on throughput agreements and what they mean and I'm charged they represent our oil companies ~~CREDIT~~. And I've talked to both sides, and they claimed in one hand ^{as long as} everything is working fine ^{in that}, it is not really charged because it is an operating expense. On the other hand if it is not working so well, it is a true liability. And interestingly enough throughput agreements in a sense is stronger ^{guarantee} than a ~~guarantee~~ in that it retains its ~~working~~ capital commitment assured against usually ^{they very} plus the ^{modern} insures the pipeline as having enough money to meet all of ^{the obligations} in the past.

So I think that it would be correct to say that the operating systems ^{that ARE} ~~have~~ proven and that people dont necessarily charge it out

So against each of these companies.'

4 You do ask the question then, are you Mr. Pipeline Borrower a major guarantor of any one elses debts? Is this a fact? You would ask this same question. Are you a guarantor

even tho it doesn't appear in dollars and cents on the balance sheet?

I'm not sure. We'd regard it very seriously, I might say.

Thank You.

RETTIG:

SENATE COMMERCE

I'm going to start with the ~~Sub~~ ~~College~~ Commission first. Mr. Groth did you have a question? Would you start it off?

Mr. Chairman, Mr. Gary sounds a little bit like my banker that keeps telling me not to go to building and then he goes and builds one next door. ^{GARY:} The reason I was asked to come up here was that I'm the guy ^{that} ~~with~~ all our clients ^{divert} ~~to work~~.

But one of the matters that troubles me ~~here~~ somewhat is the apparent disagreements between ^{the} two sections of intelligent gentlemen, one of them being you, and the other the people from Barker Temple/ ~~and~~ and Mr. Macy who is certainly from a -----

: I don't think there is any disagreement

: You seem to indicate that (if I understand your testimony) that in order for the State to build this pipeline, they would have to have the full ^{financial} credit of the oil companies. I thought Mr. GUILDERHOUSE indicated that that would be necessary.

: May I get the notes out here because I didn't hear it that way. I did not hear him say that it could be done. ^{In fact} I heard them list a bunch of assumptions and conditions, having to be satisfactory to all. And then I think they left ^{what I heard} was an implication that it might be done. Now, among the assumptions and the first one we look at is the reserves. Sufficient reserves is what I ^{would look at} ~~look at~~. We have heard testimony here that is generally known that the reserves are nine and a half million ~~dollars~~ ^{BARRELS} which are not enough to support this pipeline at the projected levels that are being talked about. Implicit here is the ^{hope and} expectation of those additional barrels will be found ^{AND}

I'm sure these oil companies would certainly have that expectation. They ^{don't} ~~do~~ know where, how much, or with what degree of certainty or assurance

But that that could be done. ~~XXXX~~ I'm talking ~~about~~ from standpoint of ^{FROM THE STANDPOINT OF FINANCING} financing. The oil companies ~~are~~ perfectly capable of taking that risk

that they won't find those additional reserves. But a lender isn't going to take that risk. He's going to want to be back ^{STOPPED} ~~stopped~~ against that event not happening. That's not his business. That's putting the lender in the oil business if you make him assume that risk. Now, if the satisfaction of that first assumption or that ^{first} ~~certain~~ condition just isn't here, at the

time the financing needs to be done so it has to be back ^{STOPPED} ~~stopped~~. Now that's true of all the ^{USUAL} ~~business~~ things that you have to ^{SATISFY} ~~set up for~~ a ^{INDEXES} lenders ^{ON},

Would you flip back in your notes to Mr. Guilderhouse's testimony which is one page before?

I understood that his fifth point was

1. Was operation pipeline sound business
2. The cost fees are various assumptions - it will cost three and
3. ~~It will cost three and~~ one-half billion It will be built and utilized.

~~XXXXXXXXXXXXXXXXXXXX~~

4. That the State's credit is not adequate to sell the G.O. bonds. Perhaps I misunderstood
5. ~~XXXXXXXXXX~~ that the oil companies will not be obligated to lend
6. their full *faith* for credit

: Lets go back to one of the earlier ones that you said that it will be built and used. Then he talked about a shipping agreement that didn't have any teeth in it, and it didn't obligate the oil companies to pay any monies, if ^{for} instance, the proof dried up, or the line was shut down for any reason. Who's going to pay the debt then?

: Thank you. Let me hit this one a little harder, for its hard even for our oil company ^{clients} ~~guys~~ to understand. Sometimes when you tell them they've got to put their credit squarely behind the pipeline financing. They ^{so far as look} ~~think that just~~ ^{the things} ~~because they have~~ been operating for years and ^{now} ~~they are~~ just going to expand a little bit we say No, put it behind there. The lender doesn't take business risks. He takes credit risks but he's not going to take the risk of ~~an~~ an economic circumstance occurring that he has no control ^{over}. He can evaluate the ^{loaning} risk of ~~axiom~~ to an oil company which is a going concern ^{earning money in various} ~~in various~~ places, not just this pocket up here ^{that pocket} or down there or in the Middle East or Venezuela, or the lower forty eight or wherever it is, he looks at a credit that is dynamic in a diversified business, diversified internationally in the case of most of these oil companies, where if something goes wrong here, we have have strength there. That's what he's looking to. He's not looking to assume a business risk that he doesn't know about. He can't do anything about finding the additional reserves, that would be necessary to put this through this line

to get it up to the two million barrels a day level. When the oil company takes ^{these} ~~this~~ risk, it does it because its optimistic and hopeful, and just to ^{round out this point} ~~that's why they have to have~~ the expectation of the profit.

GARY: Mr. Holms..

HOLMS: Yes, Mr. Gary. In earlier testimony (I don't know which page to flip back to) but ^{in earlier testimony} we had the supposition made that the tax exempt bonds would be a point and a half to two points less than they would be if private enterprise had to borrow this kind of money. With all the hazards of the bonding of a State that you have been talking about, could I get your idea about this because it seems that the State had predicated a lot of the differential in profit upon the point difference. What is your opinion?

GARY: Its somewhat an academic question. My firm is of the opinion , and by the way, Mr. Macey said the same thing, that you would have to tap every capitol market ^{if this is done} and he even said in an answer to a question, indicated what one would normally regard as the gap between tax exempt securities and taxable securities of corporate bonds, would be somewhat eliminated by virtue of the fact of having to sell large quantities of bonds to institutions that derive almost no benefit from the tax exempt status of the bonds, simply because they dont pay taxes. Pension funds don't pay any, Insurance company taxation is an instrumental way to 32% of major light companies. so that, I frankly don't think that you'd end up any lower ^{what the rate would be} ~~than~~ ^{if you had to go to} those people only. ^{The buyers} ~~XXXXXXXXXX~~ ~~BBB~~ tax exempt market is a large one consisting of individuals, banks, small banks some foreign casualty companies and in the tax exempt market, a two hundred million dollar offering is gigantic. and new purpose offerings, and this is a new purpose---this isn't a hospital, or a general obligation or an airport or a ~~XXXXXXXXXX~~ toll road. There's a lot of difference between this and a toll road ^{its more powerful} ~~its not a public utility~~. The oil companies can't use it there's ^{some} ~~gone~~ ^{wrong} so toll road ~~ix~~ is a question of measuring traffic, sure the measurement may be out a little bit according to a traffic consultant but somebody's going to use it and it gets some use --you've hear them talk about the Chesepeke Bay Bridge so if the issue were ready to go

difference of the tomorrow, and you were asking about the first hundred million dollars worth, the first thing you would have to do is go out on an educational campaign and you'd have to take the major investing corporation you'd show them what's involved, you'd educate them, you'd go on a massive campaign to educate investors, on why this is the kind of investment they should make. Never the less, it's a new venture and the first time off you have to pay for doing something new. I doubt that there would be any lower rate than what the oil companies could borrow at anyway with their credit, and I suspect that when you went to sell the first issue of bonds, you'd negotiate

you'd negotiate a rate to them appropriate to that credit, and I doubt that if you try to do any financing at all, I doubt that there would be any difference --- there would be less of a difference ^{let's say} than occurs in the normal fluctuation of bond prices anywhere. At least you couldn't measure it.

HOLM: Then, this great advantage which we have been lead to believe is there, practically evaporates under your arguments. One other thing. It seems to me that from what you said, that if the State wanted to make a bond offering of this size that this ~~do~~ advantage ~~of bonds of~~ our bonds because the private enterprise when they went, there would be seven offerings and they would all be broken down because we wouldn't go all at one time. However, wouldn't it also be true that whether or not the State went into the bond market or the private enterprise went into the bond market, there would be in fact maybe a billion thrown on the market at the offering of somebody --- maybe it comes from seven companies but there still a billion dollars being axed from the market and this is going to be a tremendous impact I know. We were told that nine hundred million from the oil lease sale dried up a lot of the money market.

GARY: Now, we're talking long term market.

HOLM: O. K. If we're talking long lease market, wouldn't the same thing be true tho, wouldn't the parallel be true whether or not the State went into it or not, or the private enterprise went into it.

GARY: I don't know how to answer that. Yes, the oil companies when they start raising their share--this will tap the market, but they have other sources. They have

internal cash flow and they will be staging it out in terms of their picture so that you won't have identifiable TAPS financing necessarily, you have Humble pipeline coming to the market for its needs whatever they are. *and it gets there in other pieces* It has the largest oil company in the world, which has an enormous cash flow so ^{that} it would be melted into its normal trips to the marketplace. I guess what we're saying is --its trips to the marketplace might come a little more frequently than and in bigger size than would otherwise be the case were they not building ^{this thing} but I submit that if they were not building this, they would be making investments in other places and coming to market anyway. I might say that in this endeavor, and studying this whole problem, that we have consulted a banker, Donald ^{who is a retired} Senior Vice President of the First National City Bank and is considered by many to be ^{the} Dean of the tax exempt municipal bond market, and who is now the consultant to the power authority of New York, ^{the New York Authority} and he has had an entire career in the tax exempt market. He concurs that all of our views that I have been expressing here today and He's concerned about the size that we're talking about. Put it another way. Let me see if this will help a little ^{if} If the oil companies happen to have organized this in corporate form and are trying to build a market with three and a half billion dollars, or 90% of that, in the next three years --I don't know what we ^{probably} would say to them if they asked us to do it--I think we would ^{say} to them, the maximum size that you can take out of the market is not that much, you'd have to do a very substantial portion of this ^{with} the banks, in term ^{loans} banks ^{if} if they could do it. When you get to really gigantic projects of this kind you're rubbing up against the capacity of the market to take something. Some of these major institutions have what are called "Legal Limits" and they can't go beyond a certain amount that any one bank. We had occasion to tote this up in connection with the gas line as somebody mentioned this morning and we got up to an amount ^{some} millions of dollars short ^{of} a considerable amount and ^{assumed} ^{some} takedowns over ^{a period} four years the maximum amount that they could commit on any one project without exceeding their legal limit and we found

enough, to get it done we would have to tap banks, current bank loans which sometimes in some money market conditions are hard to do by an amount that would also strain a commercial bank. Let me put one more thought to you, and that's the question of legal investment. The plan that's been served up to you here, contemplates a so-called modified *agreement* which is really shipping does not have in it to my way of thinking sufficient security to qualify as a legal investment where-in the elements *to legal investments* to insurance companies are there. Now, maybe it is suitable that that might be worked out with something *short of a full paid-in credit* of the oil companies but I honestly doubt it when one considers the history of this pipeline, where the proved investor could not prudently take the risk to a satisfactory resolution of all the problems facing this pipeline in their technical producibility any thing else the politics couldn't say that the far degree of adequate security is there so that you're in a situation where ~~the xxxxxxxxxx~~ you may be even denying yourself the ~~xxxxxxx~~ *biggest pool* ~~the~~ capitol there is so it doesn't make financial sense to me to tie both your hands behind your back and then call you out and raise an amount of money that's staggering

RETTIG: Thank you. I think at this time one point should be clarified. I believe that at no time has the State in its position declared or assumed any advantage from its ability to issue tax free bonds. Its sole advantage, if any, would be freedom from income taxation On the operation of the pipeline. For example: On page 4 of the States presentation by Commissioner Wolforth, they assume that two billion, six hundred thousand of the debt would bear an interest rate of 8% and only nine hundred million assumed to be issued on a tax free basis and that at 6 1/2 percent, so that even if that were all at a tax exempt rate the advantage would be relatively minor in that regard as opposed to freedom from Federal and State Income Taxes so the almost total advantage claimed by the State is in the area of income taxes, not in tax exempt bonds.

MC VEIGH:- I would like to ask Mr. Gary to comment on the advantage that the State would have in relationship to this Federal Income Tax. It's a good, healthy amount. I think its \$168,000,000 per year. Now that strikes me, as a layman, in finance as one a lot of money that the State as well as the oil companies could utilize rather than giving it to a third party like ¹Uncle Sam. What do you say about that?

GARY: I say--sure, its for the benefit for both, obviously the Federal Income taxes ^{can}~~would~~ not be paid. I don't happen to know what the tax profile of this pipeline is in the hands of the oil companies as they're projecting to do it but I know what a typical tax of the pipeline operation is, having worked on it. So I think the magnitude of the amounts ^Imentioned ⁱⁿ here are somewhat misleading. I don't know what appreciable life the ICC will assign to this pipeline. It will be critical to the economics--it will be important for the economics of this pipeline what that life is but ^{just} to the extent that the taxes are saved and I suppose if that tax saving were shared with the oil companies in the form of a lower tariff; ^{this is the state's own money} ~~this is the state's own money~~ ^{I suppose yes that would be to the benefit of all} I think this is a somewhat difficult area to talk about unless you know what you are comparing--I suspect that your comparing an apple and an orange here.

MC VEIGH: I think you would have to agree that its already been stated and ^{I think} fully accepted if we're under State ownership still its going to be regulated by ICC and that the rate regulations would follow and that if there was an expense which you would have under private ownership is non-existent under State ownership, that is the Federal tax bill then thats going to result in lower rates because we've got to assume that theres a fixed 7% amount that we can make whether we're State owned or privately owned and if theres an expense deducted from that then its got to show up someplace.

GARY: I don't know that that's so. That's my problem. I indicated here, with State ownership you must realize that ^{your money} a very substantial amount of money more than the oil companies are. For instance, they don't have to raise ^{invested money} construction because they are a going concern. If the State owns it, its a xxxxxx project and

GARY: "Project has to raise the interest earned. Project has to raise the reserve fund and it raises absolutely a greater amount of money. ^{Combine} ~~Being~~ that, with the interest rate that you would have to pay to attract the capital of this amount its apt to be more expensive--I don't think it would be cheaper. It might be more expensive than the amount of Federal Income Tax rating.

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: _____ state ownership.

: I'm not the advocate of any position of state ownership against private ownership. I'm here, I think, in the capacity to talk about an answer (??) so I have no private ^{OPINION} feelings but I think I'm here to talk about an answer.¹ Really nothing that we've addressed ourselves to, and as I said a little bit ago, this is a comparison of an apple and an orange, and in ^{SOME RESPECT} fact I just don't know whether it will come out cheaper or not. ^{AND DON'T} I think you can do a lot of work studying this but such substantial elements of dissimilarity/is not necessarily going to reduce itself down to a MEASURABLE quality. I think I might emphasize again that as a practical matter I don't see how the completion problem is solved, it isn't solved for instance by the state asking some underwriters to sign a letter saying no matter what they will divide the 3-1/2 or 4-1/2 billion dollars over a specified period of time. No underwriter can do that. That amount of capital doesn't exist. To write a Letter meaning for that way so it isn't there. And you're saying, we're not going to encumber the oil _____ completion question. Well, I don't see that anybody going to loan money without a completion undertaking here. So its a little difficult to talk about, and frankly the comparison isn't valid.

: I think that answers my question.

Rose : Mr. Gary, what INDICATIVE is the oil companies individually ^{can} here, interest, ownership concept ~~to~~ raise the necessary money - you said the money for that particular site)??) is available in the market. Then you indicate under the corporate arrangement, to form a single entity ^{That would} ~~I would~~ ^{change the picture} ~~say to better~~ ^{and wish you could clarify for me}. One thing that I don't understand is, why couldn't the

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entrepreneurs, the financiers in this situation do what is commonly ^{done} in the money market, and that is asking the principal in the corporation to provide the necessary back up for their own credit?

Gary : Well I'm assuming (??) the backups there.

Rose : Do you remember ~~under~~ the corporate setup, you said the money would be hard ~~to~~ to obtain even then? Even with the same backup and the same credit?

Gary : I'm assuming its present in both cases. What I'm saying to you is that as a mode of finance, doing it in project form, ~~xxx~~ rather than in 7 discreet ways, you don't have the ^{multiplicity} of names, you don't have the ^{giving} ~~strong~~-concern advantage, the individual companies have the flexibility to incorporate their own.....

Rose : That's what I mean ^{If you were to} Sir... ^{and backup} say, well in addition to the corporation's credit, ^{the who are the} we want the/stockholders of that corporation to come in ^{for well} and provide their own credit for backup. I know that's done in private (??) financing currently, ^{If I have} and ~~then even~~ a corporation ^{and if} when they need to make a loan, to obtain a loan, and they tell you, ^{well} your corporation isn't strong enough, and if ^{you'll} sign individually _____ we go? Why couldn't that be done in this instance?

Gary : It would be done. It would be done. In either case its exactly the same. The full faith and credit of the oil companies are behind it, and would be required _____ into this pipeline.

Rose : I have one other question:

Gary : Maybe I can.....there are seven owners here, there's Humble, Atlantic, Sohio, Phillips, and MOBIL &c. When I say a multiplicity of names instead of I mean/the Trans Alaska Pipeline system, going to market to sell three billion or more dollars worth of oil, that's one name, and investors ^{working} ~~working~~ at it have legal limits to that one name. The credit is still composite credit of the

seven oil companies, but the name on the bond is Trans Alaska Pipeline System.
Its only one name. joint Humble

If they do it in undivided/interest form the/pipeline comes to market, the
~~mobile~~
~~Robert~~? comes to market, Amerada comes to market, Union comes to market,

^{GARY: They}
Rose : You see that they may do it along all the lines of the
^{ROSE:}
rest of their financing too. I don't think there's any difference in the
availability of _____.

Gary : Yes.

Rose : Alright. The next question that I have sir

Gary: : Witness (?) my partners to make sure they agree!

Rose: : The same one that was raised yesterday ^{that which} we had ~~the~~ some
difficulty ^{IN} of obtaining an answer....you ^{seem to be} ~~said~~ there ~~would be~~ experts in
the field....assuming if we are.....^{what is going on} ~~the state is going into some one should~~
~~to go~~ into the State in some ^W ~~un~~feasible arrangement, a 3-1/2 billion dollar
issue OR MORE IN SPITE OF

Gary: ~~or~~ 35 hundred million dollar issue, spaced right,

^{ROSE: RIGHT}

^{5 MONTHS NEXT}
Rose: ^{WITH A TOTALITY OF} : 3-1/2 billion - what is the total cost to the State for
^{as the, of course, best approximation}
underwriting these counsel fees and other fees ^{RELATING} adhering to it? ^{Results}

Gary : Can I give you the cost of the first issue? As you know,
I don't really believe it can be done; (laughter) let me give you the cost
of the first issue. ^{ALRIGHT?} ^{Is it} a tax exempt following...

Rose : Well, either way....it makes no difference.....

^{GARY: Is it tax exempt?}

^{ROSE: Let's assume not.}

Gary ^{assume not:} The State issues, guaranteed by ^{The oil companies} ~~law~~, ^{contradiction of} terms,

Rose : I'm sorry, I didn't think I would be quite so complicated
The state went into it and that's all.

Gary : ~~The State may as well (??) the tax limit for taxable bonds~~
~~AS A TAX EXEMPT OR TAXABLE bond~~

^{ROSE: Right}
.....let me first talk about ~~taxes~~ ^{TAX EXEMPT BONDS}....I don't get the picture of the State
selling a taxable bond....

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Rose : Well, I thought you indicated that those bonds issued by the State would not be taxable.....I'm under the assumption that they are not. ^{that they} ~~that's why~~

Gary : Now, let me try to answer your question. There is confusion here somewhere. Tax exempt bonds, for new purposes, where investors have to be educated, and ^{OK} large size..all right, lets assume this is 100 million dollars, a large issue, for a ^{TAXABLE MARKET FOR A NEW PURPOSE} ~~new purpose~~, where you have to do very substantial education of investors, I would guess that the underwriting spread would ^{probably} have to be in the neighborhood of 2-1/2%, on the first issue. Now included in that underwriter's pay ^{pay} ~~the~~ selling commission out of that, I would say, ^{that} ~~no~~ you might have to pay a selling commission of about half of the total spread, a little more than half maybe.

Rose : Is that included in the 2 1/2 ?

Gary : Included in the 1.3 per cent . You have a management fee, to make up the managing underwriter, and underwriting fee ~~xxxxxx~~ rest of the 2-1/2%. I think if the thing were set up in such a fashion that well, lets assume the first issue is terribly successful, and the credit becomes established after this education process that goes on. Then you might expect ^{by the} ~~credit~~ ^{came} be/established and the operation became more and more proved, that the fee might decline in competitive issues. I think you should understand that the underwriting is largely a cost of sales. People don't knock on bankers' doors to buy bonds. You have to go out and sell them, and municipal bonds are sold by brokers and ^{registered} ~~xxxxxxx~~ representatives and they have to make a commission, they have to go out and sell the things. As disappointing as it may sound to you, you have to work to sell bonds. / ^{You have} pay somebody to sell them. They have to get somebody to go out and ^{sell} ~~sell~~ the story.

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And thats what this underwriting expense is. I think the witness WAS
I don't know what happened to him-----but anyway its....thats what it costs
on tax exempt -- 2-1/2%₆

Chairman : Thank you, Mr. Gary. I think you've answered the question.
We are going to take a 10 minute break. If I can just add to what you said
something that I discovered after the question was asked, that ^{the} underwriters
also carry the burden of stock buying (??) the bonds if they don't sell.
Isn't that right? Thats to be accountable too, in there?

Gary : Thats what underwriting means.
THE RISK LIKE THESE OTHER RISKS WE TAKE.

Chairman : Lets take a ten minute break.

=====

: There were some suggestions from members of the Legislature
we're going to depart from a rule that we had determined we would maintain, and that is we
thought it ~~probably~~
initially/~~probably~~ would be inappropriate for witnesses to pose questions
to witnesses. However, ⁱⁿ this area of municipal bond financing we do have
a man within the State of Alaska, he's on the staff, Commissioner of Revenue
Eric Wohlforth, has agreed, for purposes of clarification, to ask some expert
questions of our expert witness and we are going to call upon Mr. Wohlforth
at this time to ask some questions that have occurred to him in connection with Mr.
Gary's testimony. Mr. Wohlforth, would you come up here ? There's a mike
set up *at the end of the table*

Wohlforth : Thank you very much for the opportunity, Mr. Ch airman.
I am afraid the questions will not be as expert as the answers, but I'll
take a crack at it anyway. The first one, as a point of information,

how many tax exempt issues has your firm underwritten, either as a manager or co-manager?

Gary : We don't....our firm I don't know the answer to that question. We participate in large revenue financings or often where they're ^{or complicated enough} large enough so that we can lend some assistance. We have managed a number, again I don't know the number of ^{municipal} industrial revenue bonds, which are not unlike the activity that we are talking about here, I think we've managed the largest bonds in Lorain County Ohio, which is backed by U. S. Steel Company. Its also an Alaskan Co.

Wohlforth : Do I understand, and I may not have this right from your earlier testimony, that lenders do not ordinarily take economic risks?

Gary : They don't take business risks, if you will. That was said to make a formula (?????)

Wohlforth : I see. But in the case, you perhaps excluded from that consideration ^{the} total financings which are in the (default??), the one in the Chesapeake Bridge and Bay Tunnel financing, and the Virginian Turnpike high financing?

Gary : I think I also said that this pipeline isn't anything like a toll road. Among other things a toll road can be built ^{in stages} ~~xxxxx~~ utilized and generate ~~xxxxxxxxx~~ revenues as stages are completed and hooked up. This pipeline as a project doesn't generate one penny of revenue until its complete. Its one of the things about pipelines you always have to remember, that they're worthless unless they are completed. Its not true of toll roads, ^{does}

Wohlforth : Thank you. How, in your opinion, the tendency of an ownership bill present a real threat of the loss of ownership?

Gary : Well, I think thats a legal question. Talking from a business

sense, I think what is meant was that if we're going into the market with some Local bonds, and its the investor's ^(immunity?) community to worry about spending a lot of money, and not being able to enjoy a return on it, business return, if he is worried about Mobil's investment being condemned by the State, or worried about Mobil spending a lot of money that it will get a return on, then whenever you have worries in investors' minds, you are hurting finances. And if the investor is convinced for instance, if the thing works, ^{one day} and/the State takes it away, he's not penalized over in the marketplace. He will regard that credit being dissipated, ^{diminished, or} impaired if you will. *And that hurts* And that ^{results in} ~~with~~ also an increase in cost and it was also a narrowing of the marketplace. When investors worry they don't buy. ^{They say} ~~Now~~, I'll pass this one by, and get the next one.

Wohlforth : How in your opinion could the State raise the funds to condemn the pipeline?

Gary : I think I've said I don't believe the State can, without the credit of the oil companies.

Wohlforth : I see, so that's

Gary : I'm not trying to be negative here. We're talking about an amount of money, that represents a staggering burden. From a market ~~place~~ standpoint I don't see the State doing it without the credit of the oil companies.

Wohlforth : What specific financing plans have any of the member companies involved in the consortium have already been postponed?

Gary : I am not at liberty to say that. I will tell you that prospects of a threat overhanging these oil companies is because of this ^{of hostility} pending legislation, and the aura/~~mix~~ that it generates has caused us to recommend to one of these companies that ...to defer financing in this current market.

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and I don't say that you did
Wohlforth : Did you suggest that /...didn't you suggest in your
testimony that one or more of the member companies are now ready to finance
_____ on the pipeline?

Gary : I will discuss this point with clients. (??)

I think I might point out that these companies already have a fair amount
of money invested in that pipe that's sitting on the ground., and those are
expenditures that ~~xxxx~~ ought to be funded on long term. ^{The list of} What I'm
saying is that with this cloud hanging over, it's not propitious, it simply
wouldn't be propitious for them to attempt to go to market and face the kind
of doubts and clouds that this event is causing.

Wohlforth : I may sort of start up financing as you characterize
and indeed you alluded to the
this, /it is properly characterized as one ~~xxxxxxxx~~ fact that in prior
testimony references were made to the necessity of an initial funding of
a reserve, and that such a reserve, is it not true and in your experience
in such a reserve can hurt interest over the life of the bonds? Assuming all
~~xxxxxxxxxxxxxxxxxxxx~~ goes well in effect: being tied to the final ^{maturity} ~~issue~~
issue would pay the bonds off in what would be called a 'wash'?

Gary : Oh, sure, and as time goes on of course it becomes bigger
in as the debt declines
and bigger/relationship to the amount of debt outstanding/and improves the
credit as time goes on, and as you say if the pipeline is successful. What
I was referring to in my remarks was the fact that ^{that amount of} ~~that~~ ^{that reserve also} money has to be borrowed
by the State to get it, ^{to} ~~it~~ to make it a reserve, and that adds to the burden
^{which is something that the} here, ~~the~~ ^{established credit} oil companies, since they have a going concern, don't have to do,
and it's adding to the cost under that scheme of doing things.

Wohlforth : That's all I have, Mr. Chairman. Thank you very much.

Rettig : One moment, please. I wonder if you would submit to a question, Mr. Wohlforth?

Wohlforth : Surely.

Rettig : I have a short one. In this matter of reserves for bond issue, established with the purpose of servicing the debt in the event of a slowdown ~~/from some source~~, on the assumption that such reserve would be created out of monies purchased- borrowed at 8%, presumably that money has to be available, on short notice, to service the bond debt. Is that a proper assumption?

Wohlforth : This is correct and ^{the} trust ⁱⁿ ~~adventures~~ ^{that is it} usually provides this maturity when ~~a xxxxxx~~ is no longer than 12 months, 18 months or 24 months, in governments or instrumentalities of the United States.

Rettig : Under those circumstances as they exist ~~this~~ today, it would not be possible to achieve a push with it

Wohlforth : It certainly would not, in a given year. That is correct. perhaps

Rettig : In some cases it would/even make a drop in interest rates, short term rates, or even higher. There was a period, as we all know.

Rettig : Thank you very much, Mr. Wohlforth.

Wohlforth : Thank you Mr. Chairman

Chairman : Are there any questions? Senator Croft?

Croft : Could I ask Mr. Gary - has there been ^{through the choice} ~~any~~ ^{problems with} ~~negotiations~~ the financing of pipelines across either ~~xxxxxx~~ Federal land or across State of Texas, either ~~State or~~ University lands in ~~the~~ where there is at least some question as to the ~~duration~~ ~~interest~~ of the land ~~in~~ interest in the pipeline company?

Gary : Not that I am aware of. The State of Texas, being an oil state, is generally regarded as being friendly to the oil industry, and not friendly to the extent of discrimination in favor of independent ~~oil~~

but the State of Texas does depend upon oil for a ^{very} large portion of its State income and ^{is it} is generally regarded as always having taken steps which are conducive to the ^{health} industry. So I'm not aware of any problems which ^{has} have ever arisen but I would guess that perhaps some pipeliners around here may remember some.

CROFT : What about the crossing of Federal land where the interest of the carrier has been described as either ^{terminable} ~~triflerable~~ (???) or cancellable or ^{does} ~~revokable~~? Can that cause a problem?

Gary : I'm not aware of any problems that have ever occurred. ^{That's by no way of tending to diminish} on those grounds. ~~I tend to be committed to~~ my earlier testimony, ^{not about} this situation - ^{which} ~~this~~ is quite different from those.

CROFT : To what extent is the provision of SB 294 different in that regard?

Gary : Its different because this hearing is taking place. This hearing is evidence of some breakdown in communications between ^{you + the} oil companies and the State, ^{I think} so that the general impression which is left with the investing public is that there is trouble ^{there} and when there is trouble that means trouble for people trying to ^{do} ~~be~~ financing.

RETTIG : Mr. Gary, I believe what the senator meant is ^{you} ~~that they~~ do have some situation in Texas that has short term right-of-way implications. Were the conditions of SB 294 to come into ~~being~~ we may have similar short term - I think in that case 20 years - is the maximum period. Is that correct, Senator? ^{is that the point you were}

CROFT : Automatically ten years, there can be ^{up to} twenty years, and there is provision for almost automatic renewal for additional ten year periods in SB 294, ^{that was specifically what I was referring to.}

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GARY : Let me state it correctly, so it is understood. ~~The where~~
^{LIES HERE, The problem lies in the}
the problem ~~was~~, which the State has stated, that they want the limitation,
namely to renegotiate terms after five years.

RETTIG : I beg your pardon - SB 294 has a minimum term of ten
years, can be arranged (or raised?) at 20 years. Its the other bill thats
five years.

GARY : I'm not up on these numbers.

Gary : The whole point is that the oil companies have to
be able to fix their cost, to be able to say that they are _____
making a valid judgment on the return they are liable to get. By reason
of limitation of lease terms is a hint that in fact the economic groundwork
is going to be changed - whatever it is, five, ten or twenty years.
That represents an infirmity on the possibility of financing on reasonable
terms.

Chairman : Are there any other questions? Mr. Huber.

Huber : Mr. Gary, we heard from you that the financing of the
pipeline is actually hurt by such things as the pending legislation so my
percentage-wise
question for you - could you give a realistic answer/as to what relationship
availability of
has a detrimental effect on finances on construction of the pipeline is
/
represented by the pending State actions in comparison with the problems
on the Federal ^{level} ~~land~~? This means the whole problem of not having the permit
issued, etc., the delays that we have .. had already with what we anticipated
we might have so that we can actually ascertain what level you think in your
mind , percentage-wise, you think might be in sight?

Gary : Nobody can give you an answer to that question, but I'll
^{here and that nobody}
tell you the areas of concern - ~~the company~~ can tell you its 1% or 5%. Areas

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of concern are first delay and ^{Resulting From} ~~it is only for~~ delay ~~that~~ you get escalation in cost. Also resulting from delay you ^{find} find yourself, by the time you're going to market, in a condition of market where interest rates generally ^{it would be different that's why nobody can tell you} are higher - they might be lower, too. ^{PRE calling} The third factor is that we've ^{un} created uncertainty here and/certainly in the minds of investors about the viability of this system, over a long time, simply because the general impression that ~~is~~ left by all this is that there are going to be troubles, ⁱⁿ perhaps, ^{Now, that is} realizing profits from this operation ~~is perhaps~~ the worst.

~~This is the worst kind of instrumental effect~~ The worst kind of instrumental (??) effect because that is the thing that discourages investors, long term ^{So, if} investors from putting their money into it. / the market shrinks, you end up paying a higher cost because you're not tapping as broad a market.

And for ~~an~~ an operation of this kind you've got to get as broad a market as you can, so anything you do to penalize this financing is going to have an effect both on the State and ~~on~~ the oil companies. Its disadvantageous. With the result of higher interest cost and _____ and higher interest cost, have to be reflected in the tariff and that works its way back as you've heard many times in the last few days to the wellhead price. So I can't qualify it, but its something of serious concern.

: Mr. Gary, through the chair: in that case, what would be your opinion of the best thing we could do to maximize the good effects as of this moment?

Gary : Whats yours?

: I believe Senator _____ has a question.

: We all

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Josephson: . . .If we were going to have a good investor climate for industry in Alaska, bearing in mind, this Legislature will be succeeded by another, and the next Legislature by another, and bearing in mind that we will hopefully have more than one pipeline, and series of developments and projects requiring financing, that if we were to create a good investment climate the only thing the Legislature could do, would be to adopt a permanently static public policy in which we go year by year offering no change and is that the indication that the sovereign State of Alaska has to grow, that we cannot from time to time consider public policy changes without fear, and without the constant threat of a bad investors climate? If we cannot have a permanently static policy, I wouldn't think.

Gary: I wouldn't have thought so, nor would I think that's good financial planning, but I don't know how to answer to question and I think it requires a political answer and I'm a financier. We do advise a good many national governments on financial planning but I didn't hear a financial question.

Rettig: The answer to that question may appear in some of the studies tomorrow when the State reappears in its case and perhaps some of the answers can be posed at that time. I would have to agree that the question can't be answered by, or shouldn't be expected from Mr. Gary.

Josephson: Well, Mr. Chairman, let me re-phrase it then. Are not investors sophisticated to the fact that all sovereign governments reserve certain opportunity for public policy and statutory change - that's not a unique thing here in Alaska, it applies everywhere - it governs every marketing . .

Gary: Well, I agree with that. No problem there - I agree with you.

Rettig: Are there any other question for Mr. Gary? If not we'll . . .

Mr. Donaldson, apparently that concludes the . . . Senator Thomas, did you have a question?

Thomas: No, Mr. Chairman, thank you.

Donaldson: Can Mr. Gary be excused?

Rettig: I am sure . . . can anyone think of a question they might want to pose to Mr. Gary later - he will have to catch an airplane I understand.

: There were a number of them stored up the other day that haven't come today.

Gary: I am going to try and catch an airplane tonight.

Rettig: Well, thank you very much Mr. Gary. Mr. Donaldson?

Donaldson: The next witness is Tom Broussard. He's a tax specialist with the Atlantic Richfield legal department. Tom's testimony will be very short. He has a memorandum on the tax points which he has prepared for you and in view of the time element I have asked Tom to speak directly to the main points and then answer any question.

Broussard: Mr. Chairman. My name is Tom Broussard and I am a Tax Attorney in the legal department of Atlantic Richfield Company. In the last several months, together with counsel representing several other oil companies, including counsel from several law firms, we have studied the questions of federal taxation of the State of Alaska on potential profits ^{that might earn} ~~to be derived~~ from ^{The} ownership of a trans-Alaska pipeline and the separate question of the taxation of any interest received by bondholders from any bonds that might be issued by the state or a public authority for the purpose of building the pipeline. It is my opinion and that of my colleagues that it is very doubtful that either the state or its bondholders, under the bills introduced by the administration, will be exempt from federal income tax. First, considering the likelihood of the state's exemption from federal income tax on profits from the pipeline, and I gather this is the key tax exemption the state is seeking, there is no question that Congress has the constitutional power to tax the state on its income derived from ^{business} activities. The past position of the IRS up until this time has been that Congress did not intend to impose the federal income tax on a state when it was directly engaged in a business activity for the purpose of providing a public necessity or in the exercise of its police power. However, it is doubtful that the IRS will maintain that position if

asked to rule on the question of the State of Alaska operating a 3.5 billion dollar pipeline to carry oil for the benefit of a limited number of private oil companies. If the IRS did grant such a favorable ruling, where the intention of the state is, as outlined before this committee, to substitute itself for private businesses which are presently ready, able, and willing to engage in a commercial activity for the benefit of relatively few private users, and then to pass on to those companies all or a major portion of the savings from its privilege of tax exemption. Congress in my opinion is almost certain to reexamine the question of whether the privilege should be continued. The result, I believe, would be an amendment to the statute to make clear the intention of Congress that such income should not escape federal taxation. In fact, it is doubtful that congressional reaction to this proposal would be limited to this state activity alone. There was a comment before by the Chairman that the figures presented to you earlier by the state ^{do} ~~did~~ not include any benefit to be derived in the possible tax exemption on the interest received by the bondholders of any state bonds. I have had some difficulty in following the state's proposal in this regard as to what extent, if any, they expect or are planning on the benefits from tax exemption on the interest of their bonds. None the less, my memorandum has considered the possibilities that I can think of by which the state might attempt to derive that tax exemption on all or a portion of the bonds. And the memorandum attempts to consider as well as possible the different types of doing this that we could think of. ^{We} ~~This~~ resulted in a negative opinion in almost all of them, with the very rare exception and for items which were for rather small amounts, considering the magnitude of the project. None the less, I think it is important to review briefly what Congress and the Treasury have done in the area of revoking tax exemption on interest received by bondholders from certain types of bonds because I think it is indicative that what the Treasury and Congress can be expected to do in the area of tax exemptions to state income where the purposes are very

similar to those in which Congress has already acted. Now, with respect to the exemption to the income tax on bonds, the exemption is derived solely by virtue that section 103A of the Internal Revenue Code, section 103 was amended in 1968 and in the words of an Attorney Advisor in the Office of the Tax Legislative Counsel of the U.S. Treasury Department, ^{made in Jan of this yr.} "The increasing use of tax-exempt financing for purposes beyond those originally contemplated by Section 103 (A) has led to a series of actions by the Treasury and Congress to restrict such financing to the purposes for which the exemption was originally granted." The abuses which prompted Congress in 1968 to amend Section 103 was primarily the use by states of the tax exemption on the interest received by bondholders to finance industrial projects for the benefit of private companies. To my knowledge, the largest such project involved state bonds of less than 100 million dollars. The proposed legislation would attempt to utilize this privilege and the privilege of states' exemption on income on its own income for a project estimated at 35 times that amount with the resulting loss to the federal Treasury of amounts which have been stated previously possibly ~~exceeded~~ 200 to 400 million dollars a year, sorry, I take that back, that is not revenue to the federal government but taxable income on which the federal income tax would be calculated. The previous concerns expressed by Congress and the Treasury that, in this area of interest on bonds that the states ^{There} were creating unintended benefits for private businesses and significantly reducing the market available for municipal bonds being floated for needed governmental services are dwarfed by the magnitude of this proposal. The action by Congress to restrict that tax exemption on municipal bonds is contained in Section 103C of the Code and without going into detail on that section, the basic critical test for the purpose of these bonds is what is called the trade of business test and the proposed regulations which are not yet finalized are subject to change at any time by the Treasury, do state this as required of what it takes to satisfy the trade of business test and I quote, "In the case of a

facility constructed . . . or acquired with the proceeds of an issue which is ostensibly owned and operated by an exempt person (such as the proposed Trans Alaska Authority) but where one or more non-exempt persons (such as the oil companies) agree, pursuant to one or more long-term contracts, to take, or to take or pay for, a major portion (which is defined as more than 25%) of the output of such facility (whether or not conditioned upon the production of such output) for periods of time which are substantial in relation to the terms of the bonds." However, the regulation speaks in terms of output or production from a facility, the same rule would apply to guaranteeing input to a facility such as a pipeline where the revenue ^{is being} is earned by servicing or carrying crude oil. From the discussions previously given by Mr. Gary, it appears clear that the state could not finance such an ownership commitment without commitments from the oil companies to guarantee a source of supply to the pipeline far in excess of 25% ~~that is upon~~. Indeed the minimum shipping agreements ^{which have been} described by Mr. Guilderhouse (while not sufficient to satisfy investors in the view of Mr. Gary) is in my opinion sufficient to satisfy the trade of business test of Section 103C and, thus, to make the proposed bonds industrial development bonds which would not be entitled to tax exemption on their interest because, under such a plan, the companies would be asked to make a long-term contract to guarantee to provide more than 25% of the crude to be transported through the line which to me is the equivalent of guaranteeing to take or pay for more than 25% of the transportation service. Mr. Cades stated earlier that the volume of the line available to the owner companies, 7 owner companies, is subject to reduction for other users and that because of this it is different from the normal take or pay contract. However, since that commitment ^{of the} is unlikely to drop below 25% of the input and since the other users are themselves going to be limited to a very few number of private oil companies, I fail to see how this ^{is going} ~~would~~ escape the definition of the industrial revenue bonds which is previously set forth in the regulations. 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 by the Treasury, ~~and~~ it seems unlikely that Congress, in this instance, in view of the strong position it took in 1968 to attempt to close exactly this type of activity would not act to nullify such a ruling before any commitment had been made in reliance on the ruling. In fact, in our own experience in obtaining a ruling from the ~~IRS~~^{*}, some three months after the ruling was granted, we received a call from the Treasury asking whether we had taken any adverse action as a result of this, the ruling. In that case we had concluded the transaction involved, service foreclosed in the action, but from that point on their ruling requests, similar requests, were denied by the Treasury. So, it is possible that during a period of time that even if the ruling were obtained prior to your going to market and making commitments this ruling could be reversed. Perhaps one additional matter should be mentioned. It has been suggested that if the state could obtain the tax benefits upon which the administration's projections are based, that these benefits would be passed on to the oil companies either in total, as a result of an ICC ruling, that because they were tax exempt they were not entitled to the right of a normal tax payer or in part. The magnitude of any differential in interest rates, because of any possible tax exemption has already been discussed, but assume for the moment that some tax savings could, in fact, be accomplished and could be passed on to the oil companies. The benefit which the companies would perceive would not be equal to the amount of the savings derived from tax exemption because the companies would, as a result of the reduced cost of transportation, have increased their profit in other factors, in other areas of the movement of the oil openly to market, which would result in higher income taxes as a result of the increase in income. So the net benefit to the oil companies is not in the magnitude of any tax savings which the state is seeking to obtain. In conclusion, the requirements

of guarantees of the oil companies of throughput to the pipeline necessary for successful marketing of state bonds to construct the line which have been described by Mr. Gary, would 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 the tax exemption is essential to the attractiveness of the ownership bill to the Legislature. This bill is unlikely to satisfy the state's revenue needs, or its desire, ^{which was} expressed earlier, to have a concrete basis for future planning the revenue sources of the state. In the meantime, it continues to create a cloud over the private finances needed by the companies in order to place the Trans Alaska Pipeline in service as Mr. Gary has already stated. Before I ask for any questions as to the testimony I have just given, I would like to answer a question made by Senator Croft earlier. He asked whether there were any tax advantages to the separate interest pipeline operation as contrasted to the single entity pipeline. The answer to that question is, yes, there are tax advantages to be derived by the individual members depending on their own tax position as to the advantages from a financing standpoint. I'll simply say that most of the companies in this case, all of the owner companies, file consolidated tax returns. If they do not own more than 80% of the stock of any subsidiary company in which they hold some stock interest, they are not entitled to take the earnings or the losses of that company on their consolidated income tax return in the year those losses or earnings are obtained. The only way they can obtain the losses in the company, and this is of major concern when you are going into a pipeline project of this magnitude, because it is quite conceivable that the losses will be there and that they'll be substantial. The only way the owner companies can get an immediate deduction and federal tax return from that is the undivided interest in the pipeline. They could not do it if there were a separate entity incorporated to operate that pipeline. As a result of this the companies have been able to take deductions for all

federal income tax returns for some costs already incurred in connection with the Alyeska Pipeline. Those costs which are not required to be capitalized for federal income tax purposes.

Rettig: Thank you Mr. Broussard. Any questions from members of the committee? Mr. Holm.

Holm: Mr. Broussard, maybe I don't know enough to ask the right question? I though I heard you say, and I can't find it in your remarks, that we were planning to pass savings on to the oil companies. Now it wasn't my understanding we were planning to pass any of these savings on to the oil companies. We were planning to use them ourselves.

Broussard: As I recall, there was a question directed to Mr. Spahr which stated, and I'll try and paraphrase it, if the state could derive benefits they intend to derive, which I see a major part being tax exemption, exemption from federal income taxes which the private companies would otherwise pay, and were able to pass some of or all of those benefits on to the companies wouldn't we be interested. Now that implies to me that the state has at least considered the possibility of trying to pass some of those advantages on to the companies. In addition to that, the Chairman stated during Mr. Gary's testimony, the proposition that perhaps 50% of these savings might be passed through to the companies. I added it additionally in my own testimony the possibility that the ICC, which has never been asked to rule on what rate of return they should allow for tax exempt owner of the pipeline. They may require that some of the ultimate savings go on to reduce tariff.

Holm: Speaking of the possibility that we would look at our competitive position on the market and say that we'll pass the savings on for that reason, but this wouldn't necessarily put the money into the oil companies pocket. Would that change the situation?

Broussard: I'm sorry I didn't understand the question.

Holm: If we arbitrarily lowered the rate on the passing of the oil through pipeline, to put Alaskan oil in a better competitive on the world market

this wouldn't necessarily pass, there would be savings passed to someone but it would merely put Alaskan oil in a better competitive position. Would this change the situation?

Broussard: Well I'm not

a controlling economist

but to the extent that you reduce your tariff in order to put your oil in a better position on the market, I assume you not mean priced your oil at less than you could ^{optimally} ~~possibly~~ price at. So I don't see that

Holm: We would in effect be using some of the profit that we would get in these tax savings to perhaps subsidize our oil at the competitive product, but it wouldn't necessarily pass these savings on to the oil companies per se or directly would it?

Broussard: Well, I assume the state would not do so without the intention of increasing in some way its return on its own interest in the oil. Now at present, as I understand it, the state's interest in oil is not 20% of the oil. It's interest is a royalty which it has a right to take but from which I would be surprised very much if they intend to take in and a severance tax, I simply don't recall no whether they have a right to take that in but presumably you would reduce your tariff to put your oil in a better market position in order to increase some way your profit.

Holm:

Rettig: If I might, Mr. Holm, maybe I could clarify a point there with some examples. Assuming a 3 billion dollar pipeline, whether privately owned or state owned, it would be under ICC rules entitled to make a \$240 million profit. The privately owned firm would have to make a profit of approximately \$510 million in order to achieve a profit after tax of \$240 million. Approximately \$270,000.00 in income taxes would be saved and would be reflected in the tariff which would accrue to the shippers of the oil and I think this is the premise that the state's position and all of their figures so indicate. Is that correct Mr Wohlforth?

The round figures may be off but isn't that the principal inherent throughout Mr. Wohlforth?

Wohlforth: Yes it is.

Rettig: It would permit the state to deliver the oil to Valdez at a rate lower because it is not taxed, the assumption that it is not taxed. So, in effect, it would all be passed on to the shippers. Are there any other questions? Mr. Barber.

Barber: Mr. Broussard, I understand you to say that it is unlikely that the Internal Revenue Service or the Treasury Department would hold such operations as the state operated oil line tax free. Now I emphasize your word unlikely. We will never know until we put before them that question. Is that ^{not} right?

Broussard: That's true. One of the reasons that I introduced my concern about the congressional action is that I'm not all that certain that you will know, even if you do get a ruling from the Internal Revenue Service which is favorable. I think you will know when you know when you know whether Congress ^{does} or _{not} act.

Rettig: Are there any other questions? Senator Rader.

Rader: Going back to Senator Croft's question on the advantages or disadvantages to the operators of a corporate structure and undivided interest and so and so forth. If each of the participating companies in TAPS set up an individual Alaska corporation which they were the subsidiary, which they were the hundred percent owner then they could pass through any losses they had could they not?

Broussard: If they set up an Alaskan corporation with a hundred percent subsidiary to hold this undivided interest rather than using existing pipeline companies. Yes that is true. Then the same result in terms of going back to the consolidated return would be accomplished.

Rader: So that wouldn't represent any tax disadvantage to the company?

Broussard: No it would not.

Rader: Thank you Mr. Chairman.

Rettig: Apparently there are no more questions. Thank you very much.

Donaldson: The next witness is Mr. George Seymour who has appeared already before this committee and his remarks at the present time will be directed to pipeline profitability.

Seymour: (prepared statement)

REMARKS OF GEORGE A. SEYMOUR
TO ALASKAN SENATE AND HOUSE COMMITTEES
ON PROPOSED ALASKAN PIPELINE LEGISLATION
WEEK OF MARCH 6, 1972

INTRODUCTION

I AM GEORGE A. SEYMOUR. I AM MANAGER OF PART-INTEREST PIPELINES FOR MOBIL PIPE LINE COMPANY, THE COMMON CARRIER PIPE-LINE AFFILIATE OF MOBIL OIL CORPORATION. I AM AN ENGINEER BY PROFESSION AND HAVE BEEN EMPLOYED BY MOBIL FOR TWENTY-FOUR YEARS, DURING WHICH TIME I HAVE BEEN PRIMARILY ENGAGED IN PIPELINE ENGINEERING AND MANAGEMENT. MOBIL OIL CORPORATION OPERATES COOK INLET PIPE LINE COMPANY UNDER AN AGENCY MANAGEMENT AGREEMENT. I AM A DIRECTOR OF AND HAVE BEEN A VICE-PRESIDENT OF COOK INLET PIPE LINE COMPANY SINCE MARCH, 1970, WITH STAFF RESPONSIBILITY FOR THE OPERATIONS OF THAT COMPANY.

RATIONALE OF TESTIMONY

IN RESPONSE TO YOUR INVITATION TO APPEAR AT THIS HEARING, I
Cook Inlet Pipeline Co.
WOULD LIKE TO SHARE WITH YOU THAT COMPANY'S OPERATING HISTORY WHICH

WILL, WE FEEL, UNDERSCORE THE ECONOMIC RISK INVOLVED IN THE TRANS
ALASKA PIPELINE PROJECT, AND ALSO POINT UP THE SIGNIFICANT
DIFFERENCES BETWEEN A COMMON CARRIER CRUDE OIL PIPELINE AND A
PUBLIC UTILITY.

DESCRIPTION OF COOK INLET PIPE LINE COMPANY FACILITIES

COOK INLET PIPE LINE COMPANY WAS INCORPORATED IN MARCH, 1966.
ITS STOCK IS OWNED BY ATLANTIC RICHFIELD COMPANY, MARATHON OIL
COMPANY, MOBIL PIPE LINE COMPANY AND UNION OIL COMPANY OF CALIFORNIA.
THE COOK INLET PIPE LINE FACILITIES WERE COMPLETED IN THE FALL OF
1967 TO OPERATE AS A CRUDE OIL PIPELINE SYSTEM ON THE WEST SIDE
OF COOK INLET, KENAI BOROUGH, ALASKA. THE MAIN LINE OF THIS
PIPELINE SYSTEM CONSISTS OF FORTY-TWO MILES OF TWENTY-²⁰⁰²INCH PIPE
FROM GRANITE POINT TO DRIFT RIVER. A TERMINAL COMPLEX LOCATED AT
DRIFT RIVER ^{includes} CONSISTS OF SEVEN 270,000 BARREL CRUDE OIL STORAGE
TANKS, DEBALLASTING AND BALLAST WATER TREATMENT FACILITIES, LIVING
QUARTERS, OFFICES AND MAINTENANCE SHOP, AND AN AIRSTRIp AND HANGAR.
OIL TRANSPORTED TO THE DRIFT RIVER TERMINAL BY THE PIPELINE IS

414 A map of the system is attached as exhibit 1

LOADED INTO OCEANGOING TANKERS AT A LOADING PLATFORM TWO MILES OFF SHORE AND CONNECTED TO THE ONSHORE TANKAGE BY DUAL THIRTY-INCH SUBMARINE PIPELINES. THIS PIPELINE SYSTEM SERVES FIVE OFFSHORE PRODUCING FIELDS IN COOK INLET -- TRADING BAY UNIT, TRADING BAY FIELD, TEXACO NORTH TRADING BAY FIELD, ATLANTIC NORTH TRADING BAY FIELD, AND GRANITE POINT FIELD. ~~THE LOCATION OF THE PIPELINE FACILITIES AND CONNECTED PRODUCING FIELDS ARE SHOWN ON EXHIBIT I.~~

CONSTRUCTION OF FACILITIES

DESIGN AND CONSTRUCTION OF THE COOK INLET FACILITIES COMMENCED IN MARCH OF 1966. THE FIRST TANKER WAS LOADED IN NOVEMBER, 1967. THE PIPELINE, THE DRIFT RIVER TERMINAL COMPLEX AND THE TANKER LOADING PLATFORM ARE CONSTRUCTED ON LANDS ACQUIRED FROM THE STATE OF ALASKA. COOK INLET OBTAINED A RIGHT-OF-WAY PERMIT OVER STATE LANDS FOR THE PIPELINE, PURCHASED 898 ACRES OF LAND AT DRIFT RIVER FOR THE TERMINAL SITE, AND ACQUIRED A TIDELANDS LEASE ON 392 ACRES OF THE FLOOR OF COOK INLET ENCOMPASSING THE OFFSHORE TANKER LOADING PLATFORM.

PIPELINE PROJECT JUSTIFICATION

THE ECONOMIC JUSTIFICATION TO CONSTRUCT THE COOK INLET PIPE LINE SYSTEM WAS BASED UPON THE THEN ESTIMATED PROSPECTIVE DISCOVERY OF 800 MILLION BARRELS OF RECOVERABLE CRUDE OIL RESERVES IN THE AREA TO BE SERVED BY THE PIPELINE AND WHICH WOULD BE PRODUCED AND TRANSPORTED IN THE PIPELINE DURING A THIRTY-YEAR PERIOD. INITIAL COST ESTIMATES INDICATED THAT THE CONTEMPLATED PIPELINE FACILITIES COULD BE CONSTRUCTED FOR \$32 MILLION. THE FACILITIES ACTUALLY COST \$42 MILLION, AN INCREASE OF 31% CAUSED BY THE HIGH COST OF CONSTRUCTION IN ALASKA AND THE NEED FOR MORE STRINGENT DESIGN TO MEET ICE CONDITIONS AFFECTING THE TANKER LOADING PLATFORM.

PIPELINE THROUGHPUT

SINCE THE CONSTRUCTION OF THE COOK INLET FACILITIES, THE RESULTS OF DRILLING AND EXPLORATION IN THE AREA HAVE FALLEN FAR SHORT OF INITIAL EXPECTATIONS. MORE THAN THIRTY-FIVE DRY HOLES HAVE BEEN DRILLED WHICH, IF PRODUCTIVE, WOULD HAVE BEEN SERVED BY THE COOK INLET PIPE LINE SYSTEM. PRODUCERS' CURRENT ESTIMATES ARE

THAT RECOVERABLE CRUDE RESERVES ACCESSIBLE TO THE COOK INLET PIPE
LINE SYSTEM WILL ^{now} BE NO MORE THAN 500 MILLION BARRELS. THIS IS
38% LESS THAN THE RECOVERABLE RESERVE ESTIMATE UTILIZED FOR
PROJECT ECONOMICS. AS A RESULT, PIPELINE THROUGHPUT HAS BEEN AND
IS NOW PROJECTED TO BE SUBSTANTIALLY LESS THAN ORIGINALLY
ANTICIPATED AS IS SHOWN ON EXHIBIT II. UNLESS ADDITIONAL CRUDE OIL
RESERVES ARE DISCOVERED IN THE AREA CONTIGUOUS TO THE COOK INLET
PIPE LINE SYSTEM, IT IS HIGHLY UNLIKELY THAT THE PIPELINE CAN
CONTINUE TO BE OPERATED ECONOMICALLY AT THE THROUGHPUT LEVEL NOW
PROJECTED FOR 1987.

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

#38
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TARIFF AND FINANCIAL POLICY

THE COOK INLET TARIFF POLICY WAS INITIALLY ESTABLISHED TO
SET TARIFFS FILED WITH THE INTERSTATE COMMERCE COMMISSION AT A
LEVEL WHICH WOULD RECOVER ALL COSTS AND PROVIDE AN OWNER'S RETURN
OF 7% ON I.C.C. VALUATION. UTILIZING THE ORIGINAL CRUDE OIL
PRODUCTION FORECAST (ORIGINAL ^{add which is valid on} PROJECTION, EXHIBIT II), THE TARIFF
WAS SET AT 21-CENTS PER BARREL. INITIAL PRODUCTION EXCEEDED

EXPECTATIONS AND PRODUCERS' RE-EVALUATIONS OF RESERVES INDICATED THAT PRODUCTION WAS GOING TO EXCEED THE ORIGINAL PROJECTION, PARTICULARLY IN THE FIRST FEW YEARS. BASED ON EXPECTED INCREASED PRODUCTION AND THE ESTABLISHED TARIFF POLICY, THE TARIFF WAS REDUCED TO 16-CENTS PER BARREL IN MAY, 1968. PRODUCTION FELL BELOW FORECAST AND COOK INLET PIPE LINE COMPANY ENDED THE YEAR 1968 WITH A BOOK LOSS OF \$123,000 AND A CUMULATIVE LOSS OF \$1 MILLION. IN MAY, 1969, THE TARIFF WAS INCREASED TO 20-CENTS ^{per barrel} WHICH PERMITTED COOK INLET TO OVERCOME THE BOOK DEFICIT. IN APRIL, 1970, IT HAD BECOME EVIDENT THAT CONNECTED RECOVERABLE CRUDE RESERVES WOULD PROBABLY BE NO MORE THAN 500 MILLION BARRELS, AND THE OWNERS AGREED THAT COOK INLET'S FINANCIAL POLICY SHOULD PLACE EMPHASIS UPON RETIREMENT OF INDEBTEDNESS WITHIN THE LIFE EXPECTANCY INDICATED BY CURRENT ESTIMATES OF CRUDE PRODUCTION ^{with which is shown as} (CURRENT PROJECTION, EXHIBIT II), ^{that is the shaded area.} THE TARIFF WAS ACCORDINGLY INCREASED TO 22 1/2-CENTS EFFECTIVE JANUARY, 1971, WITH THAT RATE SCHEDULED TO REMAIN IN EFFECT UNTIL SUCH TIME (PROBABLY 1978) AS IT BECOMES NECESSARY TO FURTHER INCREASE THE TARIFF TO MAINTAIN A BREAK-EVEN POSITION. THE

CURRENT COOK INLET FINANCIAL POLICY PROVIDES NO DIVIDENDS TO THE OWNERS AND ALL CASH INCOME IN EXCESS OF WORKING CAPITAL REQUIREMENTS IS UTILIZED TO RETIRE DEBT. THE GOAL OF THIS FINANCIAL POLICY IS TO GENERATE SUFFICIENT FUNDS DURING THE REMAINING ECONOMIC LIFE OF THE COOK INLET FACILITY TO REPAY THE INDEBTEDNESS INCURRED TO CONSTRUCT THE FACILITY, AND TO RETURN THE OWNERS' ORIGINAL EQUITY INVESTMENT WITH NO EARNINGS THEREON.

OIL PRODUCTION AND PIPELINE THROUGHPUT

THE ANNUAL THROUGHPUT VOLUMES OF COOK INLET SHOWN ON EXHIBIT II PARALLEL THE CLASSIC PRODUCTION CURVE OF A SINGLE OIL FIELD OR GROUP OF FIELDS DISCOVERED AT APPROXIMATELY THE SAME TIME. PRODUCTION GRADUALLY INCREASES AS FIELD DEVELOPMENT WELLS ARE DRILLED FOLLOWING A PIPELINE CONNECTION TO THE FIELD. SOMETIME AFTER ALL PRODUCTIVE WELLS DRILLED IN THE AREA ARE CONNECTED TO THE PIPELINE, PRODUCTION WILL REACH A PEAK ^{that} UNLESS PRODUCTION IS OTHERWISE LIMITED FOR A PERIOD OF TIME BY PIPELINE CAPACITY, PRORATIONING OF PRODUCTION, OR RESERVOIR FACTORS. THEREAFTER, PRODUCTION WILL

GRADUALLY DECLINE OVER THE PRODUCING LIFE OF THE FIELD. UNLESS ADDITIONAL RESERVES ARE DISCOVERED IN THE AREA SERVED BY THE PIPELINE, THE THROUGHPUT OF THE PIPELINE WILL DECREASE AS THE CRUDE OIL IS PRODUCED. IN THE ABSENCE OF NEWLY DISCOVERED RESERVES, THE COMBINATION OF DECLINING THROUGHPUT VOLUMES AND INCREASING OPERATING COSTS PER BARREL WILL ULTIMATELY RESULT IN AN UNECONOMICAL PIPELINE OPERATION EVEN IF TRANSPORTATION CHARGES ARE SUBSTANTIALLY INCREASED. ULTIMATELY, PRODUCING AND PIPELINE OPERATING COSTS WILL EXCEED THE VALUE OF THE CRUDE OIL AND BOTH THE OIL FIELD AND THE PIPELINE FACILITY WILL BE ABANDONED.

CRUDE OIL PIPELINES VERSUS PUBLIC UTILITIES

A COMMON CARRIER CRUDE OIL PIPELINE FACILITY CONSTRUCTED TO TRANSPORT PRODUCTION FROM ONE OR MORE NEWLY DISCOVERED OIL FIELDS DIFFERS ^{considerably} SUBSTANTIALLY FROM A PUBLIC UTILITY FACILITY. A CRUDE OIL PIPELINE IS A SUBSTANTIALLY MORE RISKY BUSINESS VENTURE THAN A PUBLIC UTILITY ENTERPRISE OR EVEN OTHER TYPES OF COMMON CARRIER TRANSPORTATION OPERATIONS. A PUBLIC UTILITY FACILITY IS ORDINARILY

CONSTRUCTED TO PROVIDE A BASIC SERVICE TO A SEGMENT OF THE GENERAL PUBLIC, OR TO ALL MEMBERS OF THE GENERAL PUBLIC IN A GIVEN AREA. BECAUSE OF POPULATION GROWTH, A PUBLIC UTILITY NORMALLY HAS ASSURED GROWTH IN ITS BUSINESS FROM A FIXED BASE FOR AN INDEFINITE PERIOD OF TIME WITH VERY LITTLE LIKELIHOOD OF ULTIMATE ABANDONMENT OF ITS FACILITIES, AND WITH, TYPICALLY, PERIODIC RATE INCREASES TO MAINTAIN PROFITABILITY. ON THE OTHER HAND, A CRUDE OIL PIPELINE, PARTICULARLY IN A REMOTE PRODUCING AREA SUCH AS ALASKA, WILL BE CONSTRUCTED ONLY TO MEET A SPECIFIC^{ed} NEED -- ^{in this case} THE TRANSPORTATION OF LARGE VOLUMES OF NEWLY DISCOVERED CRUDE OIL RESERVES. CONSEQUENTLY, SUBSTANTIAL INITIAL CAPITAL INVESTMENT IN THE PIPELINE FACILITY IS REQUIRED AT ONE TIME AS CONTRASTED WITH THE MORE GRADUAL INCREMENTAL CAPITAL INVESTMENT OVER A PERIOD OF YEARS BY A PUBLIC UTILITY TO MEET THE INCREASING SERVICE DEMANDS OF A GROWING POPULATION. SUCH A CRUDE OIL PIPELINE FACILITY IS DESIGNED SOLELY TO TRANSPORT THE DISCOVERED AND PROSPECTIVE OIL RESERVES IN THE AREA IN WHICH THE PIPELINE IS CONSTRUCTED. THERE IS NO ASSURANCE THAT ADDITIONAL OIL FIELDS WILL BE DISCOVERED IN THE AREA SERVED BY THE PIPELINE OR

EVEN THAT THE ANTICIPATED PROSPECTIVE CRUDE OIL RESERVES WILL
ULTIMATELY BE PRODUCED AND TRANSPORTED IN THE PIPELINE. THE
ABANDONMENT OF THE PIPELINE FACILITY WHEN OIL RESERVES ARE
DEPLETED IS A CONCRETE PROBABILITY ^{from a possible but a probability} FROM THE VERY INCEPTION OF THE
PIPELINE PROJECT. THESE UNUSUAL CRUDE OIL PIPELINE RISK FACTORS
RESULTING FROM THE CHANCE LOCATIONS OF UNDERGROUND OIL RESERVOIRS
ARE INEVITABLE AND ACCEPTED IN THE OIL INDUSTRY. BECAUSE THESE
HIGH RISK FACTORS CANNOT BE AVOIDED, CRITERIA FOR DETERMINING
REASONABLE RATES OF RETURN ON OIL PIPELINE INVESTMENTS HAVE ALWAYS
RECOGNIZED THAT TRADITIONAL PUBLIC UTILITY RATE-MAKING CONCEPTS
CANNOT BE REALISTICALLY APPLIED TO OIL PIPELINE COMMON CARRIERS.

RECOGNITION OF RISK

THE WILLINGNESS OF OIL COMPANIES TO CONSTRUCT THE COOK INLET
PIPE LINE SYSTEM WITHOUT ASSURANCE OF AN ACCEPTABLE LEVEL OF
PROFITABILITY ON THE INVESTMENT IN THE FACILITY DEMONSTRATES THE
ECONOMIC RISK ASSUMED IN CRUDE OIL PIPELINE INVESTMENTS BY
ENTERPRISES IN THE PETROLEUM INDUSTRY. THE PARTICIPANTS IN THE

TRANS ALASKA PIPELINE SYSTEM PROJECT SIMILARLY HAVE NO ASSURANCE
THAT THE PIPELINE FACILITY WILL BE A PROFITABLE INVESTMENT OVER
ITS LIFE. NEVERTHELESS, THE TAPS OWNERS ARE WILLING TO ASSUME
THE RISK INHERENT IN THE PROJECT. FUTURE DEVELOPMENTS WILL
DETERMINE WHETHER THE TRANS ALASKA PIPELINE SYSTEM WILL BE A
PROFITABLE INVESTMENT OVER THE LIFE OF THE PROJECT.

Thanks you

JRK-GAS/JV
MARCH 3, 1972

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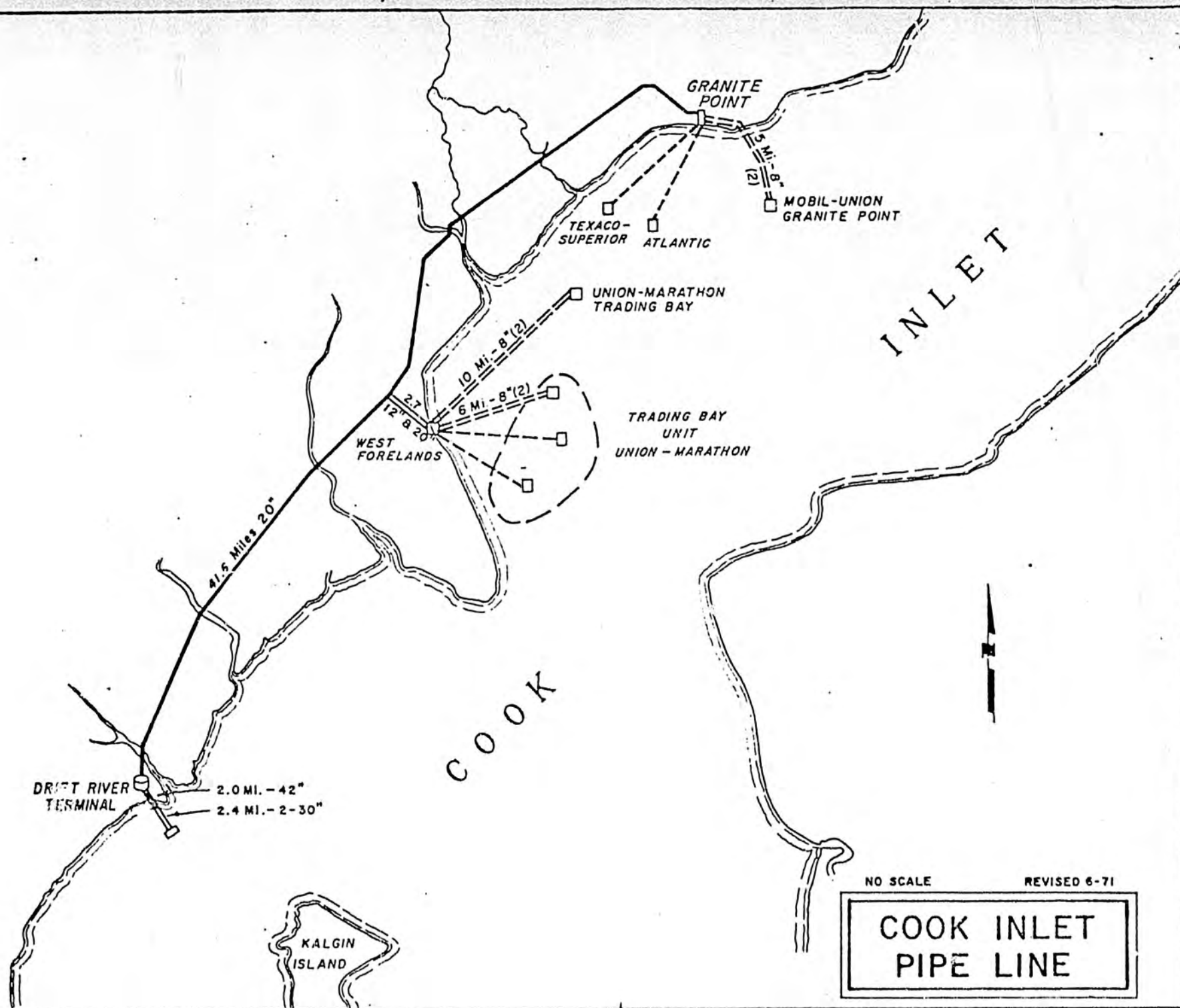
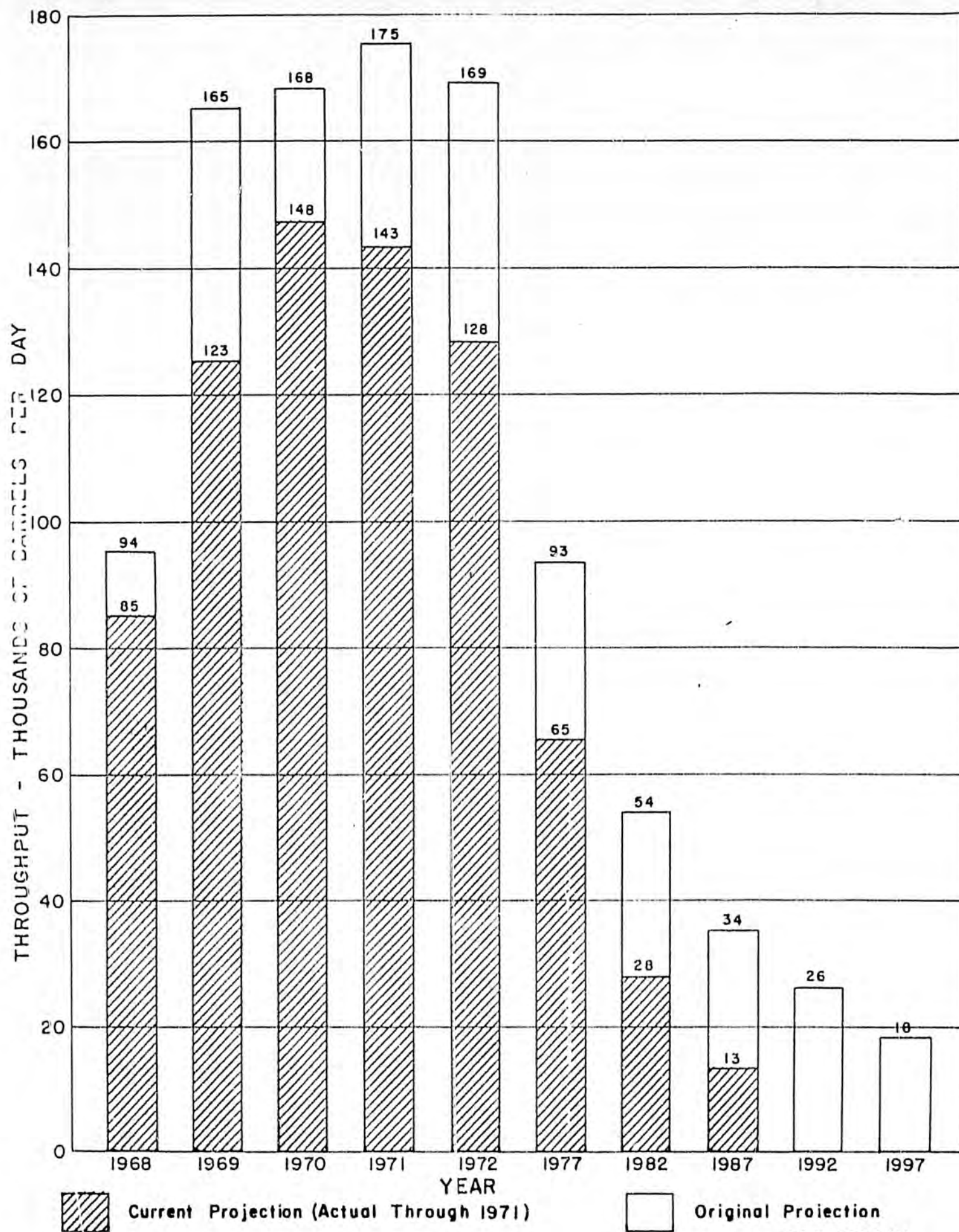


EXHIBIT I

A-2291-5

COOK INLET PIPE LINE COMPANY ANNUAL THROUGHPUT VOLUMES

EXHIBIT II



AGO 531072

Seymour: (statement was pre-typed)

Rettig: Are there any questions? Mr. Barber.

Barber: Mr. Seymour, in as much as the revenue with the state approves is directly determined by the transportation costs and in as much as you had to increase the profit to your pipeline company and ~~to~~ the transportation cost to keep them solvent. Does that not mean that the state of Alaska will pay the cost of that pipeline expense anyway?

Seymour: Let me say one thing we didn't increase the profit to the pipeline company, we increased income to the pipeline company so we could ^{AMPLIFY} amortize the indebtedness that we had. In connection with the second portion of your question, ^{UNDOUBTLY} undoubtly the increased cost of transportation, which it is to both the shippers in the pipeline who are owners of the pipeline as well as the State of Alaska ^{WHOSE} ~~who~~ royalty crude oil, as you may know, is taken on an exchange arrangement by an oil company and is shipped through the pipeline. Ultimately the State of Alaska will feel the effect of this increase for transportation costs. Yes sir.

Barber: To what extent will we feel it—in percentages?

Seymour: I've indicated the range of the tariff.. it ran from 16¢ at a ^{MINIMUM} minimum to 22 1/2¢ and you would have to develop the actual effect of this tariff increase on the State of Alaska's revenue from the oil that is produced in Cook Inlet from these numbers. I have not made that calculation.

Barber: It has been said that no matter what happens the State of Alaska will pay for the Trans-Alaska Pipeline. In your opinion, is that a true statement?

Seymour: I really don't quite understand your question. The State of Alaska will pay for the Trans-Alaska Pipeline?

Barber: Through the transportation cost and their prospective increases.

Seymour: Mr. Donaldson has indicated that ^{YOU'RE} ~~you~~ you're trying to indicate that ultimately ^{IT'S} ~~going~~ going to cost Alaska money to produce this black gold ^{THAT'S} ~~in~~ in the ground that belongs to Alaska. Is this the point you are trying to make?

Barber: No, I mean as transportation increase^s, the amount of money the State gets decreases. So we are going to pay for it in the long

Seymour: It ^edefinitely has a effect on the well head price and the taxes that are paid by the companies on the crude oil that comes out of the ground. That is correct.

Rettig: Just a little ^{CLARIFICATION}clairification on that point. The cost of the facility the total pipeline and works, will be recovered to tariffs charges to the shippers. Is this not correct?

Seymour: Yes sir.

Rettig: Seven-eighths of the oil will be shipped by the owners, one-eighth will be owned by the state. Is this correct? So theoretical seven-eighths of the cost will be ^{BORNE}bore by the shippers other than the state. Is this not correct?

Seymour: Yes sir. Now what happens to the states crude oil you may make an arrangement as you have in Cook Inlet to have this oil taken in kind by someone rather than sold to the producers.

Rettig: So, in short, the State ultimately will pay for one-eighths, towards the recovery of the cost of the pipeline. Are there any other questions?

Croft: Do you mean to the committee? (Go ahead) Mr. Chairman, as I understand, the tariff on the Cook Inlet pipeline is presently 22 1/2 cents a barrel to transport the oil less than 42 miles. (That's correct.) Is there any comparable pipeline in United States where the transportation^{is} is that high? The way I figure it we lose we get to zero well^{value} value before we get to Glenallen at that rate.

Seymour: Well first of all if you look at the post^{of} tariff of the 22 1/2 cents, sevens cents of it is pipeline transportation and fifteen and a half cents is the ^{TERMINAL}terminaling and loading aboard tanker charge. The operation at the terminal is far more costly and complicated than the pipeline transportation in this case.

Croft: Could you say, in effect, you can't compare it to any other pipeline for that reason there.

Seymour: Well, now I didn't say that. When and if we ^{ever} complete the Trans-Alaska project the ~~terminal~~ ^{TERMINAL} operation, from a stand point of complexity and operation will be a much more ~~complicated~~ ^{COMPLICATE} than the pipeline operation will be.

Croft: Considering the overall operation, do you know of any other pipeline in the United States that charges 22 1/2 cents a barrel to transport oil less than fifty miles? Do you know of any COMPARABLE TARIFF of that distance?

Seymour: I think you are again mixing--this is not just pipeline transportation. I know of pipelines that certainly charge more than six cents a barrel to transport oil less than fifty miles. But you have the storage and the terminaling of the crude oil and the loading ^{of the vessel} ~~of the vessel~~ ^{the} operation of loading facilities of which shades or distorts this picture so that you can't equate this 22 1/2 cents total ^{TC} simply to pipeline transportation. Do I answer your question in this matter?

Croft: Are those charges regulated by Interstate Commerce Commission as well?

Seymour: Yes, everything, the tariff is ^{that is} one piece of paper, which is the Cook Inlet Pipeline Tariff which lists the transportation cost from ^{GRANITE} ~~granit~~ Point to terminal at seven cents and indicates ^{THAT} where the carrier will transfer ^{PETROLEUM} ~~petroleum~~ from the carrier's tankage into the shipper's vessels at a charge of fifteen and a half cents. This is filed and approved by the Interstate Commerce Commission.

Croft: So I can understand it. Have dividends been paid to date on the Cook Inlet Pipeline?

Seymour: Dividends were paid in two years. There were none for the first two years, then dividends for two years and there will be no more dividends under the current tariff policy.

Croft: Do you know what the total of the dividends paid the?

Seymour: Yes sir, four million dollars has been paid.

Rettig: Mr. Rose.

Rose: ^{Mr.} Seymour, thank you Mr. Chairman. Mr. Seymour as I understand your presentation concerning the Cook Inlet Pipeline. When the production projections vary then the rate is adjusted accordingly. Is that correct?

Seymour: Repeat that I didn't understand

Rose: When the production projections vary then the ^{tariff} ~~rate~~ is adjusted accordingly?

Seymour: No, not normally, of course, we like to think that all projections are correct in this case as you see they were incorrect and you will note from the timing of the tariff changes that the tariff reduction or increases were made some time after we realized the decrease production. That is correct.

Rose: At that point you readjusted the tariff

Seymour: Yes sir

Rose: so that on the basis on the dual possession you would come out even in ^{the} end with no loss or gain.

Seymour: That's right. Now I would like to point out that the we didn't make just one projection when first decided to look at the evaluation of Cook Inlet. We have annual forecast from the producers ^{AS TO} at what the ^{PRODUCTION} projection we be, and they have constantly declined.

Rose: So my conclusion then and I would like you to tell me if I am right or wrong on this. Is that on that basis it can be a reasonable conclusion that a pipeline operation can be expected not to lose money in the long run but to come out even and if the ^{C. R. 16-100 HL} original projections come out ^{only} correct or nearly so, ^{W. H. 100-100 HL} In other words, ^{THE CHOICE} choose would be to come out even at the end or make a profit.

Seymour: Well, of course, everyone likes to make a profit on his investment

and as we have discussed for a considerable amount of time this week. There is a profit or a dividend limitation set by the Federal ^{GOVERNMENT} Government so that we would normally arrange to set our tariffs as I indicated initially we had our policy was to cover our operating expenses, service our debt, provide a dividend payment or ^Aprofit of seven per cent. ^{UN}fortunately this was not the case.

Rose: I am sorry Mr. Chairman, obvious the thrust of my question was not understood. What I am say^{ING} is that you can through revaluation of projections ^{ELIMINATE} eliminate, for all practical purposes, ^{THE} a loss at the end.

Seymour: Well, yes, of course, ^{UNFORTUNATELY} unfortunately, if the tariffs get to the point where the cost of transportation so drastically effects the price of the ^{your} crude oil you cease to transport anything. There is no profit guarantee at all.

Rose: Thank you Mr. Chairman.

Rettig: Senator Radar.

^{LEADER} Radar: Thank you Mr. Chairman. Mr. Seymour, looking at page 40 of the ICC report, that you gave us today. It indicates there, if I understand that form and perhaps I don't, that's why I am asking you the question. That you have three million dollars in dividends in one year, 1970. (right) ⁷ My view of what we've said here I don't understand how that is done or is that consistent with the

Seymour: Well, you see in the first three years ^{CF} in this operations prior to this time we had ^{IN 1967, WE HAD A} a loss ~~in 1967~~, in 1968 we had a loss, in 1969 we ~~had a~~ did have a profit and of course these losses and this allowable is carried forwarded, and that was the way ^{THAT} we were able to pay a 3.1 million dollars dividends in 1970. In 1969, we paid a nine hundred thousand dollar dividend.

^{LEADER} Radar: In line with that is it customary in the pipeline business to I should be concerned that return in capital.

Seymour: Yes sir. This was, as I mentioned, the policy that was finally

established that the ^{EQUITY}equity would be returned. This was done by means of dividends and that there would no future dividends in the operations.

^{BARBER} Radar: Do you normally, this kind of situation, return your ^{EQUITY}equity before your DEBT IS PAID?

Seymour: It can be done. This is a matter of choice by the ^dDirectors of the company. Now we have, also, ^{CHOSEN}chosen to increase our dept retirement rate, ^{So} hopefully it can be retired before we run out of something to transport.

Radar: Thank you Mr. Chairman.

Rettig: Are there any other questions? Yes, Mr. Barber.

Barber: I, of course, comprehend that whatever dollars was saved in transportation, that the oil companies got 80 cents out of it, and I'll put it this way. As transportation costs increase, the return to the State of Alaska decreases. Is that not true? When it is necessary for you to increase your tariff it will ultimately mean that the State of Alaska will get less money.

Seymour: That is correct.

Barber: Now we are in agreement. Thank you.

Donaldson: May Mr. Seymour be excused.

Rettig: Yes.

Donaldson: Mr. Patton was on your list as our eleventh witness. He covered all his remarks in his appearance this morning. Mr. Cortese may resume the witness seat. Mr. Cortese will speak to the legal aspect of the state ownership and ⁱⁿthe conclusion will take questions on any of the subject^s he has testified about.

Cortese: (Statement is prepared)

Cortese: Mr. Chairman, ladies and gentlemen of the committee, I hope I'll not be wearing out my welcome here before I'm done. This testimony relates to legal aspects of financing under HB's 569 and 570.

The legal aspects of the financing of the pipeline by the State or a state authority are important considerations, for the legal problems involved materially enlarge the serious doubts as to the ability of the State to provide public financing for the facility. However, as we discuss those legal problems, it should be borne in mind that even if there were no legal questions concerning state financing, a most serious, persistent and unavoidable concern is that the State simply cannot market this massive volume of financing within the time frame required. Cogent testimony has been presented on that aspect. At this point some of the legal problems will be discussed to further illustrate the sincere concerns of the producers that the State financing package being considered would cause further substantial delays and ultimately founder.

A subject of test litigation and the substantial questions involved. Let me point out that Alaska, in recent years, has undertaken bond financing in relatively novel areas, such as through the Alaska State Mortgage Association, Alaska State Development Corporation, and for the Alaska Mortgage Adjustment Plan in connection with the 1964 earthquake. In each of these instances the State has advisedly taken the basic questions of law to the Alaska Supreme Court to remove any doubt that the bonds would be valid when issued so that concerns as to legality would not further burden or thwart the marketing of the bonds. It seems most likely that such test litigation would be important with reference to House Bills 569 and 570.

Among the legal propositions which would need to be negated by such litigation are the following:

1. That the use of the state credit to finance the pipeline project is unwarranted in view of the availability of private financing, and use of state credit for such a facility in the circumstances would not serve a public purpose as required by Article IX, Section 6, of the Alaska Constitution.
2. That the State guarantee of the bonds of the Trans-Alaska Authority provided for in House Bill 569 would create a State debt contrary to Article IX, Section 8,
3. That the leasing of the pipeline by the Authority to the State as provided for in House Bill 569 would result in a State debt under Article IX, Section 8, not qualifying under the exceptions provided in Section 11.
4. That House Bill 569 would be a local or special act in violation of Article II, Section 19, Alaska Constitution.
5. That House Bill 569 involves unlawfull delegations of legislative powers to the proposed Trans-Alaska Authority and to other executive and administrative offices.

The course and outcome of such test litigation cannot be reliably predicted. Since the proposed State ownership and financing of the pipeline may be an active public issue, this might become quite different from the test litigation of the past. It is conceivable that citizens or citizen groups would intervene in the litigation, such that the scheduling of the litigation might not be that normally expected. Motions, demands for introduction of extensive testimony, and ancillary litigation, could produce extraordinary delays. It may be noted that the Alaska State Mortgage Association litigation consumed over two and one-half years. This is not rare, for bond litigation elsewhere has been quite lengthy, especially where there is involved a controversial issue, as with the Phoenix Civic Center leasing which took over 5 years, and Cincinnati and Louisiana stadiums taking a

couple of years each.

There is also the prospect of independent litigation and I would like to make reference to the non-litigation certificate requirement in bond financing.

Even if the State and its bond counsel should decide that test litigation is not necessary, the basis for adverse legal contentions is sufficiently present to indicate that others, acting independently of such determination, might nevertheless file litigation. This would pose a very serious problem in the marketing of the bonds because of the normal requirement for successful marketing that a no-litigation certificate be delivered would not be met. The no-litigation certificate is to the effect that no litigation is pending questioning the validity of the bonds, the authority under which they are issued, or the authority to provide for payment from the general or special funds committed thereto. The simple point of such a no-litigation certificate requirement is that a prospective bond purchaser does not want to buy a litigation. In this context it would appear that the pendency of such litigation would preclude giving the accepted form of certificate and thereby prevent the marketing of the bonds. I would like to point out that there are 4 types of bonds provided for in HB's 569 and 570.

1. General obligation bonds of the State, backed by the full faith and credit and the taxing power of the State in the normal fashion;
2. Bonds of the Trans-Alaska Authority guaranteed by the State;
3. Bonds of the Trans-Alaska Authority backed by the general credit of the State through the device of leasing the pipeline to the State with the State paying rentals from its general funds in sufficient amounts to subsidize any operating losses, pay principal and interest on the bonds and establish and maintain reserves to further secure the bonds.
4. Bonds of the Authority payable solely out of the net operating revenues of the Authority as might be generated over the life of the bonds, with the bondholders

taking the risk of any inability to pay by reason of inadequacy of revenues resulting from delays or interruption in construction, inadequacy of funds to complete the project, any interruption in operation, or changed economic circumstances.

On the public purpose question that I first mentioned and the question and the question of, is there a need for the State to use its credit. In view of the fact that private capital is ready, willing and able to finance the pipeline project, there is a substantial question whether the use and consequent burdening of the State's credit for this project would be for public purpose within the constitutional prohibition against use of the credit of the State for other than a public purpose. In this connection you will recall that Mr. Robert Macy, financial advisor for the Administration, pointed out that these bonds really should be backed by full faith and credit of both the oil companies and the State, and he said that in the event of some restricted commitment of the credit of the oil companies were involved, nevertheless the backing of the State

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

Cortese: of the dedication of any funds of the state to a public enterprise which or public corporation and also/would permit a mortgage of any lands of the state and of any royalties, rents or other revenues before accruing from such land. The Alaska Constitution, Article IX, Section 6, provides: "No Tax shall be levied, or appropriation of public money made, or public property transferred, nor shall the public credit be used, except for public purposes" In Ault v. Alaska State Mortgage Association decided by the Alaska Supreme Court in 1969, excuse me, in 63, the court held ~~that~~ the financing, excuse me, the Court held that the findings and statement of public policy, public purpose in an act of the Legislature did not foreclose determination by the Court of the question of whether the act would serve a public purpose, the Supreme Court remanded the case to the Superior Court for a taking of evidence pertaining to the ^{of} question, whether public purpose would be served by the act. There, the Alaska State Mortgage Association was to issue revenue bonds to provide moneys in the secondary mortgage market to stimulate housing construction. The Supreme Court said it wanted to see evidence as to the adequacy or lack of private funds in the secondary mortgage market, the effect thereon of termination of a federal program, and how the Association would reduce or eliminate adverse effects. After the case was remanded to the Superior Court and detailed testimony taken, upon a second appeal to the Supreme Court, the Supreme Court approved the program, two and one-half years later after its original decision. The Court ruled that a public purpose existed because there was a need for public financing in view of the inadequacy of private funds, as shown by the evidence, and that the program would not merely compete with private funds because the Association would make moneys available only where financing could not be obtained from the private market. Likewise, in Dearmond v. Alaska State Development Corp., decided by the Alaska Supreme Court in 1962, the court approved a program for business development loans to be provided by the issuance of revenue bonds, only after determining that private financing was not sufficiently available for long term

development loans. In Wright V. City of Palmer, decided by Alaska Supreme Court in 1970, the City's issuance of general obligation bonds to construct a plant to be leased to a manufacturer was approved upon evidence that the object and effect would be to encourage industrial development which was urgently needed because the City's , because the City's economic growth was nil, high year-round unemployment existed, jobs had been lost by the closing of mining and lumbering enterprises, there was no manufacturing in the City, and businesses were moving out of the City. The need for the City itself to take an active role in the financing was apparent. It has been held that industrial development financing serves no public purpose where the facts make it plain that private funds will provide for the project without the injection of public financing.

The case where Manning v. Fiscal Court of Jefferson County decided by the highest court in Kentucky in 1966, where the Court said that " That no public purpose is served by substituting public credit for private funds. That result appears to be consistent with the approaches taken by the Alaska Supreme Court in the cases mentioned above. From an examination of the proposed statement of legislative findings and policies contained in House Bill 569, it is difficult to perceive any necessity whatever for State financing in order to achieve the objects stated, incidently the objects stated are such as, constructing the pipeline, getting it built, the consequent job development, the decrease in unemployment, economic development in general and environmental protection, all of which have been testified upon by Mr. Patton as being achieved by private financing by Alyeska and the pipeline companies. It is difficult to percieve any necessity whatever for the State financing in order to achieve the object stated especially when it is apparent that the planning, development, and expertise represented in Alyeska Pipeline Service Co. are essential to the early achievement of the pipeline project consistent with those objectives, and in view of the substantial question as to the practical ability of the State to finance the project. It should be borne in mind that private capital has already spent or encumbered a half billion dollars

for this pipeline, that's in addition to the bonus on the lease, and is ready, willing and able to provide the balance needed. In short, the ability to obtain the objectives through private financing and ownership presents a material question of whether the use of the State's credit for this project is unwarranted and impermissible under the Alaska Constitution. And I emphasize that I am not stating this as a policy question which it obviously also is but really as a legal constitutional question. In my memorandum before you I have a section on the State guarantee of authority bonds, the indication that that would be unconstitutional state debt, the point I make here is that a guarantee constitutes a contraction^{vi} of state debt which can not be done without a constitutional amendment, apparently this has been recognized by presumably is why the House ----- the House -----^{joint} the House/draft resolution was submitted^{to this committee} on Tuesday. Incidentally I have an error in statement in the third, in the last paragraph in the last sentence which I indicate That the annual, in noting that all of the, through a guarantee all of the resources, financial resources of the State would be on the line, I noted that debt service would be apparently equivalent to the annual revenues of the State. I had ^{misconceived} ~~misconprehended~~ that I had previously examined I guess I was looking at the State budget rather than the recurring State revenues which was indicated earlier in the neighborhood of \$150 million. On that basis and on the basis of the reference^{ent} of 20 to 30 year bonds, assuming 30 year bonds and on the basis Mr. Wohlforth's assumptions of 8 and 6 1/2 percent interest the debt service would be in the neighborhood of \$300 million which is approximately twice the current recurring state revenues. I simply wanted to correct that for the records so as not to mislead. State rental lease commitment which is provided for on the bill. The provisions of Section 250 of House Bill 569 for the Trans-Alaska Authority to lease the project to the State and for the State^{to} operate or sublease the project pose serious questions as to whether State debt would be unconstitutionally created thereby. Section 250 would authorize the Governor to enter into such a lease in connection with the Authority's financing of the

project, and to agree that the State would pay the Authority ^{sufficient} ~~sufficient~~ amounts in rentals to pay the principal and interest on the bonds, the operating and maintenance expense of the project, and to provide or maintain reserves for debt service and operating and maintenance expenses. No limitation of amount is provided and the lease may be for any agreed term or may be unlimited in term. Under the lease, the Governor may also commit the State to subsidize costs of the project in any amount agreed upon with the authority. No restriction is provided as to the sources of funds of the State which would be needed to pay the rentals.

The only apparent object of these provisions is to place the State in the middle so that purchasers of the Authority's bonds might view the State's credit as standing behind the bonds, and thus obtain the benefit of the State's ^{credit} without a vote of the people. Such lease-type financing has been used or ^{tried} ~~used~~ in other state and has been sustained in some and declared unconstitutional in others as creating a state debt without constitutional authorization. Still other states have adopted constitutional amendments to permit ^{such} ~~such~~ lease financing. The validity of such financing has not been determined by the Alaska Supreme Court. The legal question is clearly presented where a ^{single} ~~single~~ purpose project is involved, such as this crude oil pipeline. For example the Illinois Supreme Court, in Rosemount Building Supply, Inc. v. Illinois Highway Trust Authority decided in 1970 held invalid a plan whereby the Authority would issue bonds, which the act said were not to be deemed to be obligations of the State, to finance highways, bridges and related facilities. The Authority was to pay off its bonds from its own revenues, but its principal source ~~of~~ was to be rentals to be received from the State through leasing the projects to the State. The State was not to be committed to pay rentals except as periodically appropriated, and if rentals were not paid the Authority could undertake operation and charge tolls or lease the projects to others.

The Illinois Supreme Court had previously approved lease type ~~off~~ financing for ^{various} ~~various~~ buildings, but here it distinguished those cases as involving the type of

facilities which were readily adaptable to other uses so that it could be assumed that other lessees could be found to pay sufficient sums if the State ceased to pay rentals. However, here it was apparent to the Supreme Court that while the State was not legally obligated to continue appropriations, there would be no real alternatives for use of such highway facilities. Thus, the Court concluded that an unconstitutional State debt would be created by such leasing program. Much the same can be said of the proposed lease commitment of the State of Alaska in connection with the pipeline project; for if at any time the pipeline was not earning enough to cover the debt, there would be no practical way to avoid a burden on the State general fund for there would be no takers for a losing facility which has no other practical use. Thus with the vast cost, and consequent heavy debt service burden, of this single purpose facility, the type of financing involving a lease commitment by the State poses a substantial constitutional question as a contracting of State debt without complying with constitutional requirements for vote of the people. I would like to summarize the balance of this memorandum without taking an undue amount of your time. The next point is that there is a substantial question as to whether the Bill 569 constitutes a local or special law violating the constitution or prohibition against passing local or special act, acts if a general act can be made applicable. And I refer to the fact that the project that may be financed is limited to this single pipeline from the North Slope to the Prudhoe Bay area, excuse me the Valdez area. And that in similar circumstances in litigation in which my firm was involved in, in Ohio we provided for the financing of state underground parking facility. Only under the State House grounds our Supreme Court under similar constitutional provisions held that since there was a general purpose in providing parking, the general purpose might be in need of satisfaction elsewhere in the State to restrict this to a single facility was a special in violation of the constitution. Incidentally that litigation took a five year period of

time. Also, I point out that there are substantial^X questions of unlawful delegation of legislative powers provided for under this bill. In particular reference is made to the granting of authority of exclusive jurisdiction control and management of all pipeline facilities in the state which would be amended by amendments submitted to this committee on Monday I believe or Tuesday which change that provision^{XO} giving the authority exclusive management control over those pipeline serving the source as defined by the Authority as conveying the oil or gas over a route as defined by the Authority so that the Authority is given -----choose as it will, which in my judgement also raises substantial^X question of unlawful delegation of legislative powers. Also I have^{made} that the leasing provision would create an unlimited rental obligation of the State for an unlimited period of time without any particular guidelines indicating an unconstitutional delegation of legislative authority to the Governor, I also referred to the guarantee ~~provision~~ as being so wide open and as being mandated really by the bond documents, the bond agreements made by the authority such that the Governor presumably would have to put his signature on any guarantee on any bonds that the authority or two members thereof had agreed should be^{so} guaranteed as being without any proper standards or restraints so as to constitute an unconstitutional delegation. The administration proposes striking that section is from the bill, however, I suggest to you that it was not ----- as was indicated to you that the proposed constitutional amendment would still need implementation and that this type of provision can be looked upon as the type of implementation that would be involved ultimately there would be certainly in that respect the serious question of unconstitutional delegation of legislative powers to the Governor. In conclusion it appears that House Bill 560 and 570 raise many substantial legal problems that could keep a large number of lawyers busy for many years; and there are justifiable concerns that they would do precisely that if enacted. In view of the delays of the project already experienced, and the economic cost thereby to the State, the concern^{over} legal problems under House Bills 569

and 570 and the further delays they can cause are important considerations for this legislature. Again it should be emphasized that, as previously testified to, even in the complete absence of any legal question, the patent inability of the State or a public cooperation of the State to successfully market such a huge volume of bonds in the short time required, presents a direct practical and critical problem which strongly indicates that House Bills 569 and 570 are practical approaches for achievement of the objectives of the State.

Rettig: Are there any questions from members of the Committee? Other members of the Legislature? Senator Croft.

Croft: I have some questions not about his recent comments but about his earlier comments about the right of way leasing act ~~was~~ concern. I'm curious as to the first two premises in your memorandum regarding right of way leases. You cited ^{your memorandum} ~~In~~ Oklahoma v. Kansas Natural Gas Co. case, and as I understand ^{that case} ~~that case~~ Oklahoma attempted to completely prohibit interstate commerce in gas, is that correct?

Cortese: Yes sir. Sought to conserve the gas only to Oklahoma.

Croft: Are you suggesting that that principal applies to 294 or 313, that there's ^{by} an element in those bills ~~in~~ which interstate commerce is absolutely prohibited?

Cortese: The principal from which I cite the case as I indicated earlier was a premise from which to develop further thought on the problem and the principal for which I cited ^{is} that a State may not use its control over land to inhibit interstate commerce. Therefore, where the utilization of state land is essential for the carrying out of interstate commerce the state cannot withhold the use of that land. Then I went on to point out that the state, since the state cannot withhold it there are limits to the conditions that it can exact to making that land available. One of which was, it can ask for reasonable compensation but only reasonable compensation in relation ^{to} ~~to~~ the value of the land provided.

Croft: Yes, I think even Prof. Weatherspoon acknowledges there is that limitation

that you have to obtain fair value.

Cortese: He speaks in terms of fair value, he speaks in terms of the productivity of the land as I pointed out earlier it's apparent he really isn't referring to the productivity of the land, he's referring to the productivity of a pipeline that has been built with private capital and is privately owned, Which are two completely separate thoughts and as I pointed out the considerations of the Supreme court in determining what is reasonable compensation relate to the use of the land for general purposes by anybody and not to the special purposes of the one given exotic user of that land.

Croft: Mr. Chairman, because of the importance of this question I would like to pursue it.

Rettig: Go right ahead.

Croft: Several questions arise as far as determining the fair value, you cited a case involving condemnation, I wonder if your reliance on that case is based on the premise that the State discretion with respect to the value of its land that it disposes of is identical to the constitutional mandate to pay fair value when it takes somebody else's land. Are you saying that those two things are identical?

Cortese: Not in isolation but in the context of a situation where oil reserves have been bought from the State and the only apparent way to market those reserves is by pipeline must cross state land and the only way to conduct interstate commerce is to cross that land, then I suggest to you that rental demands of that nature of the red line would appear to be an undue burdening of interstate commerce would appear to be way out of comparison ^{with} of the true value of that land by any rational test.

Croft: You're not suggesting that either the Impact Committee Bill¹ or the Administration² bill distinguish between intra and interstate commerce.

Cortese: No I'm Not suggesting they distinguish in verbalize but its quite apparent

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in all the discussion and all the documents that we've seen that the legislation is directed at this interstate pipeline and would not be under present consideration ~~were it not for this~~ pipeline, that's the impression I have. Correct me if I'm wrong.

Croft: If its effect is to apply equally to inter and intra state commerce does that affect your opinion in that regard. Does the state have a wider discretion as to what it can do if it does not discriminate between intra and interstate commerce

Cortese: Quite obviously I start with the basis that this is interstate commerce that we're dealing with and that the State is therefore restricted in what it can do. Going beyond that I did mention in my comments that this unusual heavy charge for the use of this land, even as applied to intra state commerce, to a gas shipper let's say, somewhere in the state, would in my judgement be a tax and a discriminatory tax having no relationship to the land therefore taxed. A discriminatory tax because it is being imposed only on those who use state land, or need state land and therefore use state land. It wouldn't be imposed upon a pipeline that was not on state land.

Croft: You're not suggesting though that the income derived ^{from the use of the land} is not at least one of reasonable measure of the value of that land?

Cortese: From the use of the land?

Croft: Yes sir, the income that's derived from the use of the land, is that one reasonable value or method of determining the ^{value of the} land?

Cortese: What I've pointed out in reference to the U.S. Supreme Court decisions is that a proper appraisal of true value of the land along this route including ^{does} that across the tundra ~~is~~ not properly take inconsideration the forth coming use of it by special users.

Croft: You are saying that's not constitutionally permissible to take

Cortese: In this context of my judgement, it is not

Croft: You cannot consider the income derived from the land as a means of determining the value of the land.

Rettig: You mean the future income derived from the land?

Croft: that in effect the percentage leased is not a ^{reasonable} means at arriving at value for use of the land?

Cortese: Certainly not in this context a percentage lease I'm sure you are aware is normally used in the context of a commercial enterprise basically a retail enterprise where the lessor is ^{leasing} renting a completed facility or space in a shopping center providing a complete space and the percentage lease is employed because the lessor developer has provided a facility which itself attracts the business, walk in trade, there I can conceptualize some relationship of the value of the use of the space to the gross income. But in this kind of context I can't remotely see how a percentage lease as I understand it is relevant to stretches ^{of land} across frozen tundra.

Croft: What if instead of one ^{application to} could cross state land instead of this joint venture arrangement each of the companies were going to construct an independent line, would they have authority to say that all lines had to be constructed within one part as ^{not} adjunct of its proprietary power?

Cortese: I doubt as an ^{not} adjunct of its proprietary power, I should think more commonly that that consideration would fit into its ^{advised} adjunct as a sovereign that it has some interest where development takes place particular facility in that that is a fair consideration of a matter of state local concern, however, you bear in mind the supremacy of the federal Constitution and of the commerce clause, so that to the extent that that local interest of the state would so conflict as to impede, interfere with excessively burden interstate commerce, the state concern would have to give way to that degree

Croft: ^{view} So as a means of its propriety power anytime an application is made to cross state lands by an interstate carrier the state's only alternative is to obtain reasonable value and grant for right of way as far as its propriety power is concerned.

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Cortese: No, not at all, if, well I'm not sure I understood, I caught the full question. Did you say if it is necessary ? for interstate commerce?

Croft: I'm saying anytime an interstate carrier applies for a right of way across state land the only alternative open to the state is to grant the permit when it obtains reasonable value, if there is ten different companies that want across state land, its a burden on interstate commerce if we deny

Cortese: No Senator Croft, what I point out in my paper, the premise the obvious premise of the bill is that this pipeline cannot be constructed without the use of state land. That's an unalterable imperative. I'm saying that in that context where it's essential to use state land where there is no practical alternative, yes, the state must permit the use at reasonable compensation. That is in my judgement supported by the cases.

Croft: That is true whether there is one application or there is 20 applications, that they cross state land and they involve different portions, if thats the only way you can get the oil out then we have to have 20 pipelines as far as our ~~proprietary~~ propriety power

Cortese:..... end of tape 39..

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Cortese: ^{CONTEXT} ~~And tax~~ that does not _____ the interstate commerce.

Croft: Well what about our authority as far the oil and gas leases are concerned. To with-hold future sales of oil and gas leases to the companies acting in interstate commerce because we don't feel that a particular discretion kind will receive fair market value and we have that type of _____/_____ to say we're just not offering our land for lease to any companies for ten years until the market price is increased.

Rettig: Mr. Croft I believe that the state in its leasing act does have the right to protect any Bids for the leasing on state land.

Croft: Yes, and I was wondering how his comments applied to that .

Rettig: If you could _____ this legislation ^{CHANCE} we'll pursue it.

Croft: Well yes, the state might feel that this year it won't get a fair value for its land if a pipeline permit is issued across state lands and next year it will, ^{does} cause it has the discretion to simply say we're not disposing of our land at all this year and we're gonna wait next year until the ^{FAIR} market value is higher.

Rettig: You're referring to right away leases.

Croft: Yes I'm curious ^{WHAT DISCRETION}

Cortese: You're ^{CHANGING} ~~guaranteeing~~ the reserves with the right of way.

Croft: Well, I'm sure as ^{how FAR} ~~well for as~~ what you see the limitation on a propriortory power goes. What are the limits, what is the discretion of the state to with-hold ^{SALE THIS} ~~say~~ of its land. And as I ^{UNDER} ~~...~~

Cortese: Well, ^{if it held} with the leasing of the oil that would be the easiest way to with-hold the sale of the right of way.

Croft: That wouldn't be...

Cortese: There would be no need of a pipeline if there were no oil sold up there.

Croft: And that wouldn't be a burden on interstate commerce, the fact that we withheld our part, even if ^{IT WINS} ~~...~~

Cortese: If you with-held the oil

Croft: Yes

Cortese: I should think not.

Croft: ^{but withholding 15} They're holding the lease ~~here~~.

Cortese: Once there's property ownership in the oil which can only be used in, by putting it into interstate commerce, that's what the Oklahoma case is about,

Croft: But we don't know that it's the only way, that may be the best way to the company, ah, but I mean one of the companies have spent over forty

million dollars exploring another route and has even said that it is ^{feasible} ~~pleasable~~ under certain circumstances, it's not the only route, does that have any ^{EFFECT}

Rettig: It's the only practical one apparently, ah that's certainly what Professor ^{WEATHERS} thinks, and what I assume the joint pipeline impact committee thought. Ah, that is the tenor of the bill, ah, I can't conceive that ah, you would have supposed that anyone would accept those conditions ^{IF} that there were some practical alternative.

Croft: This may be the best alternative ^{but} the only alternative.

Cortese: Well, I pointed out that in the Oklahoma case presumably even natural gas can be shipped without pipeline. Ah, it can be tanked and ^{carried} ~~cartoned~~. It's a preposterous suggestion, but it's probably physically possible. But that didn't stop the Supreme Court of the United States from telling Oklahoma they could not with-hold the right to give cross rights, ah, highway crossing rights to the pipeline.

Croft: Yes, but in that case Oklahoma had given ah, the right to cross ^{INTERSTATE} to domestic corporations that were engaged in ~~inprospect~~ commerce, but with-held it from foreign corporations engaged in interstate commerce.

That's a distinction that neither the administration or the committee's ^{bill} might. ^{MADE}