OWNED COMMON CARRIER PIPELINES HAVE BEEN CONVENTIONALLY ORGANIZED AND FINANCED IN ONE OF TWO WAYS, EITHER AS SO-CALLED "PROJECT FINANCING" OF PIPELINE COMPANIES ORGANIZED TO OWN PIPELINES IN CORPORATE FORM, OR, AS IS THE CASE IN TRANS ALASKA PIPELINE SYSTEM, AS UNDIVIDED JOINT INTEREST SYSTEMS.

IN THE FIRST CASE, WHERE PROJECT FINANCING IS DONE, THE CONVENTIONAL PRACTICE IS TO FORM A PIPELINE COMPANY WHICH CONSTRUCTS AND OPERATES THE SYSTEM AND ISSUES DEBT FOR VIRTUALLY ALL OF THE COST OF CONSTRUCTION, THE TYPICAL AMOUNT BEING 90% OF FINAL COST. THE DEBT IS SECURED BY THE PLEDGE OF COMPLETION AGREEMENTS AND THROUGHPUT AGREEMENTS UNDERTAKEN BY THE SEVERAL SHIPPER-OWNERS OF THE PIPELINE. THE TYPICAL SECURITY ARRANGEMENTS INCLUDE UNCONDITIONAL COMMITMENTS OF THE SHIPPER-OWNERS TO COMPLETE THE FACILITIES TO OPERATE THEM, AND IF OPERATION IS INTERRUPTED FOR ANY REASON, TO TAKE NECESSARY STEPS TO RESTORE THE FACILITIES TO OPERATION. AS PART OF THE THROUGHPUT AGREEMENTS, THE "CASH DEFICIENCY OBLIGATIONS" INEVITABLY CONTINUE REGARDLESS OF FORCE MAJEURE (ANY EVENT INTERFERING WITH OPERATION OF THE LINE). IN EFFECT, THEY REQUIRE THE SHIPPER-OWNERS TO MAINTAIN THE PIPELINE'S FUNDS AT A LEVEL WHICH WOULD ENABLE IT TO MEET ALL ITS OBLIGATIONS WHEN THEY BECOME DUE AND PAYABLE. AS SUCH, THEY ARE FIRM APPLICATIONS OF THE FULL CREDIT OF THE OIL COMPANIES INVOLVED AND, FOR THE

PURPOSES OF FINANCING, ARE EQUIVALENT TO GUARANTEES OF THE PIPELINE COMPANY'S INDEBTEDNESS.

IN THIS TYPE OF FINANCING, THE PROJECT ITSELF MUST BE DEMONSTRATED TO BE ECONOMIC AND VIABLE, AND THE QUALITY OF THE OBLIGATIONS IS MEASURED BY THE COMPOSITE CREDIT OF THE SEVERAL OIL COMPANIES INVOLVED. IN OTHER WORDS, THE INVESTORS ARE CONCERNED, FIRST THAT THE PROJECT STANDS ON ITS OWN FEET, BUT ALSO THEY LOOK THROUGH THE PROJECT TO THE ULTIMATE GUARANTORS. THIS TYPE OF FINANCING IS STANDARD AND WELL UNDERSTOOD BY PROFESSIONAL INVESTORS, AND HAS BEEN IN COMMON USE SINCE THE TIME OF THE ELKINS ACT - PIPELINE CONSENT DECREE ENTERED INTO IN 1941.

YOU MIGHT WONDER WHY OIL COMPANIES WISH TO RAISE AND LENDERS READILY PROVIDE INDEBTEDNESS AS HIGH AS 90% OF TOTAL CAPITALIZATION. THE FIRST ANSWER IS THAT THE CONSENT DECREE HAS LIMITED THE RETURN FROM PIPELINE OPERATIONS TO A SPECIFIED PERCENTAGE OF PIPELINE VALUATION. THIS INVARIABLY DICTATES THAT OIL COMPANIES MAXIMIZE THE USE OF DEBT, THE OBJECTIVE BEING TO MATCH AS CLOSELY AS POSSIBLE PERMITTED ICC DEPRECIATION WITH REPAYMENT OF DEBT. THE REASON THAT LENDERS ACCEPT HIGH DEBT RATIOS ON PIPELINES IS THAT THEY RECOGNIZE THE THROUGHPUT UNDERTAKINGS TO BE FULL APPLICATION OF THE CREDIT OF THE OIL COMPANY OR COMPANIES INVOLVED. CONSEQUENTLY, THE LENDERS ARE NOT TAKING THE RISKS OF FAILURE OF THE PIPELINE

OPERATION. THESE RISKS ARE BORNE BY THE OIL COMPANIES IN THE FORM OF THEIR BACKSTOPPING, AS WELL AS THEIR EQUITY INTEREST. THE END RESULT IS THAT THE OIL COMPANY HAS DEDICATED ONE OF ITS VALUABLE ASSETS, NAMELY ITS CREDIT, TO OBTAIN USE OF A PIPELINE SYSTEM AND A REGULATED PROFIT ON ITS INVESTMENT.

THE SECOND WAY OF ORGANIZING AND FINANCING JOINTLY OWNED PIPELINES IS AS UNDIVIDED JOINT INTEREST SYSTEMS. THIS IS HOW TRANS ALASKA PIPELINE SYSTEM IS ORGANIZED. FOR CONSENT DECREE REASONS OWNERSHIP IS CUSTOMARILY INVESTED IN, AND THE INDEBTEDNESS IS USUALLY RAISED BY, A WHOLLY-OWNED PIPELINE SUBSIDIARY OF EACH OWNER, BUT THE ARRANGEMENT STILL AMOUNTS TO A FULL USE OF THE OWNER COMPANY'S CREDIT.

IN A JOINT VENTURE, EACH OF THE OIL COMPANIES OWNS A SHARE OF THE FACILITIES, EITHER DIRECTLY OR THROUGH ITS PIPELINE SUBSIDIARY. THE PIPELINE IS NOT FINANCED AS A PROJECT; EACH OWNER COMPANY COMPLETES ITS OWN SHARE OF THE SYSTEM AND FINANCES ITS SHARE OF THE COST IN THE SAME WAY IT DOES OTHER ITEMS IN ITS CORPORATE BUDGET. THESE ARE FINANCED OUT OF ALL CORPORATE RESOURCES, INCLUDING WORKING CAPITAL, INTERNAL CASH FLOW AND ISSUANCE OF SECURITIES - IN EFFECT REFLECTING ITS OVERALL CAPITAL STRUCTURE AND DEBT/EQUITY MIX. THE EFFECT ON THE OIL COMPANY

IS THE SAME AS IN PROJECT FINANCING - IT HAS COMMITTED AN IMPORTANT AMOUNT OF ITS RESOURCES AND CREDIT TO AN UNDERTAKING THAT HAS ASSOCIATED WITH IT SIGNIFICANT RISKS. THIS IS AS REAL A USE OF CREDIT AS ANY OTHER, AND PRE-EMPTS ITS USE FOR OTHER INVESTMENTS. THEREFORE, TO COMPENSATE FOR THESE RISKS, AN OIL COMPANY MUST BE ABLE TO CONTROL THE OPERATION OF THE FACILITIES AND MUST HAVE PROSPECTS OF EARNING A FAIR RETURN ON ITS INVESTMENT COMPARABLE TO THE POTENTIAL RETURN AVAILABLE TO IT ON ALTERNATIVE INVESTMENTS.

FINANCING OF TAPS

NOW LET ME TURN TO THE FINANCING OF TAPS AND WHY WE HAVE CONSIDERABLE CONCERN ABOUT THE PROPOSED LEGISLATION AND ITS POSSIBLE EFFECT ON THE FEASIBILITY OF FINANCING TAPS.

WE ARE ADDRESSING OURSELVES TO THE FINANCING OVER A PERIOD OF YEARS OF EXPENDITURES WHICH MAY AMOUNT TO AS MUCH AS $3 1/2 BILLION. I WOULD LIKE TO EMPHASIZE AGAIN THAT WE HAVE A HEALTHY RESPECT FOR THE AMOUNT OF MONEY INVOLVED HERE. THE CHURCHILL FALLS PROJECT, TO WHICH I HAVE ALREADY REFERRED, IS THE LARGEST PRIVATELY FINANCED PROJECT IN HISTORY, AND TAPS IS 3 TO 5 TIMES AS LARGE DEPENDING UPON HOW YOU MEASURE IT.

THESE EXPENDITURES ARE TO BE BORNE BY SEVEN OIL COMPANIES, WHICH DIFFER IN SIZE AND CAPABILITY TO SUPPORT

THE COMMITMENTS INVOLVED. WE HAVE STUDIED EACH COMPANY AND MADE AN ASSESSMENT OF THE FINANCIAL CAPABILITY OF EACH TO DISCHARGE THESE COMMITMENTS WITHIN THE LIMITS OF ITS INDIVIDUAL FINANCIAL STRENGTH. TO PUT THIS IN PERSPECTIVE, I MIGHT POINT OUT THAT THE THREE COMPANIES THAT WILL OWN OVER 80% OF THE UNDIVIDED JOINT INTEREST ARE ASSUMING AN AGGREGATE CONSTRUCTION LIABILITY OF 80% OF $3.5 BILLION, OR OVER $2.8 BILLION. IF THIS AMOUNT WERE RAISED BY DEBT, IT WOULD REPRESENT AN INCREASE OF 170% OVER THE AGGREGATE INDEBTEDNESS THOSE THREE COMPANIES HAD OUTSTANDING ON DECEMBER 31, 1970.

DESPITE OUR RESPECT FOR THE SIZE OF THE TAPS PROJECT, WE HAVE COME TO THE OPINION THAT - ABSENT THE PROPOSED LEGISLATION - THE EXPENDITURES NECESSARY TO CONSTRUCT THE PIPELINE CAN BE SUCCESSFULLY FINANCED BY THE OIL COMPANIES INVOLVED. HOWEVER, THE BILLS HERE UNDER CONSIDERATION REPRESENT A SERIOUS IMPEDIMENT TO THAT FINANCING, AND I SHOULD LIKE TO SHARE WITH YOU MY CONCERN ABOUT THE EFFECT THIS LEGISLATION WOULD HAVE UPON THE ABILITY OF THE OIL COMPANIES TO CONDUCT THE NECESSARY FINANCING AND BUILD THE PIPELINE. THERE ARE SOME MAJOR PROBLEMS WHICH ARISE OUT OF THESE PROPOSALS:

1. <u>THE LIMITATION OF THE LEASE TO FIVE YEARS DURATION</u>: NORMAL PRACTICE WOULD BE FOR A PIPELINE TO HAVE

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UNDISPUTED RIGHT-OF-WAY PRIVILEGES FOR THE EXPECTED ECONOMIC AND PHYSICAL LIFE OF THE SYSTEM, BUT IN NO EVENT LESS THAN THE PERIOD OF TIME REQUIRED TO RECOVER THE COST ON REASONABLE TERMS. LENDERS WOULD REGARD THE 5-YEAR LEASE LIMITATION AS A MAJOR INFIRMITY IMPAIRING THE ECONOMIC VIABILITY OF THE SYSTEM. OIL COMPANIES COULD NOT PRUDENTLY COMMIT FUNDS FOR WHAT IS IN ESSENCE A LONG-TERM VENTURE IF THERE WAS A THREAT THAT THE ECONOMIC LIFE COULD BE TERMINATED OR MODIFIED AT THE END OF THE FIVE-YEAR PERIOD.

REGARDLESS OF THE LENGTH OF THE LEASE, I THINK IT IS IMPORTANT TO EMPHASIZE THAT WHERE A PORTION OF THE RIGHT-OF-WAY OF A PIPELINE IS GOVERNMENT-OWNED, THE GENERAL ATTITUDE OF THE HOST GOVERNMENT TOWARD THE PIPELINE WILL ENTER IMPORTANTLY INTO THE CONSIDERATIONS OF LENDERS.

2. LOSS OF OWNERSHIP: THE PROSPECT THAT OWNERSHIP MIGHT BE TAKEN AWAY FROM SHIPPER-OWNERS AT SOME INDETERMINATE TIME IN THE FUTURE NULLIFIES ANY ECONOMIC JUSTIFICATION FOR TAKING THE RISKS INVOLVED IN COMMITTING THE SUBSTANTIAL FUNDS NECESSARY TO COMPLETE THE PROJECT. AS MENTIONED BEFORE, IF AN OIL COMPANY HAS USED ITS CREDIT IN THIS CONNECTION, IT HAS FOREGONE ITS USE IN OTHER PROFITABLE INVESTMENTS. IT MUST, THEREFORE, HAVE THE EXPECTATION OF MAKING A RETURN ON ITS INVESTMENT.

FURTHERMORE, BECAUSE THE SYSTEM IS TO BE A COMMON CARRIER AVAILABLE TO ALL PRODUCERS, OWNERS WILL BE SHARING THEIR SPACE WITH OTHER SHIPPERS. THEREFORE, IT SEEMS TO US THAT THOSE THAT HAVE ASSUMED THE COST AND RISK OF BUILDING THE SYSTEM MUST BE IN POSITION TO RECOVER THEIR INVESTMENT IN PART THROUGH PROFITS DERIVED FROM USE OF THE SYSTEM BY OTHERS. OTHERWISE, THE COMPANIES BUILDING THE PIPELINE WOULD HAVE USED THEIR CREDIT FOR THE BENEFIT OF OTHERS WITHOUT COMPENSATION, WHICH VIOLATES A CARDINAL RULE OF SOUND FINANCE.

3. REGULATION: THERE HAS BEEN IN THIS COUNTRY MASSIVE FINANCING OF CRUDE OIL AND PRODUCTS PIPELINES SUBJECT TO REGULATION OF THE ICC, AND THE EFFECT OF THIS REGULATION ON THE PIPELINES AND THEIR OWNERS IS WELL UNDERSTOOD BY INSTITUTIONAL INVESTORS. WE NOTE THAT PROVISIONS OF ONE OF THE BILLS APPEAR TO GIVE THE PROPOSED TRANSPORTATION COMMISSION THE AUTHORITY TO ESTABLISH DEPRECIATION RATES AND TARIFFS INDEPENDENTLY OF THE ICC; FURTHER, THE DEPRECIATION RULES APPEAR TO BE AT VARIANCE WITH THOSE PRESCRIBED BY THE ICC.

UNLESS THESE DIFFERENCES ARE ULTIMATELY RESOLVED, WE ARE NOT ABLE TO MEASURE THE IMPACT THEY MAY HAVE ON FINANCING FEASIBILITY, BUT THE IMPACT MAY BE SUBSTANTIAL IF LENDERS CANNOT BE CONVINCED THAT THE OWNERS OF THE PIPELINE WILL BE ABLE TO

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EARN A FAIR RETURN ON THEIR INVESTMENTS. AS I SHALL MENTION LATER, UNCERTAINTY WITH REGARD TO SUCH QUESTION, OR TO THE OUTCOME OF COURT TESTS DETERMINING JURISDICTION, CAN CAUSE DELAYS AND INCREASED COSTS IN FINANCING.

4. REDEMPTION PENALTY: THE CONTEMPLATED LEGISLATION CREATES THE POSSIBILITY THAT THE OIL COMPANIES FINANCING THE PIPELINE WILL FIND THEMSELVES IN THE POSITION, VIS-A-VIS THE STATE OF ALASKA, OF "HEADS YOU WIN, TAILS I LOSE." WHEN THEY BORROW TO FINANCE THE LINE, THEY WILL PLEDGE THEIR FULL CREDIT TO REPAY REGARDLESS OF WHETHER THE PIPELINE IS BUILT, OPERATES PROFITABLY, OR IS SHUT DOWN TEMPORARILY OR PERMANENTLY FOR ANY OF A NUMBER OF REASONS. THESE ARE SUBSTANTIAL RISKS. UNDER THE PROPOSED LEGISLATION, HOWEVER, IF THE LINE IS BUILT AND OPERATES SUCCESSFULLY AND PROFITABLY, ALASKA WOULD BE IN POSITION TO TAKE OWNERSHIP AWAY FROM THEM. NOT ONLY WOULD THE COMPANIES LOSE THE ASSET GAINED THROUGH THE INCURRENCE OF RISK, BUT THEY WOULD BE FORCED TO PAY A PENALTY TO THE LENDERS WHEN THEY REDEEMED THE INDEBTEDNESS INCURRED TO BUILD THE LINE.

THERE IS A REASON LENDERS ASK FOR REDEMPTION PREMIUMS. THE TYPES OF LENDERS WHO NORMALLY FURNISH FUNDS FOR THE CONSTRUCTION OF MAJOR PROJECTS, SUCH AS TAPS, HAVE

LONG-TERM LIABILITIES, AND THEY WISH TO INVEST THEIR FUNDS AT WHAT THEY BELIEVE ARE SATISFACTORY RATES FOR LONG PERIODS OF TIME. IF A LOAN IS TO BE PAID OFF PREMATURELY THEY DEMAND COMPENSATION, USUALLY IN THE FORM OF A REDEMPTION PREMIUM. THIS IS TO OFFSET THE POSSIBILITY THAT THE PROCEEDS RECEIVED FROM THE EARLY REPAYMENT OF THE LOAN MAY HAVE TO BE INVESTED AT A LOWER RATE THAN THEY HAVE BEEN RECEIVING. BECAUSE OF THE THREAT THIS LEGISLATION POSES, I BELIEVE THAT THE PREMIUM ASKED FOR REDEMPTION IN THE EARLY YEARS WOULD BE LARGE, IT MIGHT BE AS HIGH AS 10%. AGAINST BORROWINGS OF THE TOTAL PIPE-LINE COSTS, THIS WOULD REPRESENT AN ADDITIONAL $350 MILLION. THIS MIGHT BE MORE THAN THE OIL COMPANIES WILL BE WILLING TO CONTRACT TO PAY, AND THE ALTERNATIVE MIGHT HAVE TO BE TO AGREE TO A HIGHER INTEREST RATE THAN WOULD OTHERWISE BE THE CASE. IN ANY EVENT THERE WOULD BE SUBSTANTIAL (AND UNNECESSARY) ADDITIONAL COST.

5. UNCERTAINTY: ANY FINANCING IS DIFFICULT (AND MAY BE IMPOSSIBLE) UNDER CONDITIONS OF UNCERTAINTY. THE PROPOSED LEGISLATION CREATES UNCERTAINTY. NEITHER POTENTIAL BORROWERS NOR POTENTIAL LENDERS KNOW WHETHER LEGISLATION SIMILAR TO THAT IN THE PROPOSED BILLS WILL BE PASSED. PLANS CANNOT BE MADE. TO THE EXTENT THAT THIS UNCERTAINTY HAS THE

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EFFECT OF DELAYING THE PROJECT, IT POSSIBLY COULD LEAD TO HIGHER CONSTRUCTION COSTS. A SHORT DELAY COULD EASILY RESULT IN A LOSS OF A WHOLE YEAR BECAUSE OF THE ALASKAN CLIMATE. UNCERTAINTY IS ALREADY HOLDING UP FINANCING BY COMPANIES INVOLVED WITH THE PIPELINE. I AM NOT GOING TO ATTEMPT TO FORECAST THE OUTLOOK FOR INTEREST RATES, BUT I WOULD LIKE TO MENTION PARENTHETICALLY THAT CURRENT RATES ARE WELL BELOW WHAT THEY WERE ONLY A SHORT TIME AGO. IN ADDITION, FUNDS ARE MORE READILY AVAILABLE TO INVESTING INSTITUTIONS FOR LENDING PURPOSES THAN HAS BEEN THE CASE FOR A NUMBER OF YEARS. THIS IS LIKELY TO BE A TEMPORARY SITUATION. MANY BANKERS AND ECONOMISTS BELIEVE THAT AS BUSINESS RECOVERS INTEREST RATES MAY RISE AND, THEREFORE, ANY DELAY IN ARRANGING THE FINANCING COULD WELL RESULT IN THE COMPANIES INCURRING HIGHER INTEREST COSTS. BECAUSE OF THE AMOUNTS INVOLVED, AN INTEREST RATE CHANGE OF 1% RAISES COSTS ANNUALLY BY $35 MILLION.

THEREFORE, I WOULD LIKE TO URGE MOST STRONGLY IN THE INTEREST OF ALL CONCERNED THAT THIS SITUATION OF UNCERTAINTY BE RESOLVED AS PROMPTLY AS POSSIBLE.

ABILITY OF THE STATE TO FINANCE CONSTRUCTION OF THE PIPELINE

FINALLY, WE HAVE GIVEN CONSIDERATION TO THE ABILITY

OF THE STATE TO FINANCE THE CONSTRUCTION OF THE PIPELINE. THIS INVOLVES RAISING THE STAGGERING SUM OF $3.5 BILLION, AND NO STATE HAS EVER SOLD AN ISSUE OF THIS SIZE. I AM CERTAINLY NOT TRYING TO BE NEGATIVE, BUT IT IS IMPORTANT THAT WE BE REALISTIC AND RECOGNIZE THE PROBLEMS INVOLVED IN RAISING THIS AMOUNT OF MONEY, EVEN IF IT WERE TO BE ATTEMPTED OVER THE PERIOD OF CONSTRUCTION RATHER THAN ALL AT ONCE.

ALTHOUGH CERTAINLY THE TAX-EXEMPT MARKET IS A LARGE ONE, IT IS OUR OPINION THAT IN ORDER FOR ALASKA TO HAVE ANY HOPE OF ACCOMPLISHING SUCH A FINANCING OPERATION, ALL OF THE COUNTRY'S LARGE RESERVOIRS OF CAPITAL WOULD NEED TO BE TAPPED. IN OUR VIEW, THIS WOULD HAVE TO INCLUDE THOSE INSTITUTIONS WHICH ARE NOT NORMALLY BUYERS OF TAX-EXEMPT OBLIGATIONS BECAUSE THEY GET LITTLE OR NO BENEFIT THEREFROM, NAMELY, LIFE INSURANCE COMPANIES AND PENSION FUNDS. THESE INSTITUTIONS ARE THE NORMAL SUPPLIERS OF CAPITAL FOR PIPELINE PROJECTS, AND THEY HAVE REQUIRED THE UNCONDITIONAL BACKSTOPPING BY FINANCIALLY CAPABLE PARTIES THAT I HAVE ALREADY DESCRIBED. FOR TAPS THE OIL COMPANIES ARE ABLE TO PROVIDE THIS, BUT THE STATE DOES NOT PRESENTLY HAVE THE FINANCIAL CAPACITY TO SUBSTITUTE FOR THEM.

WE HAVE HEARD THE THEORY ADVANCED THAT THE STATE CAN

DEDICATE TO THIS PROJECT ITS ANTICIPATED REVENUES FROM OIL ROYALTIES AND SEVERANCE TAXES FROM THE NORTH SLOPE, BUT THOSE REVENUES DEPEND UPON OPERATION OF THE PIPELINE AND ARE NOT "BANKABLE" ASSETS AT THE PRESENT TIME. IN FACT, THEY DO NOT BECOME VALUABLE FOR ADDING SUBSTANCE TO A FINANCIAL UNDERTAKING UNTIL THE PIPELINE IS COMPLETED AND IN OPERATION, BECAUSE THEY ARE COMPLETELY DEPENDENT ON ITS SUCCESS.

THESE CONSIDERATIONS LEAD US TO THE OPINION THAT THE STATE OF ALASKA CANNOT RAISE THE MONEY TO BUILD THE PIPELINE ON THE STRENGTH OF ITS PRESENT CREDIT RESOURCES. IN OUR VIEW, SUCCESSFUL FINANCING OF THE LINE DEPENDS, IN THE FINAL ANALYSIS, ON THE BACKING OF THE OIL COMPANIES' CREDIT.

THE QUESTION HAS ALSO BEEN RAISED OF THE STATE'S ABILITY TO RAISE AN APPROPRIATE AMOUNT OF MONEY TO TAKE OVER THE PIPELINE IN THE FUTURE, AFTER IT HAS BEEN OPERATING SUCCESSFULLY AS A GOING CONCERN. WE DO NOT FEEL THAT ANY EXPERT CAN MAKE AN INTELLIGENT JUDGMENT AT THIS JUNCTURE. THE ANSWER WOULD DEPEND UPON A HOST OF FACTORS - ECONOMICS OF THE SYSTEM AS FINALLY CONSTRUCTED, ECONOMICS OF THE CRUDE AT WEST COAST PORTS, TECHNICAL OPERATING EXPERIENCE, THE LEVEL OF TARIFFS AND DEBT SERVICE BURDENS, ECONOMICS OF ALTERNATIVE FORMS OF TRANSPORTATION THAT MAY BE AVAILABLE AT THE TIME , CONDITIONS

OF MARKETS AND LEVELS OF INTEREST RATES AT THE TIME. AS A CAUTIOUS, BUT EXPERIENCED INVESTMENT BANKER, I HAVE TO SAY THERE WILL BE OTHER FACTORS NONE OF US CAN THINK OF NOW. IF ALL THESE FACTORS TURNED OUT FAVORABLY - AND THAT HAS TO BE A LOT OF IFS - THEN IT IS CONCEIVABLE THAT THE STATE MIGHT, OVER A PERIOD OF TIME, RAISE SUBSTANTIAL SUMS WITH LESS THAN THE UNCONDITIONAL CREDIT BACKING OF THE SHIPPERS.

TO DO SO, HOWEVER, WOULD IN ALL PROBABILITY REQUIRE THAT THE STATE DEDICATE TO THE BORROWING NOT JUST THE PIPELINE EARNINGS, BUT ALL OF THE STATE'S POTENTIAL OIL INCOME IN ORDER TO EFFECT SUCCESSFUL SALES OF BONDS IN THE AMOUNTS NECESSARY TO PAY FOR THE PIPELINE. OBVIOUSLY, SUCH A DEDICATION WOULD SIGNIFICANTLY REDUCE THE STATE'S POTENTIAL ABILITY TO BORROW FOR OTHER PURPOSES, SUCH AS SCHOOLS, HOSPITALS, ROADS AND OTHER WORTHWHILE PROJECTS. IT WOULD ALSO SEEM LIKELY THAT, AT THAT STAGE, THE LARGE INCREASE IN THE AMOUNT OF GENERAL OBLIGATIONS OF THE STATE WHICH WOULD BE OUTSTANDING UNDOUBTEDLY WOULD RAISE THE INTEREST COSTS OF ANY BORROWINGS THAT MIGHT BE UNDERTAKEN FOR REGULAR FINANCING NEEDS.

Concluding Note

To sum up, the proposed legislation puts a number of clouds over the financing of this pipeline.

If it is passed as it presently stands, there would be considerable doubt in the eyes of the investing public whether the oil companies could maintain control of the operation and earn an adequate return on their investment. When doubts of this kind exist, they are severe impediments to financing and would result in having to pay higher interest costs.

We are all painfully aware how the cost of TAPS has already escalated while its construction has been delayed in Washington. I would therefore urge in the interest of both Alaska and the producers that they avoid delay and an additional increase in cost by resolving their differences so that the project can go ahead.

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SUPPLEMENT

THE FIRST CONCERNS THE VOLUME OF OIL THAT CAN BE EXPECTED TO BE MOVED THROUGH TAPS. IT HAS BEEN INDICATED THAT AN AVERAGE THROUGHPUT OF 2,000,000 BBLS./DAY CAN BE MOVED THROUGH THE PIPELINE FOR ALL BUT THE FIRST TWO OR THREE YEARS OF A 25-YEAR PERIOD. I DO NOT THINK THAT SUCH AN ASSUMPTION IS A SOUND BASIS FOR PROJECTING INCOME. IT IS TRUE THAT THE LINE IS BEING DESIGNED FOR AN ULTIMATE CAPACITY OF TWO MILLION BARRELS PER DAY, BUT A THROUGHPUT OF THIS MAGNITUDE IS NOT YET IN SIGHT. OUR OWN ESTIMATES OF PROVEN RECOVERABLE RESERVES IN THE PRUDHOE BAY AREA ARE APPROXIMATELY THE SAME AS THE 9.8 BILLION BARRELS THAT I UNDERSTAND COMMISSIONER HERBERT SPOKE OF ON MONDAY, MARCH 6. IF 9.8 BILLION BARRELS WERE PRODUCED AT AN AVERAGE RATE OVER 25 YEARS, THE AVERAGE RATE WOULD BE ABOUT 1,000,000 BBLS/DAY -- NOT 2. (THE ACTUAL RATE WOULD BE SLIGHTLY MORE THAN 1.07 MILLION BARRELS PER DAY) OUR OWN ENGINEERS' CALCULATIONS INDICATE THAT THE MAXIMUM EFFICIENT OIL PRODUCTION RATE IS 1.5 MILLION BARRELS PER DAY AND THAT SUCH A RATE CANNOT BE MAINTAINED MORE THAN 13 TO 15 YEARS, AFTER WHICH A DECLINE WILL BEGIN AND CONTINUE. CONSEQUENTLY, IT SEEMS TO ME THAT ECONOMIC PROJECTIONS BASED ON AN AVERAGE OIL FLOW OF 2,000,000 B/D AFTER THE INITIAL 2-3 YEARS OF OPERATION ARE HIGHLY SPECULATIVE, DEPENDENT UPON DISCOVERIES YET TO BE MADE AS A CONSEQUENCE OF EXPLORATION NOT YET IN PROGRESS.

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ON THE OTHER HAND, I BELIEVE THAT IT IS UNDULY PESSIMISTIC TO ASSUME THAT THE PIPELINE WILL NOT BE IN OPERATION BEFORE MID-1977. I BELIEVE THAT IT IS POSSIBLE TO BE DELIVERING OIL TO MARKET IN MID-1976. A SUBSTANTIAL NUMBER OF MY ASSOCIATES BELIEVE THAT EARLY 1976 IS A REASONABLE POSSIBILITY.

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IT HAS BEEN STATED THAT THERE CAN BE NO PROFIT IN NORTH SLOPE OIL IN THE 70'S IF THE PIPELINE REMAINS IN PRIVATE HANDS. THIS COMES AS A SURPRISE TO ME. WE ARE DOING EVERYTHING POSSIBLE TO REALIZE PRODUCTION BEGINNING IN 1976, AND I ASSURE YOU THAT WE WOULD NOT BE DOING SO WITH THE EXPECTATION OF PRODUCING OIL OF NO VALUE.

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