

SCOMM

12:2

1940 Record

and Tape # 1

5:00

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0006.3

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Donaldson

Robert Markham

Michael

Robert Markham

Markham

Thomas / Donaldson

McVeigh / Donaldson

McVeigh

McVeigh / Craft / Donaldson

Craft / Donaldson

Markham

Galata / Donaldson

Donaldson

John / Markham #86

McVeigh / Donaldson

Robert / Donaldson

Robert / Markham

Question of Markham ~~et al~~

Reconvened (McVeigh charging ~~Markham~~)

Tape 2

3/9/72

360
1.25
1800
360
450.00

4 1/2 AGO 530676

McVeigh
Chairing

- 0063.0 Rettig / Markham
- 0064.8 Donaldson
- 0067.0 Rettig / Markham
- 0070.8 Young / Markham / Donaldson
- 0076.0 Rose / Markham
- 0088.3 Donaldson / Rose
- 0090.5 Barber / Donaldson
- 0096.8 McVeigh / Donaldson
- 0097.5 Palmer / Donaldson
- 0100.0 Ten minute break
- 0100.3 Reconvened - McVeigh
- 0104.5 Donaldson intro Seymour
- 0110.5 Hubert
- 0123.6 Craft / Seymour
- 0125.0 End of testimony
- 0125.3 Donaldson intro Patton
- 0150.0 Hubert / ~~Seymour~~ Patton
- 0153.3 Miller / ~~Seymour~~ Patton
- 0155.0 McVeigh / Patton
- 0157.8 Mercedes / Patton
- 0161.0 Barber / Patton
- 0167.0 Coletta / Patton
- 0168.0 Radar / Patton
- 0169.5 Coletta / Patton

- 0173.5 Galletta
- 0175.3 End of Patton
- 0176.7 Miller
- 0178.0 Donaldson intro Cortese
- 0179.0 Cortese statement
- 0249.0 Rose / Cortese
- 0252.8 Harris / Cortese
- 0254.8 Barber / Cortese
- 0257.8 McVeigh / Cortese
- 0258.0 Groh / Cortese
- 0243.8 Holm / Cortese
- 0268.8 Recess until 3:00
- 0270.0 Reconvened
- 0271.0 Donaldson intro Gary
- 0272.5 Gary statement
- 0333.5 Rettig / Gary
- 0343.3 Groh / Gary
- 0353.0 Holm / Gary
- 0361.0 Gary: "yah, I think it does."
- 0372.3 Rettig / ~~Gary~~
- 0374.3 McVeigh / Gary
- 0383.8 Rose / Gary
- 0397.0 McVeigh
- 0398.0 Ten minute recess

- 0398.0 Reconvened. - (Rettig)
- 0400.5 Wohlfarth / Gary Chairman
- 0413.0 Rettig / Wohlfarth
- 0415.0 Craft / Gary
- 0418.5 Rettig / Gary / Craft
- 0420.5 Rettig / Gary
- 0422.0 Hubert / Gary
- 0427.0 Rettig "Adjourn"
- 0427.8 Josephson / Gary / Rettig
- 0430.0 Josephson / Gary
- 0432.5 Donaldson intro Broussard
- 0455.5 End of Statement
- 0456.0 Holm / Broussard
- 0461.0 Rettig
- 0462.5 Wohlfarth (update)
- 0463.3 Barber / Broussard
- 0484.8 Radar / Broussard
- 0466.5 Donaldson intro Seymour
- 0486.0 Barber / Seymour
- 0490.5 Rettig / Seymour
- 0492.0 Craft / Seymour
- 0497.0 Rose / Seymour
- 0502.5 Radar / Seymour
- 0504.8 Barber / Seymour

(5)

0505.5 End of Seymour
 0506.0 Donaldson intro Cortese
 0507.0 Cortese spoke
 0548.0 Croft / Cortese
 0560.0 Rettig / Croft / Cortese
 0568.0 Rettig / Croft
 0569.3 Cortese / Croft
 0573.5 Rettig
 0575.5 Recess until 8:00
 0576.5 Reconvened 8:03/10/72
 0576.8 Rettig / Haring
 0577.8 Hubert / Cortese
 0591.3 McVeigh / Cortese
 0599.0 Rettig
 0601.0 Croft / Cortese
 0605.0 Donaldson
 0615.0 End of Statement
 0615.5 Hubert
 0617.3 Mrs Fischer / Donaldson
 0620.3 Mr. Sandusky Statement
 0648.3 End of Statement
 0649.3 Phil Halsworth statement
 0666.0 End of Statement
 0666.3 Groh (Halsworth)

1061
 632

 429
 216
 181

 35

- 0669.5 Mrs. Fischer / Halsworth
- 0671.5 Mike Miller /
- 0674.0 10 min break
- 0674.3 Reconvened
- 0676.5 Wm. Hopkins statement
- 0681.0 End of statement
- 0681.5 Havelock
- 0690.5 Havelock intro Allen
- 0694.0 Mr. Allen's statement
- 0725.3 End of statement
- 0727.0 Barber / Allen
- 0732.3 McVeigh / Allen
- 0734.0 Calletta / Allen
- 0737.8 Rettig
- 0744.5 McVeigh / Allen
- 0748.0 Calletta / Allen
- 0750.8 Calletta / Havelock
- 0753.5 Craft / Allen
- 0760.0 Rettig / Donaldson
- 0761.3 Donaldson / Cabanas
- 0763.0 Cabanas
- 0788.3 Donaldson
- 0790.0 Barber / Cabanas
- 0793.5 Donaldson

(7)

- 0795.8 10 min. recess.
- 0796.0 Reconvened.
- 0800.0 Havelock
- 0802.5 Havelock intro. Wohlfarth
- 0805.0 Wohlfarth intro Jamison
- 0812.0 Jamison statement
- 0833.8 Palm / Jamison
- 0837.3 Palmer / Jamison
- 0840.3 Colletta / Jamison / Wohlfarth
- 0844.8 Fischer / Jamison
- 0846.0 Meland / Jamison
- 0847.5 Wohlfarth
- 0848.0 Jamison
- 0849.8 Palmer / Jamison / Wohlfarth
- 0855.5 Epenbach
- 0856.8 Palmer / Wohlfarth
- 0857.0 Jamison
- 0857.3 Rettig / Jamison
- 0859.0 Wohlfarth
- 0859.5 Jamison
- 0860.0 Colletta / Jamison
- 0862.0 Rettig / Jamison
- 0864.8 ~~Havelock~~ Palmer / Havelock
- 0865.0 Rettig Recess until 1:30

1060
 895
 165
 55
 3165
 15
 15

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- 0866.0 Reconvened. Rettig Channing
- 0870.0 Listen for gravel / Rettig Channing
- 0870.8 Havelock Summary
- 0904.5 Rettig joke
- 0906.5 Halm / Havelock
- 0909 - about Halm / Havelock / Wohlfarth
- 0915.0 Miller / Wohlfarth
- 0919.8 Harris / Havelock
- 0922.8 Wohlfarth / Rettig
- 0925.0 Harris / Havelock
- 0926.0 Barber / Havelock
- 0928.3 Palmer / Allen / Palmer
- 0934.0 Havelock / Kades
- 0945.5 Palmer / Havelock
- 0949.0 Halm / Havelock
- 0950.5 Colletta / Kades
- 0954.5 Colletta / Havelock
- 0956.3 McVeigh / Kades
- 0963.0 Rettig / Havelock
- 0966.0 Wohlfarth / Rettig
- 0973.3 Rose / Havelock
- 0977.0 Nubert / Havelock
- 0981.0 Wohlfarth
- 0983.0 Havelock

- 0983.5 Colletta / Wohlfarth / Havelock
- 0985.0 Rose / Havelock
- 0985.5 Havelock
- 0986.8 Recess 10 min
- 0987.0 Reconvened.
- 0987.8 Rottig intro Croft.
- 1014.3 End of statement
- 1015.5 Hubert statement
- 1017.5 Barber statement
- 1023.0 Harris statement
- 1026.8 Rose statement
- 1029.8 Muller statement
- 1034.0 Holm statement
- 1034.5 Fischer statement
- 1038.8 KIEITH SPECKING⁴
- ~~1045.0 KAY POLAND~~
- ~~1045.0 JAY HAMMOND~~
- 1041.5 MIKE COLLETTA
- 1045.0 JAY HAMMOND statement
- 1049.0 Thomas statement
- 1053.8 Kay Poland statement
- 1055.0 McVeigh statement
- 1058.8 Rottig statement
- 1064.3 End

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Culetta: ^{18p} for State acquiring money, your testimony, or my interpretation, is that this money is the problem that we face and, if I interpret your testimony correctly, one of the alternatives was the State ownership proposal. With supplementary income from severance and royalties we were going to make up the deficit in monies that we need through the profit that is allowed on the pipeline. Have you looked into any other alternatives?

Henri: Well, Representative Culetta, when you mean alternatives do you mean other natural resource development or just what is the general thrust of this.

Culetta: Yes, either in that field or coupled to the Prudhoe Bay. Is consideration being given to, recently we read in the paper where gas research not taken out of the ground. Have we considered selling our pre-owned, you know approximately 20%?

Henri: Well, right, I think that should be the essence of it is Commissioner Herbert's. But, I would say in general that I have looked at every conceivable possibility for getting income for the State, more or less, I don't mean to tell you that we spent several hundred thousand dollars on each conceivable possibility. We certainly have tried to imagine any income source. There isn't anything, including gas, that is anywhere near like oil. That is the problem. I mean the oil is so far and above the great yield~~er~~ of revenue to the Treasury that there just isn't anything else remotely comparable to it.

Culetta: Mr. Chairman. Again, I was apparently misinformed but it seems that I recall from the news article that between two and five hundred million dollars in one gas sale had been negotiated.

Henri: Well, I don't doubt, Mr. Culetta, that if they sold all the oil in the Prudhoe Slope right today that they could get a figure quite a bit higher than that, obviously, but that is the total figure over many years. My concern, of course, is to funding the budget in 1978 and 1979, not that I am representing to you that I'm going to be the one who's doing it then, but at least we have

to fund the budget then and those are the years, particularly the late seventies, that are so critical to our State.

Culetta: Mr. Chairman. Commissioner, what I am driving at is until the line is on full capacity we seem to be facing the problem . It seems conceivable to me that we should sell some of the future production now to make up the deficit until the line is on stream so that we could solve our problem.

Havelock: If I may answer that for the Commissioner. I have discussed this with a number of people as a prospect, but the effect is, and it is a strategy the State may wish to use at the appropriate point, but the strategy does not change basic lines of the projection. What you can do through the advance sale, lets take sale of oil and gas futures, is to nip off the bottom of the deep part of the V when you hit bottom. You can't sell anything, or you can't sell for any kind of advantageous price until you have the assurance that the product is going to be marketed, otherwise, you are going to be selling a highly discounted commodity. Even if you do sell it, you are selling something that otherwise you would count on in the future. So, the effect is that you can round off the bottom of the V in the bottom of the dip but you don't change the basic trend of the decade by that kind of strategy. As far as other alternatives go, I do call to your attention one of the measures the Legislature may wish to consider, one of measures we had introduced does call for a twenty mill property tax on the pipeline and related oil property as a method of raising revenue and, of course, the legislature may wish to consider the utilization of the property tax as one of the various tax tools that is available to the State in meeting its fiscal problems.

Rettig: In several different ways the question has been posed, why can't we not increase severance taxes to make up for what, otherwise, would be pipeline profit. Perhaps Mr. Wohlforth could explain where most of this pipeline profit really comes from under State ownership. Would you care to do that Eric?

Wohlforth: Yes I would be glad to. The pipeline profit is shown under pipeline income

in the years 1977, 78, and 1979 to some extent, comes from pipeline income, that is to say, in the amount of the charge which the State is entitled to make as the owner of the pipeline.

Rettig: Perhaps I didn't make myself clear. For example,

Wohlforth: as well as the fact that we are not taxable as a pipeline owner.

Rettig: That is the point I was trying make. Out of perhaps four hundred million dollars of pipeline income, perhaps two hundred fifteen million of that ^{MEANLY} is money that would otherwise go to Uncle Sam for taxes.

Rose: My curiosity is getting the best of me, what is a ?

Henri: It is an example of figures.

Groth: Joe this is the last question and I realize that I am probably being argumentative but I don't mean it. If you refuse to put anything in the budget on the value of the 1.5 million acres on the slope or the seventy seven million acres that the State otherwise has, would you sell it to me for a hundred million dollars? Of course you wouldn't, so you do have a figure on it someplace and it seems to me that that figure has to be put in your revenue projections someplace.

Henri: Senator, you're referring to lands that the State has?

Groth: Yes sir.

Henri: Of course, the lands, whether they are oil bearing lands is question number one. Again, I would have to ask whether Chuck Herbert thinks they are, but even Chuck has missed one or two acres in Alaska as to whether they have oil under them or not. So that in itself seems to be problematical, and then the question of when the oil companies would be interested in taking the oil is the thing that clenches us up. All we are talking about is a ten year period. I think that over the long run of time that we can get through the next ten years probably, our future is particularly bright in this State.

Adjournment until 2 p.m.

McVay: This is a continuation of the hearings on the pipeline proposals of the administration. Our schedule calls for us to go straight through until 6:00 this afternoon and we'll have breaks approximately every hour and fifteen minutes. Mr. Attorney General do you have the next witness?

Havelock: Mr. Co-Chairman and members of the committee, at this time the State would like to call Mr. Charles Kades of Barker, Stella, Field and Wood, special council of the State on public financing. He will discuss the statutory framework of State ownership. In connection with Mr. Kades testimony I have a distribution in line with the previous comments that I have made and other witnesses have made regarding a proposed introduction of the proposed amendment to the constitution of Alaska and with the Chairs permission I would like to distribute that now for your perusal and, in addition, we have to the amendment bill already committed to the committee we have two other proposed amendments to HB 569 which the committee may wish to consider.

McVay: Mr. Kades, when you are ready to begin would you give us a little bit of your background for the records.

Kades: Mr. Co-Chairman, my name is Charles L. Kades. I am a partner in the firm of Barker, Field, Stella and Wood of New York City. I have been a partner for some twenty some odd years. Prior to that I was overseas during WW II until about 1942. In an earlier period I had been Assistant General Council of the United States Treasury in Washington from 1933 or 1934 until 1940. After we were retained to advise the Attorney General and other members of the administration in connection with the ownership of the, or possible ownership of the pipeline by the State, we conferred at length and concluded that the device that was best adapted to providing the State ownership of the pipeline would be public authority. The authority device is not a new device. It is not untried and, at its best, under competent members, it has advantages of full private and public management. It must pay its way and usually it has no access to the public treasury. It has no stock; it is operated under Government and after its debt is paid it properly belongs to the State and to the people. Although there

has not been any project of which I am aware of comparable size to the pipeline under consideration here, there have been authority financings amounting to billions of dollars. For example, the Port of New York Authority now has outstanding about one and a half billion dollars worth of bonds and it has retired about an equivalent of that amount of bonds. The Los Angeles Power and Light Authority has outstanding about a billion dollars worth of bonds. The Power Authority of the State of New York has outstanding a billion and a half of bonds. The New York State Thruway has a billion in principle amount of bonds outstanding. The New Jersey Turnpike Authority has approximately three quarters of a billion; Illinois Turnpike Authority has over six hundred million; and the Nebraska Public Power Agency has a half a billion dollars in bonds outstanding. All of these projects have been financed without any recourse whatever to tax revenue. These projects have been self-liquidating, self-supporting, and are managed by the authority as an autonomous, independent, separate corporate legal entity. That is the purport of HB number 569 which creates the Trans-Alaska Authority as an independent corporate entity. Its membership is appointed by the Governor with the confirmation of both houses in joint session of the Legislature. It has all the general powers of a private corporation as well as a public corporation. It has specific powers to issue bonds or notes and to make agreements with the bond holders and note holders for the financing of the project and it can make rates and charges and revise them from time to time without the surveillance of any other regulatory agency sufficient to pay the interest and principal on the bonds as well as its debt service as well as the operating and maintenance expenses. It has the power to acquire the property of any other pipeline company, either by purchase of stocks or by purchase of property, or by physical property or, if necessary, by exercising the right of eminent domain upon payment, of course, of just compensation. The Act is not mandatory. The Act is purely permissive. All it does is set up the framework from which the State can then determine its next move. It is purely enabling legislation. It might never be used or it might be used in part or in whole, but it is indispensable some legal framework if the proposals that there may be State

ownership is to move forward. The hearings, I think, became confused at one point in regard to pledge of credit of the State. An independent public authority such as should be self-supporting. All of the authorities that I have mentioned are self-supporting. Sometimes it has been desirable, although I only know of one case, to guarantee the bonds, although no recourse has ever been had to that guarantee. That is in the case of the New York State Throughway, where some bonds were issued guaranteed by the State, after a constitutional amendment was adopted authorizing the guarantee, but the project has been completely self-liquidating and there had never been any of payment of any of the interest or principals out of the revenues. Did one of the amendments that the Attorney General introduced or offered to the committee at the opening of this session eliminates from this act the recittal or from this bill, the recittal in the legislative findings that it is clear to be in public interest for the State to guarantee the principal and interest on bonds issued to finance the facility. The other amendment eliminates the section which provided to the extent that the constitution permitted the bonds might be guaranteed. Now, that section was pure surplus and really doesn't belong in the bill because the constitutional amendment provides that, if it is adopted by the people, then the Legislature is authorized by an act to guarantee the bonds but, first of all, the constitutional amendment is required to pass the people and, secondly, another Legislature must act to pass a law before any of the bonds are guaranteed. So there (Its redundant) for anything of that character to be in this bill, thats why it has been eliminated. As it stands, the bill authorizes an authority to make plans and to proceed with the project but doesn't require the authority to do anything, and doesn't in any way pledge directly, or indirectly, the credit of the State or the taxing power of the State. I may say of this connection that the project, as defined in the Act, is much broader than the pipeline. There are many other things that are required to be built which would be revenue producing. For example, port facilities, airports, docks, wards, storage

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

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

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

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

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

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

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

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

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

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

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

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

Kades: The House joint resolution?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Kades: I am not clear on the question.

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

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

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

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

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

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

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

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

Havelock: ^{The only Attorney General involved in act is the question of} Mr. Kades, so the committee may be fully informed , I wonder if ^{of the} you might talk for a moment or two about the , how you would arrange for, or ^{of the} what the principles which would apply to tax exemptions of the bonds which the ^{the way} authority might issue for this purpose. ^{and some feel}

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

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

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

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

McVay: Mr. Barber.

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

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

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

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

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

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

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

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

in the event that they are not paid for.

Kades: That's true correct.

Rose: Thank you.

Kades: Mr. Holm

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

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

How I would know if this ^{now} field now

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

Holm: Now you people are bond counsels?

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

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

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

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

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

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

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

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

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

Hester: Mr. Rettig has another question.

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

the possible non-taxable status, of the bond?

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

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

Kades: Such as the severance tax.

Rettig: Correct

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

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

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

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

Joe Bryson

March 6, 1972

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

AGO 530707

0179.0 Miller/Temple
0182.5 Rose/Temple
0185.3 Radar/Temple
0187.5 Bowman/Temple
0188.5 Josephson/Temple
0191.5 Swanson/Temple
0193.5 Mike Colletta/Temple
0196.5 Farrow/Temple
0198.0 McVeigh/Temple
0198.3 Rettig/Temple
0203.0 Temple - End of statement
0203.8 Recess -- reconvened
0204.0 Bruce Campbell statement
0212.3 End of Campbell statement/Rettig
0213.3 Holm/Campbell
0214.3 Rose/Campbell
0218.0 Christiansen/Campbell/Havelock
0220.5 Rettig
0221.8 Havelock
0222.3 Recessed until 8:00 a.m. tomorrow.

March 7, 1972

0224.0 Reconvened
0224.3 Rettig intro. Wohlforth.
0225.0 Rettig
0226.0 Wohlforth statement
0269.5 End of Wohlforth to Havelock
0271.0 McVeigh "can everyone hear...."
0273.0 Larry Eppenbach statement

0284.0 McVeigh
0284.3 Groh
0285.8 Wohlforth
0287.5 Groh/Wohlforth (McVeigh "speak up, etc.")
0288.3 Christiansen
0289.0 Havelock
0290.5 Holm/Eppenbach
0294.0 Wohlforth answers
0299.0 Havelock "May I comment." Holm
0297.8 Havelock
0306.5 Christiansen (McVeigh chairing during
question and answers)
0307.5 Wohlforth
0308.5 Havelock
0309.0 Young/McVeigh
0310.8 Rettig/Wohlforth
0312.8 Eppenbach
0315.0 Palmer
0316.3 Wohlforth
0317.5 Eppenbach
0318.5 Wohlforth
0319.0 Rettig
0320.3 Havelock
0322.0 Recess for ten minutes

(From this point to the noon recess is a bad tape and you
will have to go to the Department of Revenue transcript
to take your transcript. I will give what I have down on
my log anyway.)
0322.0 McVeigh
0324.5 Havelock intro Henri
03226.3 Henri

0368.0 End of Henri statement
0368.3 McVeigh chairs - Groh/Henri
0378.0 Young/Henri
0380.0 Wohlforth
0386.8 Eppenbach
0388.3 Holm/Henri
0394.0 Hubert/Henri
0396.0 Barber/Henri
0398.0 Thomas/Henri
0401.5 McVeigh/Josephson/Henri
0404.0 Palmer/Henri
0407.8 Rettig
0408.5 Eppenbach/Palmer
0411.5 Palmer/Havelock
0414.8 McVeigh
0415.8 Colletta/Henri
0420.0 Havelock
0422.8 McVeigh/Rettig/Wohlforth
0425.3 Groh/Henri
0429.3 McVeigh - recess.
(End of bad tape)
0428.5 Reconvened McVeigh
0430.5 Havelock intro Kades
0433.0 McVeigh
0433.5 Kades statement
0450.8 End of statement
0451.0 Groh/Kades
0455.0 Christiansen/Kades
0468.5 Young/Kades

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0478.0 Havelock/Kades
0489.8 Barber/Kades
0494.8 Rose/Kades
0501.0 Holm/Kades
0507.3 Rettig/Kades
0519.8 McVeigh/Havelock
0520.5 Kades
0521.3 McVeigh/Havelock
0522.0 Kades
0523.0 Rose/Kades
0525.5 Recess until 3:15
0527.8 Reconvened
0532.5 McVeigh
0532.8 Havelock/Wohlforth
0535.3 Havelock intro Gildehaus
0536.0 Gildehaus statement
0568.0 End of statement
0568.5 Groh/Gildehaus
0572.3 Rose/Gildehaus
0575.8 Wohlforth
0578.3 Rettig/Gildehaus
0589.5 Havelock/Gildehaus-Rettig
0594.0 McVeigh/Gildehaus
0600.8 Eppenbach/McVeigh
0604.3 Gildehaus
0611.0 Rettig/Gildehaus
0612.0 Eppenbach
0612.5 Wohlforth

AGO 530711

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0684.8 Havelock

0686.0 Groh/Rettig

0687.5 Havelock intro

AGO 530712

0687.5 Havelock introduced Hellen
0688.8 Hellen statement
0704.0 End of statement
0704.5 Rettig/Hellen
0713.0 Holm/Hellen
0714.0 Holm/Havelock
0717.3 McVeigh/Hellen
0774.3 Groh/Hellen
0726.3 Havelock/Groh
0727.3 Rose/Hellen
0734.8 Hubert/Hellen
0738.8 Rettig/Havelock
0741.0 Holm
0741.5 Christiansen/Rettig
0743.5 Wohlforth
0743.8 Rettig - adjourn until 8:00

March 8, 1972

0745.0 Reconvened
0746.0 Sen. Croft statement
0778.3 End of statement
0779.0 Groh/Croft (Rettig chairing)
0786.5 Radar/Croft
0789.0 Rose/Croft
0792.0 Hubert/Croft
0797.5 Barber/Croft
0802.5 Croft statement
0805.0 Rettig/Croft
0807.3 Rose/Croft
0810.0 Hubert/Croft

AGO 530713

0813.0 Croft finish
0813.3 Rettig statement
0817.8 Recess until 9:15
0818.0 Reconvened
0821.0 Rettig introduction of Spahr
0876.8 End of statement
0876.3 Holm/Spahr
0897.3 Miller/Spahr
0910.0 Groh/Spahr
0916.5 Radar/Spahr
0921.0 Croft/Spahr
0925.3 Thomas/Spahr
0930.0 Josephson/Spahr
0938.0 Merdes/Spahr
0949.0 Recess until 1:30
0950.3 Reconvened at 2:00
0952.0 Rettig/Donaldson
0953.0 Donaldson intro Williamson
1005.8 End of statement
1006.0 Groh/Williamson (Rettig chairing)
1008.0 Donaldson
1009.3 Holm/Williamson
1012.0 Donaldson
1013.5 Rose/Williamson
1015.3 Donaldson/Rose
1017.5 Williamson
1019.3 Donaldson/Rose
1022.3 Williamson
1025.0 Rettig
1025.5 Donaldson

1028.3 Radar/Williamson
1032.5 Donaldson/Radar
1036.3 Hubert/Rettig/Donaldson
1041.3 Croft/Williamson
1047.0 Barber/Williamson
1048.0 McVeigh
1052.8 Palmer/Williamson
1056.5 Croft/Williamson
1058.0 Radar/Williamson
1060.0 Donaldson
1061.3 Thomas/Donaldson
1068.5 Donaldson
1063.0 Recess for 10 min. - Reconvened
1066.0 Donaldson intro net three witnesses.
1068.0 Harry Jones statement
1097.5 End of Statement
1098.0 Rose/Jones
1100.3 Miller/Jones
1106.3 McVeigh/Jones (Rettig chairing)
1112.5 Groh/Jones
1116.5 Hubert/Jones
1124.5 Holm/Jones
1130.5 Donaldson intro Markham
1131.5 Markham statement
1196.5 End of Statement--recess
1197.00 Reconvened - Rettig
1200.0 Holm/Spahr
1200.8 Groh/Spahr
1206.3 Palmer/Spahr
1210.3 Donaldson/Palmer

1213.8 Hubert/Spahr
1222.5 McVeigh/Spahr
1229.5 Rose/Spahr/Donaldson (we'll try to get an answer...)
1242.8 Mr. Spahr left.
1244.0 Recess

End of Tape #1

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AS A UNIT IN THE ORIGINAL DOCUMENT.

OUTLINE OF PROPOSED TESTIMONY
BEFORE
THE SENATE COMMERCE COMMITTEE
HON. RON L. KETTIG, CHAIRMAN
AND
THE HOUSE LOCAL AFFAIRS COMMITTEE
HON. RICHARD C. McVEIGH, CHAIRMAN
3:00 p.m., March 6

1. The Concerns of State Policy
Statement of Governor (Lt. Gov. Red Boucher)
2. Alaska's Stake in North Slope Oil
leases, royalty, severance and netback (Charles Herbert,
Commissioner of Natural
Resources)
3. The Federal Role in North Slope Oil
I.C.C. regulation - how it works,
federal pre-emption (John E. Havelock,
Attorney General,
Pipeline Coordinator)
4. The Cost of Building the
Trans-Alaska Pipeline System (Bruce Campbell,
Commissioner of Highways)
5. The Impact of Costs on Revenue
Methodology - Comparison of State
and Private Ownership Cases (Eric R. Wolfroth,
Commissioner of Revenue)
6. Impact of State Revenue on the
State Budget (Joseph R. Bond,
Commissioner of
Administration)
7. The Advantages of State Ownership
Issues and Answers (H. B. Temple III,
Temple, Barker & Stone)
8. The Statutory Framework for
State Ownership (Charles Kaden,
Hawkins, DeLofield & Wood)
9. Arrangements for the Public
Financing of Pipelines (Tom Giddens,
Temple, Barker & Stone)
10. The Marketing of Public
Pipeline Issues (Robert Macy, Kuhn,
Loeb & Co.)

Page No. 6
Mr. Rettig: Now at this time we will proceed with the administration witnesses,
Attorney General John Havelock.

Mr. Havelock: Thank you Mr. Chairman. The opening witness we present for the Committee here today is the Honorable Eric E. Wohlforth, Commissioner of Revenue, who will speak generally to the impact of pipeline costs on revenue. Commissioner Wohlforth.

(Mr. Rettig)

Before Mr. Wohlforth commences his testimony, I would like to point out just a slight kink in our plans. We ~~are~~ ^{are} going to commence questioning from ^{committee} members and legislators immediately following testimony of all out-of-town witnesses. It would be helpful if you do have questions, ^{concerning} the administration staff and others who reside in Juneau to save your question, certainly make notes of them so that you can ask those questions at a later time at the individual committee meetings when these measures are being considered.

(Mr. Wohlforth)

Thank you, Mr. Chairman, members of the committee, let me first point out one of those unhappy events which happens in the course of preparing documents and that is for these two years 1980 and 1981 some typist made a reversal of some of the figures. The figure 3397 should be under state taxes, the figure ³⁷⁰⁵ ~~3307~~ should be under state taxes, that conversely taxes should be in the other column. I think that we see readily from the sequence of figures that that typing reversal did occur and I'm very much indebted to ^{gentlemen} the unidentified/who called it to my attention at 7 o'clock this morning.

The figures which are, although done graphically, are hard to see from, by any of those who are sitting in back of the room or any person who doesn't happen to be ^{far} farsighted, are depicted in a hand-out entitled, Exhibits to support testimony before these Committees, with yesterday's date. Committee members have those exhibits now and they will see ~~XXXX~~ little tick marks after the two places where the unfortunate figure ^{is} reversal occurred. My job this morning/to summarize past projections of North Slope revenues and those presented today based upon private ownership and to contrast the effect of private ownership case with the case of the pipeline owned by the State of Alaska. The most recent public North Slope ^{oil} revenue projections before those which

Governor referred to last week were made by the Division of Oil and Gas in cooperation with the Department of Revenue as part of the State's contribution to the Federal impact statement which was released by Governor Egan in July of 1971. These projections were developed from a computer model which was based on the information then available to the State of Alaska and showed various and numerous economic cases on differing assumptions again, based on facts then assumed to be ascertainable. The July 30 report which is contained in the State's contribution to the impact statement states, ^{CN} page 166, that "the originally estimated \$900,000,000 cost of the pipeline has already increased considerably, present cost estimates range from one million to 2.1 billion, that will occur I am sure, frequently, to 1 billion to 2.3 billion dollars. These revenue projections use the assumption of one billion dollars, as the lowest ^{installed} cost of the pipeline and 2.5 billion as the highest estimate. A footnote to this statement gives backup for the State's then cost estimates. This footnote notes that as late as July 19, 1971, Aleyeska furnished the State Department of Revenue an estimate of \$969 million dollars as the cost of the entire contract, and the footnote concludes with a reference to a statement from Interior Secretary Rogers C. Morton, in the late spring of 1971 that environmental regulations and environmental precautions are contributing to a higher price tag of about 2.3 billion dollars. So it was this figure of 2.3 billion dollars which was used on the State's most likely estimate of North Slope revenues. ~~The revenue estimates included in the State's report developed from this estimates of total cost, the revenue estimates most likely estimate of North Slope revenue.~~ The revenue estimates included in the State's report developed from this estimate of total cost assumed refinery value in the year, fiscal year 1975, /was the then estimated start-up year, that is refinery value on the West coast of ^{\$}3.37 a barrel, marine transportation costs of 44¢ and pipeline tarrif initially of 80¢ per barrel, giving a wellhead value of ^{\$}2.12 per barrel. From these figures it was estimated that total royalties and taxes would amount to \$164,000,000 a year in fiscal year 1976. The first year, then assumed, of pipeline operations. In the second year of operations fiscal 1977, the total revenue was estimated at 278,000,000, the third year,

\$282,000,000, in the fourth year \$311,000,000. In the then-estimated, and I repeat then-estimated, fifth year of operation, fiscal year 1980, pipeline tariff was calculated at \$.47 a barrel with marine transportation costs of \$.52 leaving a wellhead value of ^{\$}2.56 per barrel. In that year, fiscal 1980, we showed then, a total of \$348,000,000 in total royalties and severance taxes from the pipeline. And we didn't stop with one set of assumptions. Other assumptions were run with different assumptions. Estimates were run with different assumptions. For example, one set the pipeline cost \$1 billion again with the initial production year 1976. A wellhead value of \$2.75 with lower marine transportation and tariff, ^{produced} ~~showed~~ fifth \$212,000,000 in revenues the first year of production and the ~~third~~ year of production on this optimistic, optimistic ^{from} on the point of view of the billion cost of the pipeline, was assumed to capture, ^{the State} ~~it say~~ was assumed to capture in that year \$412,000,000 in pipeline revenues. A then pessimistic case which assumed a pipeline cost of 2.5 billion showed a wellhead value of \$1.76 in the initial year of 1976 and royalties and taxes ^{value} of \$136 million in that year. In 1980, however, at a wellhead/of \$2.20 a barrel, royalties and severance taxes reached the figure of \$297,000,000. Incidentally, and obviously, in all these case, one of the main reasons wellhead value increases over the years is that transportation costs go down as the volume of oil/^{shipped} increases. Now several important events have come to light which have required the State to revise downward drastically its revenue estimates. The first indication of the fact that the State was incorrect in assuming as it did, in July, 1971, for its contribution to the Impact Statement, the first indication that the State was incorrect at that time in making ^a ~~a~~ assumption that a production/^{flow} starting at 600 barrels per day would reach 1.7 million barrels per day in the second year of production was disclosed in the summary ^{description} ~~project~~ of the transalaskan pipeline system received by the State this fall. On page 55 of ^{that} ~~the~~ document it is stated the pipeline will be brought to full capacity in ~~three~~ stages. In the initial phase of operation the system will have the ability to transport 600,000

barrels a day, and I'm paraphrasing page 55 of the summary impact statement. The reports goes on to state that the second phase is tentatively scheduled to be completed approximately 2 years after initial start-up. In this phase the report states the system will have the designed capacity of 1.2 million barrels per day. The final phase so says the report, is expected to be completed approximately seven years after initial start up, that is a pumpage flow at which time the pipeline will reach its ultimate capacity of 2.0 million barrels per day according to the description in the statement. In other words, ^{there} ~~it~~ will be, according to the statement, at least five hundred thousand barrels per day less production in the second year of operations and each year thereafter for the initial seven years. The next shock to the State was ~~xxx~~ disclosed by the S.E.C. Registration Statement filed by British Petroleum Company *Ltd.* submitted on October 12, 1971. In the offering circular accompanying that registration statement the following statement is made on page 24, "the initial construction phase of the pipeline is expected to provide a minimum aggregate throughput capacity upon completion of 600,000 barrels per day. This capacity is designed to be expanded in two stages. The first stage resulting in a total capacity of 1.2 million barrels per day, and the second a ^{total} capacity of 2.0 million barrels per day. Parenthetically, no reference to the time of build-up. It is presently estimated that the cost of the pipeline upon completion to the 600,000 barrels per day capacity would be approximately 2.3 billion and that increasing the capacity to 2 million barrels per day would increase the cost by \$400,000,000. On November 10, 1971 Atlantic Richfield, together with the City Service Company, filed a registration statement with the Security and Exchange Commission stating that "the cost of the system upon completion ^{to} the 600,000 barrel per day capacity is presently estimated to be approximately 2.4 billion of which the company will be responsible for approximately \$675,000,000. The additional costs to all participants of increasing the capacity to 2 million barrels per day is estimated to be at least \$400,000,000. Thus by mid-November, 1971, the total pipeline costs ^{had} ~~were~~ escalated to 2.8 billion, or \$500,000,000 over the average case assumed in July when the State made its revenue estimates. In fact, it increased \$100,000,000

in less than one month between two SEC filings by companies involved in the North Slope pipeline. This dramatic increase in pipeline costs, revealed in official documents at the time of Governor Egan's first announcement on State ownership, made it urgently necessary that the State finally determine independently the likely magnitude of the pipeline costs. Commissioner Campbell has already indicated the independence study which the State has made through its consulting engineers, Tibbets, Evan, McCarthy and Stratton, and the foundation for the present estimate of 3.5 billion. These figures have been recently developed, along with an independent evaluation of operating costs, so that for the first time the State can make a reasonable projection of the probable amount it can expect to capture from North Slope revenue. And incidentally, in the hand-out of exhibits there is a breakdown in addition to the comparison of public and private ownership of the construction costs table which Mr. Campbell ~~referred~~ referred to yesterday. We will make additional copies of those available if they are in short supply, ^{if ~~for~~ other} ~~_____~~ senators, representatives or members of the public desire to see them. The base case shown today in graphic form assumes the total pipeline cost of 3.5 billion financed 90% by debt, at an interest rate of 8%. It conforms to the Aleyska throughput assumption of full production only in the 7th year of pipeline operation. It shows the same ICC permitted rate of return as shown in the State's projection in July. In the fourth year from the beginning of construction or the first year of operation, for 1977 we now show a negative well-head value or no state revenues. This was the year comparable to that in which it was earlier shown that the state would capture at least \$164,000,000 in total revenues consisting of royalties and severance fees. The fifth year, 1978, the second assumed year of operation we earlier estimated \$278,000,000 in State revenues. In these two years alone the net revenue loss to the State over earlier estimates amount to \$442,000,000. By the sixth year, or 1979, the new projection shows \$84.6 million ~~in~~ ~~in~~ oil severance and royalties revenues. Earlier we estimated \$282,000,000 for that year. The net loss by that year over earlier estimates is \$640,000,000. Not until the 15th year of pipeline operation do royalties and severance taxes amount to near the amount shown in ^{our} ~~an~~ previously made estimate before the second calculated year **AGO 530722**

In that 15th year we show severance and royalty revenues of \$277 million. Now the question ~~is~~ ^{it} has been asked, and not only has been asked, it has been asserted that this is the most pessimistic of all/cases ^{possible} which can be produced by the State for its revenue picture in the late 1970's and 1980's. I'd say that the answer to that is clearly no, for three reasons. In the first place the revenue loss figure mentioned above is no effect to our expectations now of first pipeline operation in the year 1977 whereas in July we assumed the full year of revenues ^{starting} on July 1, 1975. That is to say we show a \$640,000,000 loss comparing three years of operation regardless of start. In the second place we show state taxes in each year of operation of approximately \$33,000,000. For these first three years of operation ~~the~~ ^{state} income taxes are estimated to total approximately \$100,000,000 or 3 times the \$33,000,000 a year. This assumes full state ^{income tax} ~~impacts~~ on pipeline profits. Experts have indicated that this itself may not be ^a realistic assumption. Even, however, with the most optimistic income tax estimate, net revenue loss from earlier projections amounts to \$540,000,000 during the critical first three years of operation. Thirdly, calculation of the 7% permitted rate of return on valuation may err on the low side. This was alluded to yesterday by Mr. Temple as the legalities of the possibilities were discussed by Attorney General Havelock. I can only say that the leading text on the ~~XXXXX~~ subject which is Petroleum Pipelines and Public Policy by Arthur Johnson, cites numerous instances of the slowness of the ICC to actually evaluate pipeline costs and its heavy reliance ^{to} on figures supplied by industry. And its well known to the Committee and/the public at large that the Cook Inlet pipeline valuation itself took nearly three years to complete. The 7% figure again is not high when it is remembered that there are seven separate proposed pipeline owners, each of whom may aggregate earnings of each of its other pipelines when the 7% rate is considered. We will hear further expert testimony on this later. The point here is that is entirely possible that higher return rates ^{may} ~~will~~ be permitted at least until the valuation of the pipeline is complete and possibly there after when earnings of other pipeline companies are aggregated to arrive at a total rate of return for a particular pipeline company. The next case shown on the chart and to some, seeable on the wall, assumes the case

of the economic effect of State ownership of the pipeline. Financing is assumed in the amount of \$1 billion dollars in each of the first two years of construction at 8%. \$900,000,000 in the third year, ^{of construction} at 6.5%, \$215,000,000 at 8% in the first year of operation and \$310,000,000 in the second year of operation, and I may say that Mr. Eppenbach who will follow me will give you some more precise detail on the assumptions that went into the assumed case of public ownership I'm now discussing. This case also assumes the same ICC permitted rate of dividend payoff as assumed for the private case. ^{mainly} The 7% percent which is a cash ~~XXXXX~~ ^{dividend} limited payout limitation in each year of the projection. In arriving at the State's net cash flow which is indicated at the top of the chart assuming public ownership, pipeline income, royalty and production payments, in arriving at the State's net cash flow operating expenses, amortization and interest on bonds, are deducted ~~XXX~~ from gross income. During the first year of operation net cash flow to the state ^{through} ~~Karrif~~ is, as you can see from the chart, \$230,000,000 and royalty and severance taxes amount to \$15.7 million for a total of \$245,000,000 ~~XXXXX~~. Obviously, in State ownership no Federal or State income taxes are calculated ^{on} ~~in~~ pipeline income. Mr. Kades will speak to ^{this} ~~us~~ later today, explaining ~~XXXXX~~ in detail the assumption legal rationale for that statement. In the fifth year from the beginning of construction, or the second year of operation, net cash flow is \$228,000,000 which together with royalty and severance taxes of \$17,000,000 produce a total ^{of} \$245,000,000 for the State. In the sixth year from the beginning of construction and the third year of operation, net cash flow amounts to \$227,000,000 through the tariff and total royalties and severance taxes amount ^{to} \$123,000,000 for a total \$350,000,000 or for those who are farsighted, \$350.94 ^{million} as shown on the chart. In the 15th year cash flow is reduced to ^{\$183,000,000} \$180,000,000 by reason of the fact that the pipeline has depreciated but total royalties and severance taxes amount to \$297,000,000 for a total to the State Treasury of \$480,000,000. Now let me emphasize that this case makes almost identical assumptions to the private case described before. It should be

emphasized that net income to the State is computed after debt service on State bonds.
To avoid a speculative argument on the ^{possible} differential between interest rates on the State's debt, which may be tax exempt, versus taxable interest on private borrowing, we show all but \$900,000,000 in state bonds at the same 8% rate as shown in the private case. I think the 8% can be, we could spend the day arguing 8%, 7% or 9%, we all know the trend of interest rates in recent years, the fact that double AA corporate ~~AAA~~ bonds are selling today at about an interest rate level of 7.23 gives me comfort that 8% is as good an estimate of interest on both state and public borrowing and indeed conservative on state borrowing ^{as} which can be arrived at today. The main differences between the assumptions lie of course ^{in the fact,} as I have stated before, ~~is~~ that the State is not subject to Federal income tax and obviously will receive no State income taxes from the pipeline since ^{it} ~~XXX~~ is assumed to be the owner. The timing of the bond issues for both the public and the private cases is the same, although the term of the public bond issue is ^{shorter} ~~shorter~~ 25 years, indicating heavier debt service loads and the state of course is assumed to finance the pipeline 100% ~~and~~ on a step basis. Now we ~~can~~ ^{could} make numerous additional assumptions, and we have made additional assumptions, ^{on} the question of the matter of public financing, the manner of private of private financing, the assumed debt equity ratio of private financing, the rate of return permitted either to the State or to private pipeline owners, interest rates payable by the State and private pipeline owners, the effective tax rate in private ownership, to mention only a few. We know and the Committee knows, and I believe ~~that~~ each Senator and Representative in this room knows, that estimating the effect of a project of this size and magnitude based on events three to seven years away, must rest on ~~an~~ assumptions which are to a degree speculative and you will hear testimony that our assumptions are probably incorrect. The point is that no one can say with absolute certainty what our revenue picture will be with the pipeline in private ownership. We have now, however, tested ^{prior} ~~XXXX~~ assumptions based on new and in two instances, official information before us. I refer to the Aleyeska Impact Statement and the more recent SEC

filings of ~~the~~ two of the member companies. This effort and this information has convinced the administration that it must attempt to do now what it can to remove the uncertainty of the revenue picture in the late 1970's and the late 1980's and this attempt to remove the speculation and to give the State the tool to move forward in this regard is the thrust of the bills that are here before ~~you~~ you today. The details of the bills, the theory and rationality ~~XXXXXXXXXX~~ will be addressed by other members to come before you, but I see it in the context of State's effort to remove the degree of speculation about which we are in when the pipeline ^{starts} ~~is~~ to flow and when State revenue's can, to some degree begin to be hoped for.

Mr. Larry Eppenbach, L. E. Eppenbach, will explain to you now how our projections were made ⁱⁿ ~~and~~ some additional details, and some of the detail on the chart before you.

Thank you.

Thank you Commissioner.

Mr. Havelock. A little comments, perhaps, about now to explain the methodology used in discussing with Commissioner Wohlforth, Mr. Chairman, he acknowledged recognition that there is considerable complexity to the testimony as presented by himself and Mr. Eppenbach and if the Chairman wishes that...so that details are not lost in the minds of those

END TAPE 6

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

Date of meeting: March 7, 1972

MR. EPPENBACH: Mr. Chairman, Committee Members: In testimony already presented, you have heard a great deal about revenues, talks of pipelines, calculations of royalties and production taxes, and permitted dividends. Rather than to add more numbers, more formulas, more calculations, I think it would be prudent now to pause and develop perspective on the numbers already given to you about the many charts. To do this I should like to talk first about how the State brought all of its pipeline information together, to calculate what is ^{usually} the most important piece of information thus far--that is, the new estimates of total annual income from the North Slope. As has already been indicated, we employed a computer model which simulated each year the economic operation of the pipeline, the various conditions regarding ownership, financing, taxes, and earnings limitations. In a sense, an income statement was prepared each year for the owner of the line. This income statement does not appear so very different, at least in terms of these expressions, from that of any other income statement. Gross revenues to the pipeline are derived from its tariff charge in barrels of oil transported through the line. That gross revenue less the cost of operating and maintaining the line less depreciation less interest cost of financing the line will produce the net income figure. From that we deducted any Federal or State income taxes paid to calculate a net-after-taxes income. Similarly, the cash flows to a pipeline company is much like that of any other business, is equal to the net-after-tax income plus any additional cash flows which may be generated because the depreciation charge that is provided for in the income statement happens to be greater than the volume of bond retirements made by the company. The only place the pipeline operation appears different economically to that of the ordinary company is in the dividend payout allowed each year by the pipeline company to its owners. Again, as was discussed yesterday and this morning, that dividend is not some percentage of equity or some rate of return on capital investment,

but is a percentage dividend allowed on the valuation of the pipeline as determined by the ICC. The ICC valuation approach takes into account many issues: original cost of the line, depreciation, percentage increases for going concern value, and additional percentage increases for inflation. Our computer model had to also simulate this ICC valuation. In very general terms, during the first year of operation we calculated ICC valuation to be about \$3.25 billion. In the following years it decreased and increases slightly as additional phases of operation were under way providing for a higher throughput and eventually decreased in value as the line began to depreciated.

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

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

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

Under conditions of private ownership, a very different case develops. Here in the initial year a total of about \$37 million should accrue to the State. Where does it come from? Three million two hundred thousand dollars of it only comes from the North Slope in the form of gas royalty and production tax payments. This is gas that is assumed to be shipped in a trans-Canadian gas pipeline. The remaining \$34 million comes from State income taxes. In the 7 per cent dividend case displayed here there is no positive wellhead value for oil during the first two years of operation under private ownership. In this case, for there to begin to be some positive wellhead for oil during those first two years, the dividend payments must be no greater than 4.75 per cent, and even if the dividend was lowered to zero during those two years, the State's income of approximately \$53 million under those conditions would be, of course, less than one-third of that estimated as recently as last year.

I shall present at the close of the testimony this afternoon a series of cases for the Committee to study that explore this question of taxation and dividend limitation. For the present, however, let us return to these two cases that we have displayed before you. Again, they provide a legal 7 per cent ICC dividend. In the private case, even though a negative wellhead value is indicated for the first two years, it is quite possible that the oil companies would still pump oil as their true cost of shipping their own oil through their own pipeline may be different from their calculated cost of shipping the State's oil through their own pipeline. Not only is the dividend permitted legal, but together with the

costs and throughput capacity limitations as stated in the Impact Statement, this case of private ownership of the line appears quite possible. So are the revenues it generates.

That finishes my testimony. I believe now questions are in order.

CHAIRMAN: We'll take questions from the Committee, Senate group, Senate Commerce Committee; Senator ^{Groth} Groth?

SENATOR ^{Groth} GROTH: At one time when the legislative oil consultant testified before the Legislature he indicated that it would be possible that the oil companies may hasten the date on which the 2-million-barrels-per-day capacity goes into the line. Assumptions here, as I understand you, are based on the premise that ^{throughput} 2 million barrels per day will not be achieved for a period of seven years. My question is: Have you inquired of the companies as to whether they intend to hasten that throughput arrangement to sometime earlier than seven years?

WOHLFORTH: We plan to answer that, Senator ^{Groth} Groth. The official document which came to the State is dated August 1971, and received and analyzed about in the September-October time frame. We made reference as recently as Friday directly to the main impact Statement itself to determine where that seven-year throughput date was ^{in the} in the official Impact Statement. Commissioner Brewer called the several officials in Washington who could make that determination, and he has assured us that that is the figure that's there. I feel it's a figure we have to live with, and we may hear testimony from oil companies later that indeed that is not the correct assumption, but I really think that's a matter for them to ^{check} see to and perhaps Mr. Sparr, himself, whom I understand is the lead-off and direct witness.

GROTH: Eric, I understand that if you've looked at the Statement, but insofar

as a direct inquiry then, gentlemen, do you intend to do this sooner than seven years? That discussion, I gather, has not taken place.

WOHLFORTH: We've had discussions. I, personally, have not discussed it with any oil company official. Others have, may have, discussed it. I do not know what their direct answers may have been to that statement.

GROTH:
GROTH: Thank you.

CHAIRMAN: Thank you. Are you through? Senator Christiansen. Please stand up and speak up as loud as you can, please, so they can hear in the back.

CHRISTIENSEN: Mr. Chairman, yesterday just before we left I asked a question and I believe Mr. Havelock said that I would be answered later on. As a matter of fact I think you answered part of it when I asked the question came out where this bond, in case it didn't pass, then what would happen? Would we still have the pipeline or what would we do?

HAVELOCK: I think I indicated, Senator, that we are not now proposing that a bond issue be proposed to the people, but we do have a constitutional amendment to propose that will allow State guarantee. That question would be an academic one. There is always the question of whether the people or the Legislature of the State of Alaska wants to do something, and if the Legislature does not wish to do something, then ~~something~~^{nothing} will happen. The wishes of the people, the wishes of the Legislature are binding on the State.

CHAIRMAN: Are there any other questions? Senator Meland? Members of the, Senator Holm.

HOLM: Perhaps you can tell me why you only made it a ten-year projection or an eleven-year projection on this chart. What happens if project it to maybe 20 years?

EPPENBACH: For reasons of room and also time here, and having our ^{computer} results transmitted from Massachusetts to here in Alaska, we confined the analysis to specific years--first five years and then the eighth, tenth, and fifteenth year of operation. We have the ability to make a longer term estimate. We have analyzed ten years of operation with fifteen years of time periods overall. A more direct answer to your question--~~we tried~~^{in 1982} to establish in a graph to about 1988 within stock since you would be in Phase Three Operation at that point. They would tend to level off a bit. There may be some marginal increases but on the whole we would expect the effects of inflation to just about equal both in costs and in higher refining prices of oil.

HOLM: So then you expect the next ten years the distance would level--would start to narrow.

EPPENBACH: That's right. The capacity of the pipeline, as we understand it now, will not be increased ^{during these} in another ten years. It would take an increase in capacity to have those charts continue to move up right off the paper.

HOLM: Then one further question. If I were the Alyeska Pipeline Company and knew I wasn't going to get any additional profit from ownership and operation of the pipeline, I doubt if I'd contract with you to build at the same price that I would build if I were building for my own use. Now, are you assuming that they will build at the same price for you as they would build for themselves^{or is}?

WOHLFORTH: Well, I think we try to achieve comparability in the suit cases. I indicated in my testimony (I hope I sufficiently indicated) that we had now achieved something which we felt was a great deal firmer in concept than we had certainly last July. To achieve comparability in the one case versus the other the \$3.5 billion total landed cost of the figure was assumed. It may be, indeed, that that is not the ultimate price. It may be, indeed, that some of the \$3.5 billion cost is not an allocable, ascertainable cost of the State or some slight

amount may be more, but as a gross, and I should say perform an economic projection, we thought it would do the Committee a service to stay with the basic landed at stall cost figures.

HOLM: I also assume that you have not considered any other contractor for the construction of this pipeline because they are already the owners of all this pipe and a lot of construction so far.

WOHLFORTH: Mr. Campbell is far better--is he here this morning?

CHAIRMAN: Yes, he's here.

WOHLFORTH: Far better to speak to the composites of the \$3.5 million (\$3.5 billion --I guess I'll do that every five minutes for the next couple of days) which are set forth in the chart which is here before you and indeed there is a figure here which shows costs to date before start of construction and makes component references to costs thereafter. I defer anything further on that to Commissioner Henri.

? With your permission, may I comment first?

HOLM: I just wanted to assume (1) that Alyeska is the only party that you considered as being the contractor for this, and that they then will probably build in a little bit extra ~~cost~~ to the pipeline because they are almost a captive contractor.

HAVELOCK: First of all, Mr. Holm, the State ownership of the pipeline does not mean that there is no interest or profit available to the industry. Their interests and our interests basically identical in one respect--that we all expect to enjoy a substantial benefit to getting that pipe, that oil underground, and moving it to market, and the fact that the incidence of their benefit shifts from the profits obtained from the pipeline to other aspects of the chain of commerce

doesn't seem to me reduces their incentive. As to the particular incentives in operation, if the pipeline is owned by the State of Alaska and they are a contractor to build that pipeline, they have a particular incentive to operate with maximum efficiency in that construction because under the ICC rule the contractual costs will become the valuation base which we will in turn charge back to the shipping companies for the cost of transportation. So they would then have an incentive which in fact does not exist now to keep costs down. Thirdly, you touch upon a question, or applied in a question which I believe Senator ^{Cross} Groth commented on yesterday or addressed you yesterday, which is: What if the pipeline owner/company just don't cooperate? And I think there are three responses to that. First of all, the first response that comes to my mind is: What if the sovereign State of Alaska doesn't cooperate? This is not exactly a situation where the State is without bargaining position. Not only do we have bargaining position, but we also have a substantial interest. This is a situation where the private interest involved vastly exceeds the interests of the public of the State of Alaska.

I may say that in our discussions with the industry we have given some consideration to alternative contractors, but in our discussions have mainly assumed with the industry that in the event that public ownership was deemed to be in the public interest that in fact they would be willing and agreeable to contract. Once they get by the hurdle of public ownership in the first place, as a question of State public policy, I don't believe that we would expect their non-cooperation. There has been no sign in the hundreds of man hours we had in talking with various representatives of the industry that they that they in any ultimate sense, that ^{the industry} they would refuse to cooperate. They approach our negotiations with the most--we have had occasional confrontations--type of meetings where tempers where tempers have got up, which is expectable under the circumstances, but they have approached it by and large as a gentleman and

responsible businessman. I have not heard anybody speak in the terms used as to noncooperation. Which reminds me of Commodore Vanderbilt's famous line: "The public be damned--ain't it my railroad?" Nobody has said to us: "The public of Alaska be damned--ain't it our pipeline?" So in the discussions we had, rather than and the people of the State of Alaska, our discussions have pretty well worked themselves out based upon feasibility and the desirability from the point of view of the public policy of the State, and the extent of the commitment or sacrifice that we might be calling upon the industry to make in adjusting these new arrangements. And it is not only a question of sacrifice, of course, but of benefit to the industry. We have not asked them to give up, without compensatory advantages, which we can see for the industry in these arrangements.

The last point I might make on it is that we aren't really going to find out where we are until we have the tools, that is, the permissive legislation which would enable us to go forward and talk with them and move into the next stage of negotiation with the industry based upon an authority bill that the Legislature might adopt. I think it is first for the Legislature of the State of Alaska to decide whether it is the public policy of the State, or should be the public policy of the State, to have public ownership of the line and then to ask questions as to what the attitude of the industry is and whether they are willing to go along rather than the other way around.

Sorry to have talked at such length, but that does meet some of your points.

CHAIRMAN: Are there any other questions on State affairs? Senator Christiansen.

CHRISTIANSEN: Mr. Chairman, I hate to keep asking this question, but talking about \$3.5 billion, and if we don't bond outsel^{ves}f, where are we going to get that \$3.5 billion to build the pipeline? Then if we do build it, are we going to use

this first revenue to pay it back, or?

WOHLFORTH: I may just point out that the pipeline income here is shown under public ownership. This income is after debt service, Senator. Debt service is off before you get to this, that's been calculated. On the assumptions we've made so far, the debt service is shown as a deduction from gross income and this is net income, and I think that may answer a tiny portion of your question. It is assumed that the money would be borrowed in all events.

CHAIRMAN: The next three witnesses will be addressing themselves to the question you raised as to the market situation. Senator Young.

YOUNG: Will we be allowed to call any of these witnesses back again?

CHAIRMAN: That's the plan. The reason we're departing from the regular procedure is that because this witness will probably not be available at that time. Address questions to the administrative or administration officers. Mr. Rose.

ROSE: Only one question. That's on the difficulty on our payment during the initial payment period. That revenue starts going in. Now, I assume that the bonds require a yearly net interest payment, and how would that be met?

WOHLFORTH: Again, we'll address more specifically the ^{level of} authority bond issue by Mr. Kades. As with other public authority issues, interest is borrowed or capitalized during the construction period.

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

RETTIG: Question to Mr. Wohlforth. You referred to the first table ^{in the} income from the pipeline under "Private and State Ownership." In the year 1988 you called our attention to the sharp drop in pipeline income from \$235 million

in 1983 to \$183 million in 1988, and I believe you attributed that to the impact of depreciation that had then taken place. Recalling Mr. Temple's testimony of yesterday, it indicated that pipeline valuation, which is the base ICC permitted profit, you stated, I believe that this valuation was based on replacement costs. Well, what effect would this depreciation have then, if that be the case?

WOHLFORTH: First, let me say, Mr. Chairman, I'm going to turn this over to Mr. Eppenbach who will have the full text of Mr. Temple's testimony before you hopefully within an hour or so, and you take it away on that basis, Larry.

EPPENBACH: Senator, replacement cost is clearly a function of replacement from original cost. The higher the value of the line, then, the larger the dividend, assuming a constant rate of dividend, whether it be 5.5 or 7 per cent, or higher. Now, ^{Palmer} ~~Herbert~~ Temple did testify that replacement cost was a significant component of the ICC valuation formula. In developing this model to simulate what ICC valuations would be in any particular year, we did include a percentage inflation factor to estimate replacement costs. We found, however, that the formula was quite complex, and in later years it was also ~~component~~ of the formula, we'll call that depreciation, so that the net effect was yes, inflation was there ~~it was building~~ up the value of the pipeline for a period of time, but then eventually using the ICC's own table for depreciation. The value of the pipeline fell off. Now, I can't tell you more than that right now other to say what we did--what will happen--how the ICC will value the pipeline. As far as I'm concerned, it is a matter of great uncertainty right now. Thank you.

RETTIG: That's all I have.

CHAIRMAN: Are there any questions now from other members of either the House or the Senate? Senator Palmer.

PALMER: Yes, Mr. Chairman. Perhaps this information has already been given

and, if so, please forgive me, but I do have four questions--they are all related. We will all hope, of course, that there will be many more structures found on the North Slope that will use the pipeline. On the other hand, we have to assume that there may not be. Therefore, what figures do you ^{have} for ^{Prudhoe} First of all for total Bay Reservoirs and then the amounts recoverable? We did think of that yesterday, I think, but I would like to know what figures you used.

WOHLFORTH: Really, Mr. Herbert is the expert witness on this subject. We know, Senator Palmer, that 9.4, which is the de ^{Gaulle} Gaulle, or 9.6 billion, which is the de ^{Gaulle} Gaulle-McNaughton proven reserve estimate, has been variously assumed to have been increased to \$14 billion, and in a Canadian magazine referred to as 50 billion in the total field and adjoining field. The figures that we used, very frankly, showed enough oil to flow for 25 years to amortize at the rates of, amortize a \$3.5 billion bond issue.

PALMER: Do you have that figure?

EPPENBACH: No sir. We made that assumption that given the ^{9.6 billion barrels} 9.6 billion barrels proven today that there would be additional ^{reserves proven} (cough) by the time ^{after the fact or} (cough) the last bond issue was issued to support a 25 year debt. They contrasted that on private financing, that is, ownership of the line by private industry. We calculated 30-year debt, assuming they would also ^{budget} their credit ^{internal} on their bonds.

^{billions of dollars} PALMER: You are basing the debt service on the assumption that there will be a reserve found? The pipeline will be utilizing those reserves in addition to the Prudhoe reserve?

WOHLFORTH: That's correct.

^{follows} : That concludes my group of questions

CHAIRMAN: Are there any further questions? Senator Rettig.

RETTIG: Just one item of clarification to Mr. Havelock. Perhaps in your

in reference to your comments that the State does have a certain amount of bargaining power because its, etc.

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

TAPE # 8

Senator Rettig: The oil that we are speaking about, have we not already sold the 7/8th interest in that oil and is not that now ^{the} a right to the 7/8ths of the oil invested in the oil companies, doesn't this perhaps give them some sort of a weighted vote in these matters:

Havelock: Well I think that certainly in our discussions Senator, we have attempted to weigh and recognize the private rights that are involved, and I don't mean by any means to suggest that the private rights of the industry should not be given all the considerations appropriate. While the oil is in the ground, my understanding is that it is the oil of the people of Alaska and if the leases are not exploited it will revert to the people of Alaska, but certainly you are quite correct that 7/8ths that one, as the oil comes out of the ground, it's theirs and it is entitled to be given recognition as we recognize any body else's right to private property in the State.

Senator Rettig: Are there any other questions now? (Ten minute break)

The State of Alaska would like to call the Honorable Joseph Henri, Commissioner of Administration who will testify as to the impact of State revenues on the State budget and related issues. I ^{may} state as Mr. Henri has found, that in discussion with him he has indicated that he would like to have the opportunity to get full presentation before the committee in advance and that ~~if~~ he has no objections to questions relating to his testimony when he concludes his remarks. I would like further to say with regards to, I said the later witnesses would be answering Senator Christianson's questions, I was really referring to Mr Kades, Mr. Gilderhouse, and Mr. Macy who are the witnesses that follow Commissioner Henri.

Joseph Henri: Written Testimony

TESTIMONY OF JOSEPH R. HENRI
Commissioner of Administration, State of Alaska,
Before the Senate Commerce Committee
And the House State Affairs Committee
At Juneau, Alaska, 6 March 1972,
Regarding Income From North Slope Oil and Gas,
And How it Affects the State Budget

Mr. Chairman and Members:

I am Joseph Henri, Commissioner of Administration. This part of the State's presentation deals with budget expenditures vis-a-vis income to be derived from North Slope oil and gas extraction. The essential questions are:

1. Will we be able to maintain our current level of services, adjusted for population growth and inflation?
2. Will we be able to increase our level of service to meet compelling needs recognized by this administration, the legislature and the citizens of Alaska?
3. Will we have to reduce our level of service, and if so, what are the activities affected?

The answers to these questions rest in the amount of dollars the State can expect as its share of the Prudhoe Bay oil basin. Once upon a time, the Department of Administration felt much more certain about future State income than it does today. When will the

pipeline begin? What extraordinary man-caused interruptions will delay its completion? What will be the first year capacity of the line? The second year? The third? What is the maximum extraction rate the basin structure will prudently allow? What volumes of oil can be expected in any of the first seven years of the pipeline? What will be its final cost?

All of these variable factors, well known to each of us in this room, make budget planning extremely difficult, because the major part of Alaska's State revenue has come and will come from ~~the~~ North Slope resources. In the budget now pending before the legislature, we have recommended a total general fund expenditure of \$311.7 million; ^{these are state dollars} of this sum, \$97 million will have to come directly from the Prudhoe Bay bonus money, the principal, and \$52 million more from interest earnings on the investment. As we dip heavily into the corpus - invade the principal - interest earnings diminish, compounding the revenue problem. Our present or anticipated recurring revenues are simply too low to fund our present and anticipated expenditures. We are depleting our savings account. As the following year's budget figure increases, more of the principal will have to be spent; the interest yield will dwindle further. Obviously, we will soon hit the bottom of the barrel. Only large and new revenues from the North Slope can allow us to continue our present budget growth rates.

What is the growth rate we have recommended for Fiscal Year 1973? For the general fund, it is 3.5%; for the total budget, 4.6%. We have had to slash so dramatically the rate of increase because pipeline delays and cost escalations have darkly influenced

our future revenue projections. With ~~such~~ a small increase in the budget, a number of programs have already felt the chill winds of dollar scarcity. The proposed Fiscal Year 1973 budget contains such unpalatable things as holding school foundation funding to the current year's level, regardless of enlarged student population; keeping the University's ^{of Alaska's} increase to \$800,000 in the face of a claimed need for an addition of over \$5 million just to maintain current activities; a limitation of nursing home care and general medical relief; foregoing general obligation bonds for lengthening two more ferry boats, and for a larger program of airport construction. There are many more "pinches" in the budget, besides ^{those I have mentioned.} Nonetheless, so far we have not jeopardized any State activity essential to health and safety. These painful adjustments herein noted were recommended in spite of the fact oil was projected on stream in July 1976; now another year's delay - or more - seems probable. The consequences are obvious.

Our budget book for Fiscal Year 1973 projects a growth rate of 6% compounded annually through 1976, and 8% thereafter through Fiscal Year 1981; covering a ten-year period. Further, it envisions capital improvement bond authorizations of \$60 million in 1974, and \$100 million in the next biennial election, and each one thereafter. I can only characterize these projected budgets as "modest." They are very little more than maintenance figures. Program dollars will still be limited. Careful budgeting and allocation will still be required. New starts and new programs will be exceedingly selective. The 6 and 8% growth rates most likely ^{are highly} mean a shortage of funding for the school foundation plan, and for the revenue sharing program with local governments. Yet, I express to you, ^(No. 1000) the gravest concern that actual receipts in the State treasury during the next ten years may be pitifully shy of the sums needed even to maintain our austerity.

Previously, in the testimony of Commissioner Wohlforth and the Department of Revenue, test cases have been articulated regarding revenue to be derived under (A) private ownership and (B) State ownership of the crude oil pipeline. All of us realize that a multitude of variations in revenues and expenditures are possible under each heading, that is under private ownership or ^{public} ~~public~~ ~~ownership~~ ownership. Nevertheless, for purposes of comparison we have presented two likely cases and their dollar results: Both examples entail the seven-year oil volume build up delineated in the Department of the Interior Environmental Impact Statement submission by Alyeska, a 7% dividend to the owner, a line cost of \$3.5 billion, and oil on stream in July 1977.

Exhibits A and B, attached at the conclusion of these remarks, portray the figures - and the story - for the decade 1972 - 1982.

We might just pause, Mr. Chairman, and refer the committee to those for a second if I may. Exhibit A is the computer run on private ownership, and you can see the assumptions that go into these calculations, the debt service for each year on these bonds, the growth rates of the budget for each year, and so forth. Then Exhibit B, are the same assumptions, identical assumptions based on private ownership. I beg your pardon, Mr. Chairman, Exhibit A is the private ownership and Exhibit B is the public ownership. As you can see the bottom column of the right hand side in exhibit A that is the general fund at the end of the fiscal year 1982, has a deficit of \$1,135,000,000 under the private ownership case, whereas in exhibit B, the general fund in the lower right hand column at the same year at the ~~end~~ end of fiscal 1982, has a surplus in it of \$450,000,000. Those runs of course need to be carefully studied and I shan't take up your time this morning with them.

Under the private ownership case, Exhibit A, were Alaska to continue to increase its budget expenditures at the 6 and 8% rates, mentioned earlier, the first year of

deficit would be Fiscal Year 1978, wherein we would experience a shortfall of over \$156 million. This shortage would increase so that by Fiscal Year 1982 the deficit would be \$1,135,000,000. Of course, deficits for operating expenditures are in fact impossible under our State constitution; instead of experiencing a billion dollar deficit ten years from now, we would in actuality have to reduce State expenditures radically.

Under the private ownership case the State could have in its treasury at the end of Fiscal Year 1982 the sum of \$45 million if, and only if, its operating expenditures in every year of the planning decade rose annually by only 1%. Now an increase of 1% equals in fact a huge cut in all programs, and the elimination of many. And what the figures look like in that case are portrayed in Exhibit C which is the computer run showing budget increases of 1% annually over that period. And, the assumptions there are the same, the assumptions as of the first two exhibits; when the line will start and through what volume and so forth.

The dollar crunch is graphically portrayed by the following paradigm. Under the private ownership operating budget column, increasing annually at 1%, the available dollars, are, recorded. And there, Mr. Chairman, if I may direct the committee's attention to the following page of my testimony, page 6, to the paradigm which is also available, I thought they were in big figures, they are when you try to see them on the wall over Mr. Weiner's head. In the charts called "Comparison of Funds Available, Private vs Public Ownership, and I might say all these figures are in thousands so that actually the figures on the paradigm are in millions of dollars. It addresses itself only to our operating budget. Now this year for a base of reference in our budget book is \$276 million. This figure is referenced in my testimony under fiscal year 1973. So getting into the 1974 budget, which is the one the legislature will be considering just next year, you already begin to see a difference in available dollars under public and private ownership, whereas under public ownership in 1974 we would have available to spend approximately \$293

million, under the private ownership plan there would only be available \$279 million. And so forth on up where you get into very dramatic areas. Let's compare, for instance, fiscal year 1978 which isn't too many years away, under State ownership of the pipeline in the example we furnished you here, the state would have to spend on operations, that's not the total budget, just the operating portion, \$384 million whereas under private ownership the state would have to spend in the same ^{YEAR} for operations, \$290 million. Almost \$100 million difference in that year. And as we say at the end of the column of figures the difference over the planning decade, in operating expenditure ^{OPERATING DOLLARS} the State would have available to it ^{IS} ~~would be~~ \$925 million. The difference in debt authorizations, that is ^{CAPITAL} ~~capital~~ improvements, ^{the number of buildings and other improvements} ~~what~~ the legislature and the people would authorize, ^{WHAT WE COULD AFFORD} ~~is~~ a difference of \$365 million, ^{WORTH OF BUILDINGS} ~~is~~ a difference of \$365 million.

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

if private ownership budget column could be
~~The~~ Contrast ¹ these with the operating budget under public ownership, ~~the first~~ column on the left. The ~~figure~~ shows that if the State of Alaska owned the pipeline there would be sufficient dollars in each of the next ten years to meet our planned 6 and 8% annual increases. In fact, the revenue would be sufficient to raise the budget from these maintenance or austerity levels so that expansion of present services and the addition of new ones could be handily realized. Were the oil line privately owned the State would have almost a billion less dollars to spend over the next ten years. ^{and} We would be able to authorize 365 million fewer dollars for capital improvements.

THATS
I might say, Mr. Chairman that the 6% and 8% increase in the budget ~~which is~~ portrayed in our budget books ^{SUBMITTED} presented to you in January, ^{BY THE GOVERNOR} those increases were projected on the State Revenue Projections figures which Commissioner Wohlforth and Mr. Eppenbach ^{TO THE COMMITTEE EARLIER} discussed in great detail ¹ this morning. Now the projections are not valid because the revenues will not materialize at the dollar amounts portrayed to you in the revenue book. Going on to page 7.

*You might just
truly look at the
Mrs. Chairman.*

The attached graphs, Exhibits D and E, portray what I have been saying. Exhibit D is on the front of the room ^{behind the} and ^{SO-CHAIRMAN-behind MRS BRICSON} it shows in graphic form what we have just testified to, that if the budget went up at the 6 and 8% rates under the private ownership example here, the general fund would be depleted, completely depleted in January of 1978, in the middle of fiscal year 1977, that is the blue line on the left of the chart. Whereas under public ownership, State ownership of the pipeline, the State general fund would dip to a low of \$231 million in the fiscal year 1976 and go up at the end of the decade we're speaking of, 1982, to about \$450 million in the Treasury. That's exhibit D, Exhibit E is the graph portrayal of Exhibits B and C. In other words Exhibit B is the public ownership case raising the budget at 6 and 8% and Exhibit C is the private ownership case, you might say the subsistence case, whereby the State budget would go up 1% annually. And if the State budget were to go up only 1% annually under the factors given in our private ownership example here the State treasury would have \$45 million dollars ^{in '82} by 1982. But as I say, all of the programs we have believed in would have been decimated thoroughly.

In Exhibit D, under private ownership of the oil pipeline, the general fund would be depleted around January of 1978. On the contrary, under State ownership of the line, the precipitate dive to insolvency would stop in 1976 at a general fund balance of \$231 million, and rise to a plateau of \$450 million in the general fund by 1982. Furthermore, as Exhibit B shows, the total expenditure for that year would be approximately \$605 million, and the total revenue \$602 million; a parity between income and expenditure would have been achieved, and a surplus of almost half a billion dollars enjoyed. In actuality, no doubt, were the funds from State ownership available, the administration and the legislature would have expanded the budget faster than the 8% increase portrayed for the years 1977 and beyond so that no such surplus would likely exist at the end of fiscal year 1982.

The private ownership case I have presented to the Committees, Mrs. Chairman,

necessitates an abrupt and drastic reduction in State services and activities. I cannot tell you with certainty where the administration or the legislature would cut, but I can cite a few startling and likely areas of impingement in each of our program categories:

The State pays approximately 90% of local ~~sk~~ school district costs, constituting roughly 30% of annual State dollar expenditures. That State aid would be materially reduced; it would be impossible for the local areas to maintain present educational standards through increased property taxes. State Operated Schools and the University of Alaska would have to radically abate their present service levels.

The welfare or social services activities of the State would experience vast curtailment in the number of eligible^{5/2} cases and the amount of benefit dollars; many people would be compelled to leave Alaska; distress or even starvation would haunt many who decided to stay. Public health and mental health retrenchments could force the closing of the Alaska Psychiatric Institute, and a diminution or abolishment of the State's work in drug abuse, alcoholism, tuberculosis testing and venereal disease control. The necessitated nullifications of State expenditure in these areas will in turn lose large amounts of federal dollars now enjoyed. Our ability to operate and maintain an effective Pioneers' Homes program will be materially impaired.

No new fish hatcheries would be built. No hunter safety program would be initiated. Salmon yields in Southeast Alaska would remain significantly below maximum sustained yield. Land use planning and the inventorying of our natural wealth would be jeopardized, thus making management of the State's surface and subsurface resources haphazard at best. Added park and recreational sites would be forgotten, and the maintenance of existing facilities lessened. Many Alaska communities would remain without sewage treatment facilities. Programs for coastal zone management, environmental engineering, permafrost and soils engineering would likely be abolished.

In the category of Public Protection, disaster planning, the Public Utilities Commission, the Alaska Transportation Commission, and most consumer protection programs would be impaired or fatally weakened.

The State police would experience a great shrinkage in manpower, and the courts and their ancillary agencies could not cope with their workloads.

Tourist promotion would have to be seriously curtailed and our work in research, in community improvements and grant assistance, and conventions and trade shows would most likely fall by the board. The work of the agricultural loan fund and the small grain incentive program would be enfeebled or eliminated. The Division of Planning and Research and the State Economic Opportunity Office would be crippled or possibly dropped.

Our program of revenue sharing with the local governments, around \$7 million in the current year, would no doubt go out the window. The Marine Transportation System for Southwest Alaska would likely be eliminated, and service in Southeast materially contracted. Airport maintenance in rural Alaska would be severely curtailed, likely forcing the winter closure of those ports, thus isolating a large part of Alaska for five months of the year, denying medical and other critical services. Likewise, winter maintenance of many of our highways would be only a pale reflection of the excellent job being performed today.

The various boards and commissions whereby Alaskan citizens take a direct and active part in the work of the State government would be minimally funded, or in some cases, unfunded. I am speaking of activities like the Western Interstate Conference on Higher Education, the Athletic Commission, the Status of Women Commission, the International Development Commission, the Pioneers' Advisory Board, the Yukon-Taiya Commission, the Rural Affairs Commission, the International North Pacific Fisheries

Commission. Our Youth in Government program, recently instituted with such great success, would likely be abandoned.

I might say, Mr. Chairman, that I notice a certain aura of disbelief when I recite these cuts here, but I can tell you from my own experience as chairman of the budget review committee, that each one of these representations I have made, is made with a lot of insight and forethought, and I am absolutely confident that if the revenues materialize as projected under the private ownership case, very many of the exact programs I have mentioned will have to be severely cut or even abolished. There is no other way to do it, our State does not have the ability to, as you know, _____ with huge annual deficits. We have to make our budget balance. I do not represent to you as the view of this administration, that each of these reductions suggested above, would come to pass under the private ownership case, where trade in Exhibits A and C. Nevertheless, no one can say that many of the above dire consequences would not eventuate under that case. Undoubtedly some would. The ~~an~~ economic and social dislocation would be grievous indeed.

The purpose of my remarks is that this State has a vital interest in an adequate share of North Slope riches. If we do not realize that share, State expenditures over the next decade will be woefully inadequate to do the job Alaskans expect from their government. The solution we propose to sufficiently fund the budget is the ownership of the crude oil pipeline by the State of Alaska.

I thank you for your attention.

mc 1/4 E

Groh: May we have questions now from the members of the Senate.

COMPARISON OF FUNDS AVAILABLE

PRIVATE VS PUBLIC OWNERSHIP

(ALL FIGURES IN 1000)

FISCAL YEAR	PUBLIC OWNERSHIP		PRIVATE OWNERSHIP	
	OPERATING BUDGET *	DEBT AUTHORIZED	OPERATING BUDGET *	DEBT AUTHORIZED
1972	260186.5	71000.0	260186.5	71000.0
1973	276232.7		276232.7	
1974	292910.7	60000.0	278994.8	15000.0
1975	310485.1		281784.3	
1976	329114.1	100000.0	284601.8	20000.0
1977	355443.1		287447.4	
1978	383878.5	100000.0	290321.5	20000.0
1979	414588.8		293224.3	
1980	447755.8	100000.0	296156.1	20000.0
1981	483576.2		299117.3	
1982	<u>522262.2</u>	<u>100000.0</u>	<u>302108.1</u>	<u>20000.0</u>
TOTAL	<u>4075433.7</u>	<u>531000.0</u>	<u>3150174.8</u>	<u>166000.0</u>

* All figures refer to expenditure from general fund only
 Difference in Operating Expenditure is over \$925,000,000
 Difference in Capital Debt Authorization = \$365,000,000

Exhibit A

STATE OF ALASKA
DIVISION OF BUDGET AND MANAGEMENT

BUDGET PLANNING MODEL

Private

RUN ID RUN 3
DATE MARCH 3, 1972
COMMENTS

PRIVATE OWNERSHIP
7% TARIFF
BASE CASE
OIL IN 77

ASSUMPTIONS

ANNUAL RATE OF INTEREST ON GENERAL FUND = 6.00%
ANNUAL RATE OF INTEREST ON NEW BONDS = 6.00%
MATURITY PERIOD ON NEW BONDS IN YEARS = 20.
% ABOVE G.F. UNENCUMBERED BAL. UNEXPENDED = 0.0 %

GROWTH RATES FOR OPERATING EXPENDITURE FROM PRIOR YEAR

1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
6.2%	6.00	6.00	6.00	8.00	8.00	8.00	8.00	8.00	8.00

NEW BOND AUTHORIZATIONS IN EACH YEAR

1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
71000.0	0.0	60000.0	0.0	100000.0	0.0	100000.0	0.0	100000.0	0.0

FISCAL YEAR	NON INVESTMENT REVENUE	INVESTMENT INTEREST	TOTAL REVENUE	OPERATING EXPENDITURE	DEBT SERVICE	MISC EXP SHD TAXES GF CAP EX	TOTAL EXPENDITURE	SURPLUS OR DEFICIT	GENERAL FUND END OF YEAR
1972									761266.2
1973	162269.1	42496.7	204730.7	276331.0	24020.8	11358.6	311710.3	-106979.6	654288.4
1974	182367.0	35772.1	218139.0	292910.7	29666.2	11756.5	334313.4	-116174.4	538114.0
1975	190047.0	28146.4	218193.4	310485.1	329731.5	17769.8	356208.4	-138015.0	400099.0
1976	136752.0	18960.8	207712.8	329114.1	33479.2	13200.6	375813.8	-168171.1	231927.9
1977	220569.0	8673.9	229242.8	395441.1	35373.3	13153.0	403969.4	-174726.6	57201.4
1978	225954.9	-2938.6	222966.3	383878.5	39390.5	13719.0	436938.0	-214021.8	-156320.4
1979	314776.0	-14823.9	299952.1	414588.8	42474.9	23358.3	480441.8	-180469.8	-337310.1
1980	329299.9	-26743.6	302556.3	447755.8	46529.0	25105.1	519389.9	-216833.6	-554143.8
1981	332012.4	-41200.4	290811.9	483576.2	47129.4	25167.5	555873.0	-265061.1	-819264.8
82	344154.7	-59641.5	285513.1	522262.2	52863.3	8.5	60182.0	-216210.9	-1135315.0
	249019.0	-10379.5	247981.0	381634.5	383899.9	17696.8	637592.0	-1896782.0	

AGD 530752

Exhibit B

STATE OF ALASKA
DIVISION OF BUDGET AND MANAGEMENT

BUDGET PLANNING MODEL

Public

RUN ID RUN 4
DATE MARCH 3, 1972
COMMENTS
PUBLIC OWNERSHIP
7% TARIFF
BASE CASE
UIL IN 77

ASSUMPTIONS

ANNUAL RATE OF INTEREST ON GENERAL FUND = 6.00%

ANNUAL RATE OF INTEREST ON NEW BONDS = 6.00%

MATURITY PERIOD ON NEW BONDS IN YEARS = 20.

% ABOVE G.F. UNENCUMBERED BAL. UNEXPENDED = 0.0 %

GROWTH RATES FOR OPERATING EXPENDITURE FROM PRIOR YEAR

1974	1974	1975	1976	1977	1978	1979	1980	1981	1982
6.2	6.00	6.00	6.00	8.00	8.00	8.00	8.00	8.00	8.00

NEW BOND AUTHORIZATIONS IN EACH YEAR

1974	1974	1975	1976	1977	1978	1979	1980	1981	1982
71000.0	0.0	60000.0	0.0	100000.0	0.0	100000.0	0.0	100000.0	0.0

FISCAL YEAR	NON INVESTMENT REVENUE	INVESTMENT INTEREST	TOTAL REVENUE	OPERATING EXPENDITURE	DEBT SERVICE	MISC EXP SHD TAXES GF CAP EX	TOTAL EXPENDITURE	SURPLUS OR DEFICIT	GENERAL FUND END OF YEAR
1972									761268.2
1973	162264.1	42466.7	204730.7	276331.0	24020.8	11358.6	311710.3	-106979.6	654288.4
1974	182367.0	35772.1	218139.0	292910.7	29646.2	11756.5	334313.4	-116174.4	538114.0
1975	190047.0	28146.4	218193.4	310485.1	32973.5	12749.8	356208.4	-138015.0	400099.0
1976	188752.0	18960.8	207712.8	329114.1	33474.2	13299.6	375883.8	-168171.1	231927.9
1977	430209.0	15116.4	445325.4	355443.1	35373.3	14482.8	405299.1	40026.3	271954.3
1978	434394.9	16675.3	451070.2	383876.5	39390.5	15217.0	438486.0	12664.2	284558.4
1979	547066.0	19533.7	566599.7	414588.8	42494.9	27486.9	484570.4	8209.3	366567.7
1980	550369.9	23532.2	573902.1	447755.8	46529.0	28341.7	522628.5	51273.6	417841.3
1981	567522.4	26121.0	593643.3	483576.2	47129.4	28359.7	559065.2	35018.1	452859.4
1982	575119.7	27090.4	602210.1	522262.2	52033.3	29747.4	604042.9	-2767.8	450156.6 +
	3320529.0	253634.8	4041965.0	3316342.0	383899.9	195111.9	4391075.0	-311111.4	

AGD 530753

Exhibit C

STATE OF ALASKA DIVISION OF BUDGET AND MANAGEMENT

BUDGET PLANNING MODEL

RUN 10 RUN 3
DATE MARCH 3, 1972

COMMENTS
PRIVATE OWNERSHIP
7% TARIFF
1% GROWTH
GREATLY REDUCED CAPITAL EXPENDITURES

Budget
Increases
Annual

ASSUMPTIONS

ANNUAL RATE OF INTEREST ON GENERAL FUND = 6.00%

ANNUAL RATE OF INTEREST ON NEW BONDS = 6.00%

MATURITY PERIOD ON NEW BONDS IN YEARS = 20.

% ABOVE G.F. UNENCUMBERED BAL. UNEXPENDED = 0.0 %

ANN OPER EXPEND GROWTH RATE AFTER 1ST YR = 1.00%

NEW BOND AUTHORIZATIONS IN EACH YEAR									
1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
71000.0	0.0	15000.0	0.0	20000.0	0.0	20000.0	0.0	20000.0	0.0

FISCAL YEAR	NON INVESTMENT REVENUE	INVESTMENT INTEREST	TOTAL REVENUE	OPERATING EXPENDITURE	DEBT SERVICE	MISC EXP SHD TAXES GF CAP EX	TOTAL EXPENDITURE	SUPPLUS OR DEFICIT	GENERAL FUND END OF YEAR
1972									761268.2
1973	162264.1	42469.7	204733.8	276232.7	24020.8	11358.6	311612.0	-106878.3	654389.8
1974	162367.0	36208.7	213575.7	278994.8	29646.2	11756.5	320397.5	-101821.8	552567.9
1975	170067.0	29928.1	219975.1	281784.3	32973.5	12749.8	327507.6	-107532.5	445035.4
1976	186752.0	23147.4	211899.3	284601.6	32478.4	13290.6	330390.6	-118491.3	326544.1
1977	220569.0	16705.2	237274.2	287447.4	32921.2	13153.0	333521.5	-96247.3	230296.8
1978	225954.9	10787.1	236741.9	290321.5	33723.5	13719.0	337764.0	-101022.1	129274.8
1979	314776.0	6882.4	321658.3	293224.3	34212.3	23358.3	350794.8	-29136.4	100138.3
1980	329299.9	5394.7	334694.5	296156.1	33887.2	25105.1	355148.3	-20453.8	79684.5
1981	332012.4	4182.2	336194.5	299117.3	31872.0	25167.5	356156.8	-19562.3	59722.2
1982	344154.7	3140.6	347295.2	302108.1	33246.7	26698.5	362053.3	-14758.1	44964.1
	2493194.0	176845.6	2659040.0	2849986.0	319001.6	170000.0	3385343.0	-716303.9	

AGD 530754

Exhibit D
ENDING GENERAL FUND BALANCE

Private vs Public Ownership
Budget Book Expenditure Plan

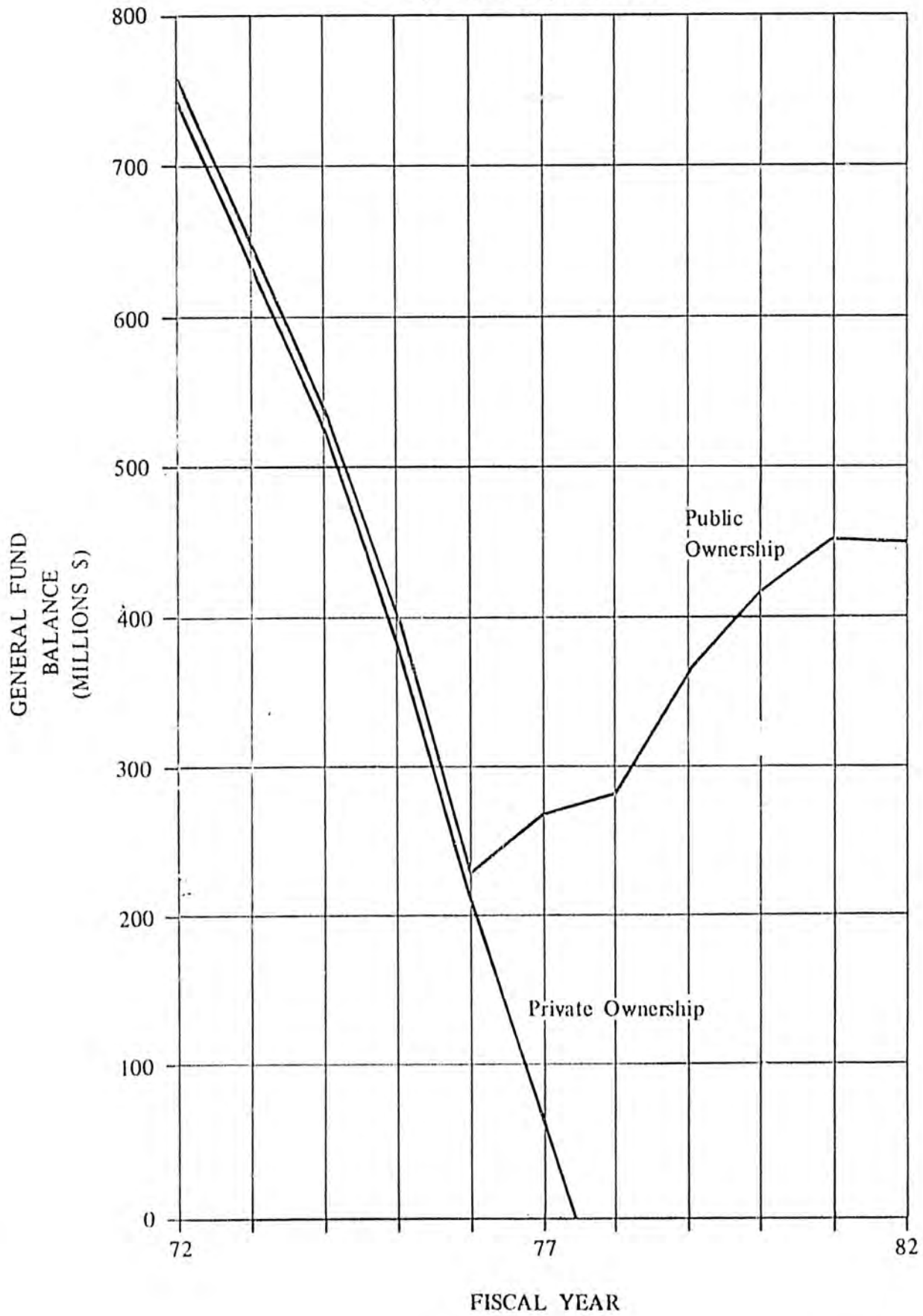


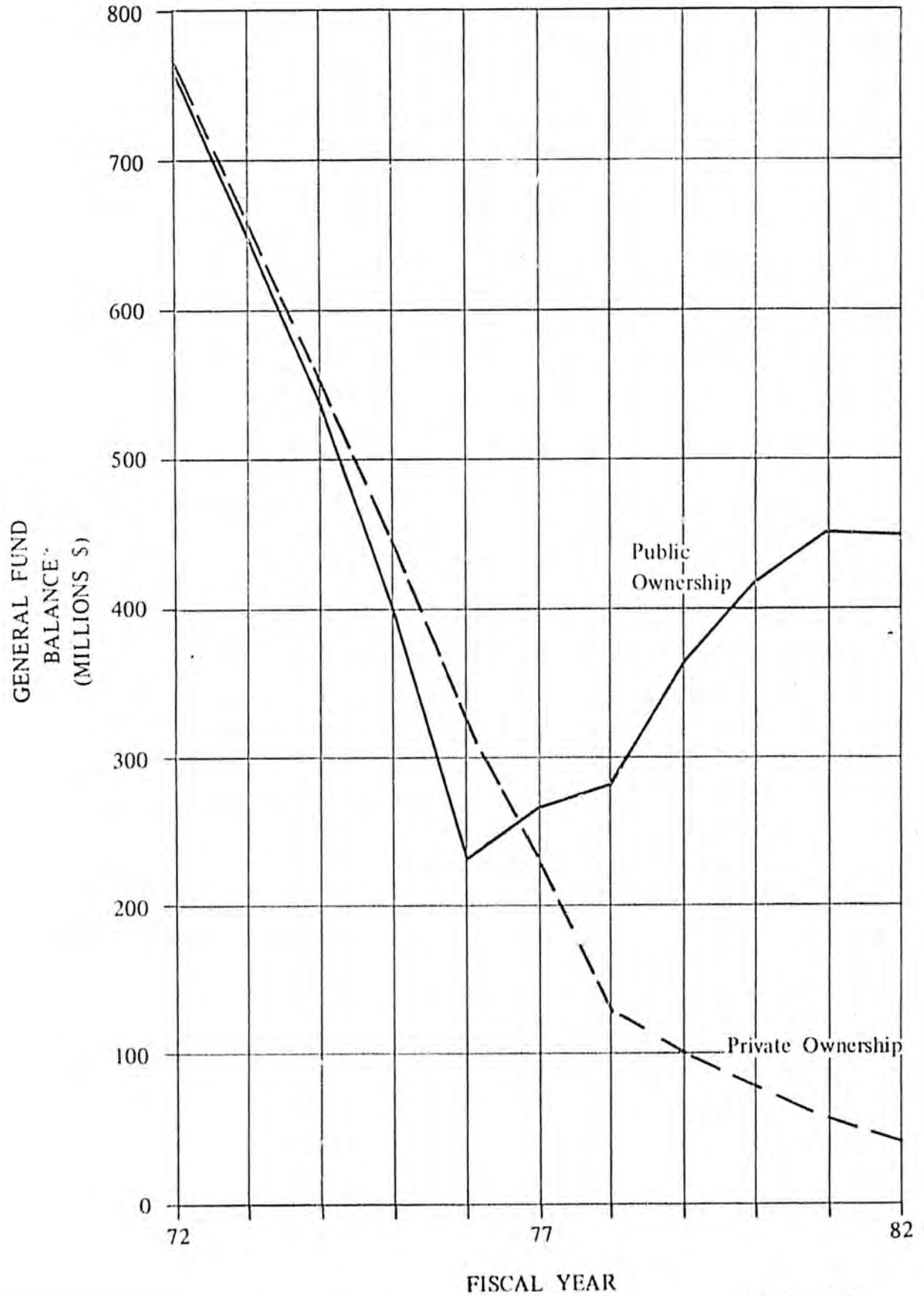
Exhibit E

ENDING GENERAL FUND BALANCE

Public Ownership Budget Book Expenditure Plan

vs

Private Ownership Subsistence Expenditure Plan



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

TAPE # 9

... Groth: ... selected land less valid federal leases, and just the other day here within the last couple of months we have selected another 77 million acres. You anticipate no revenues from any of these places?

Henri: Senator, the examples I have given you, A and C on the private case do not contain any private ownership, any further income of the ^{Private} ownership case but I'd like to fortify or expand on that observation by saying the amount we are spending over income right now is about \$150,000,000 over ^{income} this year and as the budget increases, the dollars over income will expand rather dramatically and so except for the Prudhoe Bay oil ~~in~~ in those huge volumes there would be no way in my estimation to lift further bonus sales ^{or some} from other economic development to make up the dollars we need to increase the budget even by 6% to say 8%, so let me say that just by general allusions of possible sales and possible income we analyze ~~taxxtdl:xxxxdunxx~~ those possibilities the dollar volume is not there.

Groth: It still remains inconceivable to me ^{if you can} to make \$900,000,000 out of 400,000 acres which is what we did, you have a million and a half ^{right} acres there in round figures, I don't know what the correct figure is, but that is what Chuck testified to, and if you've got 77 million acres of additional land or at least in that portion ^{if it} which we're going to get out under the Statehood act, whether that's 77 million acres is it or not, I don't know how you can conceivably say that that is going to produce zero money. And in the case of the public versus private ownership of the pipeline you say that that is going to produce zero money in order to argue for the public ownership, it just doesn't seem reasonable. I can't conceive that nothing is going to come out of that.

AGO 530757

Henri: Senator, I am addressing my remarks for the next planning decade not presume for the next 50 years and I ~~assume~~ that once the environmental business is settled satisfactorily for this country, that leases will be valuable again, but I am very doubtful that any oil company is going to go up and lease further land until they are pretty sure about whether they know what the government is going to do about their present holdings. ^{So} I don't believe that it is prudent at all to anticipate income up there ^{in reasonably} ~~is~~ the ~~recent~~ near future. And further on the amount of dollars if we were to find a taker for our lease offering, ^{future} you will notice that Commissioner Herbert's testimony covered, I think it was almost a million dollars sold before the September, 1969 sale which brought in hardly a tenth of that. *In other words, there may have been a ^{unique} sale.*

Groth: Mr. Chairman, I understand Joe, my problem is that i can't conceive that in these projections that you have, did not feed anything in on these estimates on the basis that all of the other lands that the State owns, and all of the other ^{the State} interests/~~it~~ has, and the ^{of} the boom and room here is to what is going to happen to get into public ownership of the pipeline is the inevitable result without putting in any bucks at all for all of these other assets. And that is where I have the problem.

That to be a representative, believe me I am not going to be or trying to be
HENRI: My references from a budget point of view, now there is an underlying conviction that we have here from the Governor on down, and that is that the budgets of the state should be increasing steadily and systematically, in other words you shouldn't have a budget that ^{has} high rise then next year cut off a lot of people who have been depending on these expenditures, so unless we can pretty clearly say that out there somewhere ~~at~~ at the end of the ten year period that there is going to be some more money coming in, if we can't ~~save~~

say that with some certainty then we have to adjust this years spending and next years spending as if there wern't that money there because it is too speculative, ~~it~~ too remote, and that, what I am addressing myself to is the budget and if we can't reasonably calculate some money out there then I think the budget has to be adjusted each year now as if ^{we weren't} ~~we are~~ going to get the money. Now that's based on one thing that is different since 1970, and that is that we are spending beyond our income in this State for the first time. ^{would} ^{anywhere near} We have no trouble/like that if our expenditures were equivalent to our ~~income~~ income, but it is not, as I say we are spending almost twice as much as we are taking in which means that our savings account will be depleted, and then where are we if these new revenues do not materialize.

Groth: Without being argumerative Joe, you presume those to sign in zero value to all that other land and that 77 million acres and I respectively suggest to you that it may have some value greater than zero, and if you ~~feed~~ ^{feed} that into the projections then all of the alcoholism, VD, ~~assisted, programs~~ athletic commissions and youth commissions might still continue.

Senator Young: ^{I think I've had my proposals rejected here before} Mr. Chairman, first let me say that some of the proposed

proposed testimony taken place at the present place is the administration time of state transition game protection right now.

But one thing bothers me, Mr. Henri and this is if we build this pipeline we have to go into debt or a guaranteed debt of 3-1/2 billion dollars, what effect is this going to have on proposed bond issues already before the legislature, for instance 6 million for highways, sewers and waters, etc. According to my latest figures it will be so far in debt for guarantees that there will be no market for the bonds

they are putting before the legislature now.

Henri: Senator, I would like to refer the answer to that if I may to Mr. Macy, who is here from Kuhn, Loeb and also Commissioner Wohlforth who I think can do a better job.

Wohlforth: I think the basic answer to that question is that, as I represented of in New York as I stated about a month ago, a North Slope bond issue ~~is~~ would ~~have~~ necessity have to be so well secured and so able to stand on its own feet that it would ^{not} jeopardize ordinary State bonding programs, that the essential security of ^{general} state/obligation bonds are recurring revenues of the State ^{of the State} ultimate power on to tax/an ad valorem basis its 2.7 million assessed valuation. What we are talking about here and what will be described in detail by Mr. Gilderhouse and Mr. Macy is a bond issue which is essentially self liquidating and does not reflect adversely and therefore would not reflect adversely on the State's general obligation bonding power. It would be I believe a separate sustaining utility type bond issue, as compared to our general obligation bond issues each of which do encumber our State's credit and each of which are assessed in the bond rating communities on a per capita debt basis, on the basis of assessed valuation to total bonded indebtedness. In addition it is pointed out to me that as said previously that we, the bond issue ~~on the size~~ of this size can have a positive effect on Alaska bonds of necessity it would reach a broad market of new investors and create interests in Alaska, those, a range of investors in Alaska that are growing now but who have not yet nearly reached the number we had hoped for, and of course the net income which we show available after debt service in the public case, is income ^{to} ~~from~~ the State

treasury.

Young: O. K. Let's carry this thing a little further. Lets say the pipeline to build, if the state builds the pipeline, we're dealing with a world energy here and if they find that other oil companies or companies find a cheaper source of power for world energy, now true they have to produce a certain amount, but what if they are not competitive what does that leave the the State. In paying their bond issues off.

Wohlforth: To a certain extent I have ~~xxx~~ analogized this with the question which was posed yesterday, there was a replacement found for ~~possiblx~~ Fossil Fuels, we expect a replacement from Fossil Fuels maybe in the year 2010. The existing indications are that there is a need for North Slope oil and that will continue. The refinery price on the west coast has escalated and indeed it is much higher on the east coast, so that there are projections underlying projections that are used, just as there are in other financings based on utility type self liquidating financing which give, it seems to me, the degree of confidence necessary to finance the pipeline itself. And indeed no bond investor is going to put monies at debt, and at risk unless he ^{similarly} ~~similarly~~ is assured the State that the oil will flow in the estimated quantities. It to a certain extent has to be and will be a test of the market.

Young: Commissioner Henri, another thing, Senator Groth hit upon, that you geared our whole income into the ownership of the pipeline of the North Slope Oil. Entering the projections of the other testimonies given today is there any thought given to the possibility of revenues generated by the ^{year} gap field that is on the North Slope, the monies that will be generated to the mid west states, that the pipeline will possibly go through Canada?

Wohlforth: I think Mr. Eppenbach can answer that.

Eppenbach: Yes sir. They are fully included in our estimates. We assume that in 1977 the price of gas at the wellhead will be about 20 cents. Obviously the production of gas is the function of the production of oil. We've made those consistent and we assume the price of gas at the wellhead will increase ^{assuming} about 1 cent every five years, ~~and~~ that gas will be transported through Canada through a Trans Canadian pipeline into the mid western markets in the U. S.

Holm: Commissioner Henri, as I read the figures, the first chart up to the left there, and I added them ~~up~~ up, if my arithmetic is correct, we are saying that State ownership will total a billion and one half dollars net increase to the State over the next 10 or 11 years. That is if everything goes right. Presuming that the State's bargaining position is good now and might be a little bit worse in the coming years without intervention by the State, after all any oil company worth ^{it} salt can see that we are going to desperately need money due to the testimony that has been given. What is going to happen to our future oil lease sales and the net income to the ^{state} city; have you built this in; what is going to happen as the oil companies see this localization or parallel to nationalization of the oil industry in the State of Alaska and as they contemplate this couldn't we ~~lose~~ lose more money that way by investments in the State in the oil leases, by investments in the State in the oil industry than we would gain theoretically by taking over the pipeline ownership.

Henri: Representative Holm, Senator Groth referred to additional oil lands in the North, I would like to speak a little bit further on that latter, but, there are more as we all know than 7 oil companies. Now if there were other oil companies that wanted to get these future oil lease lands I think that State ownership ^{of the} ~~along these~~

lines would enhance the desirability of those leases because they would know the State, as a public agency would allow them to use the line, whereas if the line were dominated by the owner who had the existing discovery *of the oil* it may not be that way. So I think the ownership would not be a hindrance, it would be a help.

Holm: Well, aren't we presuming, at least this has been my understanding it is going to be a public carrier either way?

Henri: Yes, but I will defer to Mr. Hellen and others about how that concept works under ICC regulations of private ownership. My impression is, simply saying, ^{it is} ~~it is~~ a public carrier does not give all the answers. Furthermore in the State's case of private ownership Mr. Temple clearly brought out yesterday that there is going to have to be a voluntariness, what ever you want to call it, between the oil companies and the ~~State~~ State if the State is ever going to own the pipeline, at least under the sale of bonds, municipal bonds and I would think that if the package were not fairly palatable to the oil companies that somehow they are not going to do it anyway.

Holm: Well then you are presuming in all of your figures, projections, that the State take over the pipeline, will not depress the market for our future sale of oil leases.

Henri: I think that would be something that we ^{have} tend to guard against very carefully. We obviously would not want to do that. I think we all agree with Senator Rettigs' remarks that we want the state to be a favorable place for investment. But nevertheless we have a great stake of getting something out of our resources to?

Huber: Mr. Chairman, Commissioner Henri, on Page 3 of your testimon v

Joe, you project about, rounded off, \$50,000,000 a year general obligation bonding programs for State capital programs. Now what ~~ix~~ retirement term is anticipated on those bonds, and ~~can~~^{is} the interest from principal payments ~~has~~ been included in the public ownership draft line on exhibit E?

Henri: The term, Mr. Chairman, Mr. Huber, is 20 years, and debt service has been included in the run and if I may Mr. Huber, refer ~~k~~ you to exhibit B where it that information is given there. Exhibit B in the computer run/gives the interest assumptions, the annual rate of ~~interest~~ in the general fund, in other words what we have earned in the Bank of America funds of 6% and so forth, is all spelled out, and your answer ^{is} is the debt service was included for 20 year payoff.

Huber: Well what concerned me was the debt service in the initial bonding.

Barber: Mr. Henri, through the Chairman, the Committee it ~~is~~ has always been my assumption that we are currently using up our North Slope \$900,000,000 to the extent of the State ~~k~~ sharing in local government and in other ^{endeavors} efforts. In other words of our normal budget is running somewhere between 220 and 240 million dollars and we're using up somewhere between 60 and 80 million dollars a year out of our North Slope fund. Now are those figures approximately correct?

Henri: I think the, we are using this year, Mr. Huber, the Governor's budget proposed ~~in~~ taking 97 million of the principal of the North Slope Fund and of that almost entirely used for local government.

Barber: That was my understanding. Thank you.

Senator Thomas: Mr. Chairman, I have the impression that they haven't really explored all of the alternatives, and I would like to ask, since we may not have a chance to ask later on, if they have looked into the alternative of increasing

the severance tax or / and at the same time possibly substituting the cents per barrel for the severance tax; if it is so to what extent would each of those have to be changed to forestall this down the road based upon your 3.5 billion dollar figure.

Henri: Mr. Chairman I will defer a full rounded explanation of that, Senator Thomas, I do have two observations if I may. One, the severance tax as it exists, is as you know a percentage of the value of the oil ~~to~~ per barrel of the wellhead. Obviously, under the private case that he's giving you the wellhead has no value the first few years, so would produce no severance income. If the severance tax were amended to ~~be~~ instead of an ad valorem item, to be a cents per barrel item, there is no magic to making up the deficiency in our budgetary income because no government is allowed to tax to confiscation. I haven't actually calculated that out, I would say that the, to equal the throwoff of ownership of the pipeline which is a legal, valid receipt of money, to equal that to hoist up the severance portion would probably be confiscatory, I don't know. I suspect it would be a God awful amount of cents per barrel.

Thomas: Mr. Chairman, could I just ask would it be possible by using the cent barrel arrangement to persuade industry not to take such great profits out of the operation of the pipeline.

Henri: I couldn't answer that. They own their line and I presume they ~~like~~ ^{have a right} to take a dividend from it.

McVay: Mr. Chairman, one more, ~~xxxxxx~~ when we have a chance to hear their response during these hearings, the pipeline committees have proposed a lease sale arrangement.

Josephson: Someone mentioned that ~~xxxxxx~~ the most alarming thing about

your three r's is Joe, that we might be able even to increase legislative salary.

Henri: I carefully avoided that.

Josephson: Commissioner, have you predicated the impact of the Native Land Claim Settlement in your revenue projections, how do they fit into your revenue projections?

Henri: Yes sir, they are in there, I am going to ask Larry Eppenbach to tell you exactly how they are in there, but the impact of the native 2% over-rise is in the figures.

Josephson: No, I meant the additional economy or impact, favorable impact of the economy generated by economic activities.

Henri: Again I'd like to get Larry... My impression is that we haven't tried to estimate what the ^{funding} ~~future~~ money of these native corporations will mean to the States economy. There again it is so speculative, and I'd just like to re-emphasize Mr. Chairman, my point of view in these hearings, it comes as chairman of the budget review committee and from a convention which is probably shared by many in the room, that the budget shouldn't be at a certain level one year then come into a cleft so to speak and fall off. I think you have to calculate your budget increases or decreases if they are necessitated gradually over a period of years. In other words at least, ^{while} ~~while~~ we have now given to you, the legislature, a 5 year planning projection and we have tried to avoid the very speculative incomes in the future so as to keep our budget ^{steady and} ~~study~~ reliable.

Palmer: Mr. Henri, you have mentioned this matter of ^{speculative} ~~the~~ items of the budget several times, this was a response, as I understand it, as Senator Cook mentioned

has not been
additional land sales, plugged into future revenue projections because it was to speculate ~~on~~ a few weeks ago, before the Senate Finance Committee and then later that week before the resource committee we had the same type of commentary testimony from the people in charge of the Division of Oil and Gas, Mr. Burrill and Mr. Gilbreath. When it was pointed out that the revenue projections for North Slope Oil would decrease in the 1980's because of the 9.6 million recoverable barrels, or billions rather, and that this would be decreasing in the mid 80's, I believe it is ^{estimated} ~~rated~~ 2 billion barrels a day and *in* about 14 years those reserves would be ~~the exhausted~~ exhausted. Now in response to the question of, Mr. Burrel said that it was too speculative as far as any other reserves up there to slug any other values into revenues. That they could not because they had to be prudent, come up with any other figures for production through that pipeline and therefore revenues would decrease in the 1980's. And yet you are saying, as I understand it, that it will require 25 years of production rather than 12 or 13 years of production, to amortize the cost of the construction of the pipeline. If the State builds it, it is our gamble, if the company builds it, it is their gamble. I don't understand how we cannot afford to ~~use~~ be speculative in one instance and we can in the other.

Henri: Well Senator, you have spoken to two sides of the budget, income versus expenditures. My remarks on speculation were primarily about the level of expenditure and as to the ingredients of the revenue side of the budget I defer *that* it to Mr. Eppenbach who has those computer runs and why he thinks they are valid.

Rettig: Mr. Henri just to verify Senator Palmer's question, his question was a very good one, he did refer to the speculative nature of the possible lease sales, on

the other hand the State ~~has~~ in suggesting State ownership and the 3-1/2 billion dollar debt is speculating that there is a lot more/^{oil}than we now know is in the Prudhoe Bay field. Is that your point Senator?

Palmer: Yes sir.

Eppenbach: Senator, when revenue estimates were prepared and discussed with you by Mr. Burrell and Mr. Gilbreath they were referring to 9.6 billion barrels of Prudhoe Bay reserves. We based our reserve figures here for purposes of financing State ownership of the pipeline from the total of the reservoirs on the North Slope already leased. And I would defer further questions on this to Commissioner Herbert. Now Have I... In terms of State financing of the lines we were not speculating on it, future reserves, we were planning that additional reservoirs would come onto line, those reservoirs already located in the lease area. Their timing may be characterized as a form of ^{intuitive} judgement, but ^{we have looked at} nevertheless we expect over the 10-20 years that there would be additional reserves of oil coming from new reservoirs that have not yet been estimated to contain reserves but are nevertheless there, that would provide oil to the Trans Alaska pipeline. That is oil in addition to the 9.6 billion barrels that Mr. Burrell talked about.

Palmer: ^{10 to 20 years} Would we have the assurance ^{that} of these reserves that will be recoverable from the Division of oil and gas, ~~the existing~~.

Eppenbach: Commissioner Herbert already testified on that point, that there are no assurances to date, he did imply that right now it would take perhaps ~~to~~ another year to get those assurances but he did ^{indicate} communicate about 100 million barrels of oil were available at least in one of the pools. I for one would like to hear the

oil companies respond to this ^{question} in some detail.

Palmer: A second question if I may then, it was stated that an increase in severance tax, this is a response to ^{Senator Thomas' questions} questions, in order to reach the income required by the State it might reach the confiscatory level and therefore be impossible, but it seems to me that there is a given amount of money to come from this resource regardless[?] whether it ~~is~~ from the pipeline or whether it is severance tax or regardless of where it comes from, that there is still X number of dollars that will be available. I don't understand how it would be confiscatory if ^{we} take it through severance tax and it would not be if we take it through a pipeline profit.

Havelock: If I may comment ^{to that} at this point Senator, I think that a cent per barrel tax ~~is~~ is one of the alternatives/~~of~~ that the legislature can consider among other tax possibilities. I don't think it is our intent to say that it is not an appropriate tax. There are a number of reasons ^{-the} why it has economic disadvantages, and the man who ~~wh~~ould probably testify most on this would be Walter Levy. The ~~cents~~ per barrel tax is a little bit like a lot of complaints we've heard about the gross receipts tax, apply to the cents per barrel tax, that is it does not ^{necessarily} relate to economic realities in the oil industry. But it certainly is a possibility as providing a floor shall we say to revenue, I think the industry, the ^{comments} economics they've made to us about it, is they would rather pay taxes in other _____ through the cents per barrel formula. That is my impression. But it certainly is one of the tax avenues that the legislature can consider.

Palmer I might add that Walter Levy

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PAGE 1

Tape #12

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

page 2
Tape #12 (continued)

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

(Mr. Rettig)

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

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

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

Mr. Havelock: May I respond to that?

Mr. Rettig: Please do.

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

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

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

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

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

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

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

Tape #12 (continued)

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

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

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

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

Mr. Rose: Thank you

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

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

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

Tape #12 (continued)

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

Mr. Havelock: Mr. Chairman, Members of the Committee, at this time we would like to call Mr. Tom Guilderhouse of the firm Temple, Parker & Slone, Economic Consultants to the State. Mr. Guilderhouse. . . . He will speak about the arrangements for public financing, various alternatives for public financing available to the State, public financing and pipeline. Mr. Guilderhouse

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

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

Tape #12 (continued)

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

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Tape #12 (continued)

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

Tape #12 (continued)

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

Tape #12 (continued)

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

Tape #12 (continued)

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

Tape #12 (continued)

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

Tape #12 (continued)

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

Tape #12 (continued)

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

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

Sp

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

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

_____: Is this on?

_____: Yes sir.

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

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

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

GROH
Groth: In other words, we would ask them to guarantee the construction of the contract and take the risk of completion on this project.

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

GROH
Groth: And do they make a profit here?

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

GROH
Groth: Do they put up bonds in the event of a noncompletion?

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

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

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

GROH
Groth: Okay, thank you. I have no other questions, Mr. Chairman, thank you.

McVeigh: Senator

Rose: Mr. Whelan

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

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

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

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

Rose: Say if you have to ^{ISSUE 112} _____ which would be the last one and the smallest, not the smallest, ¹¹² almost the smallest one, second smallest ~~one~~ is also indicated at eight per cent but the thing that I don't understand if we were to qualify for tax exempt status which would appear to be the case on the assumption of issue number three then why would not that assumption hold as well on the other four issues?

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

Wohlforth: Issue three is a gross assumption of those facilities which would be conventionally tax exempt without question, gross etc., and ^{or} would qualify under the environmental exceptions to Section 10DS of the Internal Revenue

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

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

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

McVay: The Senator Rettig has a question?

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

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

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

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

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

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

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

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

Guilderhouse: Yes sir.

Rettig: What would the State do with this?

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

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

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

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

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

Guilderhouse: Yes sir.

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

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

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

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

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

_____: Thank you.

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

_____ : Yes, sir.

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

_____ : PLEASE PLOSY

_____ : So this is very general. So that would result in substantial savings, ^{AS FAR AS DEBT SERVICE IS CONCERNED} as far as debt service is concerned.

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

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

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

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

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

_____ : Should have a run..... *more specifically*

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

_____ : Let me continue with *FEDERAL* Federal and State taxes that we calculated, that would be paid by private ownership, in our private ownership base case.

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

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

Moving on to the third year of operation, the Federal income tax and State income tax ^{5,100,000} remain roughly the same - 34 million in State, 158 million dollars in Federal.

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

_____ : Third year. Yes sir.

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

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

Am I right?

_____ : You are right.

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

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

because ^{75¢} say for example if it takes ~~5¢~~ to ship a barrel of oil from

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

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

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

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

_____ : Yes.

_____ : In other words they would save a quarter a barrel if its ~~1/4~~

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

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

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

can make. ^{Its} /that simple a calculation, 7% of 3 billion dollars. Now the profit - if you're going to use the 7%, is 210 million dollars. Equate... ^{AND}

use these numbers and we come up to around 200 million dollars. ^{SE} Well, in terms of the cash position of the oil companies, its a ^{PROFIT} ~~foot~~ ^{BUT IF}. I could say

something...I'll make it quite clear that this is a _____ ^{7.5% (?)}

sort of an opinion and nobody else really has anything to do with it, its strictly ours. That ^{there} might be a way to make this concept more feasible

and engender the environment in which cooperation might take place, ^{by} suggesting to the oil companies that under state ownership it might not chose to build its

tariff structure around a 7% return. Say perhaps the State not only would provide this type of savings but ~~could~~ ^{COULD} conceivably develop its tariff

structure on a basis ^{something} /less than the maximum. Again I want to emphasize that this is TEMPLE, BORDO & Sloan speaking . As a suggestion for consideration,

if you ever reach the point where you are driving ^{TRY TO SUGGEST} _____ this is favorable climate TO TRY TO COME TOGETHER ON THE VARIOUS ISSUES

_____ : Right, that was sort of what I was thinking, ^{in terms} /of each having a benefit, not one at the expense of the other.

_____ : I heartily recommend that.

_____ : Only one other thing that bothers me - the oil companies of course would have the right to depreciate the pipeline as ~~xxx~~ an asset, I assume.

_____ : Yes sir.

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

Now, how does that gear into that?

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

_____ : ~~XXXXXXXXXXXXXXXXXXXX~~ Okey.

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

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

_____ : Yes, sir.

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

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

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

_____ : So they'd get a substantial advance, I would think.

I THINK SO, YES, SIR, UNDER

~~Under~~ the right circumstances I think there are tremendous advantages to the oil companies, both in reduced costs and in reduced financing burdens. (?)

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

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

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

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

Eppenback: If I may add _____ Mr. Chairman, the cases showing estimated income to state public ownership which Chairman McVay was eluding ^{by 404. And shown on chart} ~~page 3~~ and reduce dividen levels 7, 5.5, and 4, so that the committee has this information before us and again to perhaps being a little oversensative to refute any imputation of the state had shown only the worse case or that the governor has ^{the} ~~made it~~ ^{only} ~~the~~ worse case, these charts are before the committee and we'll be ready to respond to them at your pleasure.

Rettig: thank you.

Wohlforth: Senator Raider has a question,

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

Guilderhouse: Well, mines just an opinion, I happen to believe that ownership of the pipeline will enhance the states ability to issue general revenue bonds. I think that ownership of the pipeline increases the security of the states total income package. I think, first of all, I think the pipeline is a good business, and because its a good business , or a sound business, and lets say it would be operated in a sound fashion. The ability to protect the states well head and protect the states royalties and severences, generate lets say a moderate st surplus or even a large surplus, however

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

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

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

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

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

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

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

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

Guilderhouse: To the cost of the bonds? ah,

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

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

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

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

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

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

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

Farrow: Thank you

Guilderhouse. Mr. Farrow,

Farrow: The point you brought up in response to this _____

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

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

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

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

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

Guilderhouse: Yes sir, in my opinion it would.

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

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

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

McVay: ^{the state} ~~the state~~ Like to call Robert Macy, ^{of the} _____ Company of N.Y.

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

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

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

XXXXX

risks can be satisfied by absolute guarantees to the investor. Each, however must be addressed to some degree in the financing plan, and the relative degree to which these risks are secured. We'll determine not only the feasibility of the financing, but also the cost. We understand that extensive economic and engineering studies are available as background data and _____ some investors concern. The sizeable investment already made by the oil companies is undoubtedly a plus. In addition the state could, in theory, take certain steps to provide additional financial reserve to cushion the impact on the servicing of temporary unforeseen problems related to the afore major risks. However, these assurances alone, we believe, are insufficient to facilitate the market, the successful marketing of an issue of this magnitude. Furthermore, from all the suggestions which our group has considered, we know of no feasible plan which does not involve to some degree the cooperation of the oil ^{companies} ~~companies~~ with the state, in arriving at a feasible financing plan. The question is what form of co-operation is necessary and desirable? The first and most obvious to an investor, is to have both the full faith and guarantee of the state and the oil ^{companies} ~~companies~~ behind the issue, however we understand while the oil companies in particular may not wish to pledge their credit in this fashion. An alternative, and one we must recognize as a significant ~~XXXXXXXX~~ jump, in terms of the risk, as viewed by the investor. Is to restrict the liability or financial exposure of the oil companies in any financing, to the state which they have in the AKN oil venture. We have heard several possibilities suggested along each line ⁵ including those expressed earlier in these proceedings. Upon consideration, we believe that subject to the conclusion of satisfactory, contractual agreements with the oil company and others pertaining to the construction and utilization of the piping, that it is possible that these agreements coupled with satisfactory guarantees by the state, could make such an issue feasible. In conclusion, we ~~XXXXXX~~ believe that if as there appears to be in earlier testimony, there are sound, economic, and social reasons for the state

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

XXXXX

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

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

Macy: Senator Groth, One of the difficulties I think we all encounter in answering questions like this and one of the reasons ~~XXX~~ why I really outlined what we considered the major risk to the investors in such an issue, is that to satisfy any one of these risks ~~XX~~ there's a whole variety of different guarantees, different methods, that are used ^{to} satisfy the risk element to the investor. I think that perhaps it would be, I think it is pre-mature, if I may say so, to try to dissect one risk, or one method. And say well if we provided this then this would make it feasible, because frankly, I think until the legislation has been passed to set frame. And some feasible plan, or some mode of cooperation has been established with the oil ^{company.} That you cannot come up with sufficient pieces of a plan to satisfy, ^{to really make any meaningful judgement,}

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

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

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

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

I haven't had any other questions. Thank you

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

Macy: I believe it is.

Barber: The prime factor in initial negotiation.

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

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

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

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

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

Barber: Senator Rettig

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

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

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

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

Rettig: Thank you.

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

Rettig: I understand.

McVay: Any other questions - Mr. Farrow

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

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

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

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

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

RITTING:

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

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

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~~for, as a matter of~~

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

RETTIG,

We have, ~~perhaps~~ perhaps as you are no doubt aware, /one of the highest/ indebtednesses per capita of *bond* of any state at this time, and I am aware that many of the bond underwriters *look at it its on the books* already to be authorized.

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

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

Thank you.

ALICE

Any further questions? Mrs. Fisher?

Mrs. Fisher: Mr. MACE (Melsdig???) If HB 569 is passed, if everything went right, what time would you estimate the first bonds could be sold? This could be a guess estimate.

MACE: I would say the first bonds ~~could~~ *might* be sold.....the time factor, point of departure, the time after this cooperative agreement is reached with *the oil companies* SO IT BECOMES given that that is reached, and that with suitable inputs from the investment community, that this agreement can be brought up to.....the investment bankers judge to be a satisfactory level of investment grade, I would assume that within three

if you will

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to six months after that, the bonds could ^{you could} ~~would~~ begin to sell the bonds. (924)

Now we also have conditions over which none of us have control. It is not only

as I understand it

^{NOT ONLY} it's a question of whether you can sell the bonds. ^{AS HOW MUCH YOU CAN} you might be able to sell

the bonds, how much ^{OF THE BOND:} you can sell ^{AND} the bonds ^{FOR} at what cost. ^{AND} these are

subject to market conditions, which we have relatively little control over.

MCVAE:

Other questions? Mr. ~~Brooks?~~ Grohst?

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

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

GROH:

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

MACY: Yes, that is the principal ~~(924)~~ amount of THE ISSUE.

TAPE 15:

page 4

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

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

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

(much hilarity)

HOLM:

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

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

HOLM: Approximately how much less?

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

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

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

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

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

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

HOLM : No, I understand, but its

 : I understand, the.....

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

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

MACY : That is correct.

HOLM : Thank you.

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

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

Mr. Rose?

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

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

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

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

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

RETTIG : Are there any other questions?

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

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

Wohlforth : ~~I am afraid I cannot~~ any improvement ^{there} as unfortunately I was ~~some~~ in conversation at my table.

W: Can you rephrase it?

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

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

RETTIG : Are there any other questions?

WOHLFORTH : ~~It would be the largest~~ ^{It's the largest or next} ~~PROJECT~~ ^{FINANCED} ~~It would certainly be the~~ largest project in the Western Hemisphere and I.....the second largest in the world, to be perhaps "smart alecky" negotiable ^{THINK} ~~an~~ ^{AGAIN,} arms length transaction between those public officials responsible for the public purse, or those people who are performing services. And again, I ~~think~~ ^{think} its of the magnitude ^{ON WHICH} unfortunately I ~~where~~ ^{where} don't think the committee can begin on meaningful information.

MCVINE : Its not on a minimum fee schedule?

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

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

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

are you ready to proceed?

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

^{To FIND OUT} about this preliminary question of whether they were willing to....if I may
~~about~~ answer this in sort of an analogy....I suppose if possible that I could get

up from this table and go and ask the attractive girl at the end of the table whether she's willing , and I'm sure she'd tell me to go jump in the lake. ^{IF I} On
^{Did so.}

the other hand, if I invited her out ^{TO DINNER} I might get a good deal more information, ^{ABOUT} whether she was willing.....start looking in store windows, I would
^{AT FURS & DIAMONDS}

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

^{GROH} Grothe is probably quite aware of the answer to this. (laughter) This is

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

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

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

GROH : Did you ever ask them "are you willing to sell?"
BETTIG : ^{ITS BEEN covered in the papers quite fully.} According to the papers, quite willing. (???)

BETTIG : The answer was "no."

GROH : Then, what are we doing here?

BETTIG : He is still taking them out to dinner!

GROH : ^{I see.} Havelock: Before Mr. Helkin starts

^{with his} ~~as part of the~~ testimony, Mr. Chairman, there is a bill that is not before this committee, ^{BUT} which will relate to the subject matter generally which will be testified before other committees, which is the so-called 20 mill property tax

^{TO} law on ~~the~~ ^{oil} pipeline ^{EQUIPMENT} transportation, which is very much related to the subject

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

Testimony of Eric E. Wohlforth
Commissioner of Revenue

March 6, 1972

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

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

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

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

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

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

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

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

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

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

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

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

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

between SEC filings. This dramatic increase in pipeline costs revealed in official documents at the time of Governor Egan's first announcement on State ownership made it urgently necessary that the State finally determine the likely magnitude of pipeline costs. Commissioner Campbell has already indicated the independent study which the State has made through its consulting engineers, Tibbets, Abbott, McCarthy and Stratton, and the foundation for the present estimate of \$3.5 billion. These figures have ^{been} just recently been developed along with an independent evaluation of operating costs so that for the first time the State can make a reasonable projection of the probable amount it can expect to capture from North Slope oil revenues. /

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

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

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

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

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

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

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

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

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

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

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

JOINT HEARINGS ON PROPOSED PIPELINE LEGISLATION

MARCH 6 THROUGH MARCH 9, 1972

WITNESS REGISTER

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

MARCH 6 THROUGH MARCH 9, 1972

WITNESS REGISTER

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

MARCH 6 THROUGH MARCH 9, 1972

WITNESS REGISTER

<u>NAME</u>	<u>AFFILIATION</u>	<u>REPRESENTING</u>
1. S. C. SANDUSKY	DIVISIONAL MANAGER	MARATHON OIL COMPANY
2. DON DICKEY	GENERAL MANAGER	STATE CHAMBER OF COMMERCE
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BY THE RULES COMMITTEE BY
REQUEST OF THE GOVERNOR

1 IN THE HOUSE

2 HOUSE JOINT RESOLUTION NO.

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 SEVENTH LEGISLATURE - SECOND SESSION

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

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

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

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

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

23 SECTION 3. STATE DEBT. No state debt shall be contracted unless
24 authorized by law for capital improvements and ratified by a majority of
25 the qualified voters of the State who vote on the question except that the
26 State may guarantee by law bonds and notes of a public enterprise or a public
27 corporation of the State created or empowered to construct pipelines for the
28 transportation of oil or gas or both and may by law authorize such public
29 enterprise or public corporation to mortgage any State lands or properties

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

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

Page 2, line 26:

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

Page 19, line 12:

Delete all of AS 44.58.260.

Statement of Charles F. Herbert
Commissioner of Natural Resources

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

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

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

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

Bonuses received from the sale of State leases on the

North Slope:

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

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

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

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

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

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

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

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

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

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

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

not begun to run.

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

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

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

3% on the first 300 barrels per day

5% on the next 700 barrels per day

6% on the next 1,500 barrels per day

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

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

Derivation of State income from royalty and severance tax is:

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

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

3/6/72

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

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

SCHEDULE OF JOINT HEARINGS ON PROPOSED
PIPELINE LEGISLATION

COMMITTEES:

SENATE COMMERCE COMMITTEE, RON L. RETTIG, CHAIRMAN.

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

LOCATION: GOLD ROOM, BARANOF HOTEL

BILLS TO BE CONSIDERED:

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

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

SB 315 - Creating Alaska Oil and Gas' Transportation Commission.

SB 294 - Creating Alaska Leasing Board.

HB 569 - Establishing Trans-Alaska Authority.

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

MEETING SCHEDULE:

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

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

Testimony of Lawrence Eppenbach
State Investment Officer

March 6, 1972

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

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

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

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

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

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

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

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

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

under conditions of public ownership.

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

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

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

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

TESTIMONY OF JOSEPH R. HENRI
Commissioner of Administration, State of Alaska,
Before the Senate Commerce Committee
And the House State Affairs Committee
At Juneau, Alaska, 6 March 1972,
Regarding Income From North Slope Oil and Gas,
And How it Affects the State Budget

Mr. Chairman and Members:

I am Joseph Henri, Commissioner of Administration. This part of the State's presentation deals with budget expenditures vis-a-vis income to be derived from North Slope oil and gas extraction. The essential questions are:

1. Will we be able to maintain our current level of services, adjusted for population growth and inflation?
2. Will we be able to increase our level of service to meet compelling needs recognized by this administration, the legislature and the citizens of Alaska?
3. Will we have to reduce our level of service, and if so, what are the activities affected?

The answers to these questions rest in the amount of dollars the State can expect as its share of the Prudhoe Bay oil basin. Once upon a time, the Department of Administration felt much more certain about future State income than it does today. When will the

pipeline begin? What extraordinary man-caused interruptions will delay its completion? What will be the first year capacity of the line? The second year? The third? What is the maximum extraction rate the basin structure will prudently allow? What volumes of oil can be expected in any of the first seven years of the pipeline? What will be its final cost?

All of these variable factors, well known to each of us in this room, make budget planning extremely difficult, because the major part of Alaska's State revenue has come and will come from the North Slope resources. In the budget now pending before the legislature, we have recommended a total general fund expenditure of \$311.7 million; ^{those are State &} of this sum, \$97 million will have to come directly from the Prudhoe Bay bonus money, the principal, and \$52 million more from interest earnings on the investment. As we dip heavily into the corpus - invade the principal - interest earnings diminish, compounding the revenue problem. Our present or anticipated recurring revenues are simply too low to fund our present and anticipated expenditures. We are depleting our savings account. As the following year's budget figure increases, more of the principal will have to be spent; the interest yield will dwindle further. Obviously, we will soon hit the bottom of the barrel. Only large and new revenues from the North Slope can allow us to continue our present budget growth rates.

What is the growth rate we have recommended for Fiscal Year 1973? For the general fund, it is 3.5%; for the total budget, 4.6%. We have had to slash so dramatically the rate of increase because pipeline delays and cost escalations have darkly influenced

our future revenue projections. With ~~such~~ a small increase in the budget, a number of programs have already felt the chill winds of dollar scarcity. The proposed Fiscal Year 1973 budget contains such unpalatable ^{items} ~~things~~ as holding school foundation funding to the current year's level, regardless of enlarged student population; keeping the University's ^{of Alaska} increase to \$800,000 in the face of a claimed need for an addition of over \$5 million just to maintain current activities; a limitation of nursing home care and general medical relief; foregoing general obligation bonds for lengthening two more ferry boats, and for a larger program of airport construction. There are many more "pinches" in the budget, besides ^{as I mention}. Nonetheless, so far we have not jeopardized any State activity essential to health and safety. These painful adjustments herein noted were recommended in spite of the fact oil was projected on stream in July 1976; now another year's delay - or more - seems probable. The consequences are obvious.

Our budget book for Fiscal Year 1973 projects a growth rate of 6% compounded annually through 1976, and 8% thereafter through Fiscal Year 1981, covering a ten-year period. Further, it envisions capital improvement bond authorizations of \$60 million in 1974, and \$100 million in the next biennial election, and each one thereafter. I can only characterize these projected budgets as "modest." They are very little more than maintenance figures. Program dollars will still be limited. Careful budgeting and allocation will still be required. New starts and new programs will be exceedingly selective. The 6 and 8% growth rates most likely mean a shortage of funding for the school foundation plan, and for the revenue sharing program with local governments. Yet, I express ~~confidence~~ ^{hope} that the revenue receipts in the State treasury during the next ten years may be pitifully shy of the sums needed even to maintain our austerity.

Previously, in the testimony Commissioner Wohlforth and the Department of Revenue, test cases have been articulated regarding revenue to be derived under (A) private ownership and (B) State ownership of the crude oil pipeline. All of us realize that a multitude of variations in revenues and expenditures are possible under each heading. Nevertheless, for purposes of comparison we have presented two likely cases and their dollar results: Both examples entail the seven-year oil volume build up delineated in the Department of the Interior Environmental Impact Statement submission by Alyeska, a 7% dividend to the owner, a line cost of \$3.5 billion, and oil on stream in July 1977.

Exhibits A and B, attached at the conclusion of these remarks, portray the figures - and the story - for the decade 1972-1982. Under the private ownership case, Exhibit A, were Alaska to continue to increase its budget expenditures at the 6 and 8% rates, mentioned earlier, the first year of deficit would be Fiscal Year 1978, wherein we would experience a shortfall of over \$156 million. This shortage would increase so that by Fiscal Year 1982 the deficit would be \$1,135,000,000. Of course, deficits for operating expenditures are in fact impossible under our State constitution; instead of experiencing a billion dollar deficit ten years from now, we would in actuality have to reduce State expenditures radically.

Under the private ownership case the State could have in its treasury at the end of Fiscal Year 1982 the sum of \$45 million if, and only if, its operating expenditures in every year of the planning decade rose annually by only 1% (see Exhibit C). Now an increase of 1% equals a huge cut in all programs, and the elimination of many. A

The dollar crunch is graphically portrayed in the following paradigm. Under the private ownership operating budget column, increasing annually at 1%, the available dollars are recorded. Contrast these with the operating budget under public ownership, the first column on the left. The figure shows that if the State of Alaska owned the pipeline there would be sufficient dollars in each of the next ten years to meet our planned 6 and 8% annual increases. In fact, the revenue would be sufficient to raise the budget from these maintenance or austerity levels so that expansion of present services and the addition of new ones could be handily realized. Were the oil line privately owned the State would have almost billion less dollars to spend over the next ten years. We would be able to authorize 365 million fewer dollars for capital improvements.

(Graph on following page)

COMPARISON OF FUNDS AVAILABLE

PRIVATE VS PUBLIC OWNERSHIP

(ALL FIGURES IN 1000)

FISCAL YEAR	PUBLIC OWNERSHIP		PRIVATE OWNERSHIP	
	OPERATING BUDGET *	DEBT AUTHORIZED	OPERATING BUDGET *	DEBT AUTHORIZED
1972	260186.5	71000.0	260186.5	71000.0
1973	276232.7		276232.7	
1974	292910.7	60000.0	278994.8	15000.0
1975	310485.1		281784.3	
1976	329114.1	100000.0	284601.8	20000.0
1977	355443.1		287447.4	
1978	383878.5	100000.0	290321.5	20000.0
1979	414588.8		293224.3	
1980	447755.8	100000.0	296156.1	20000.0
1981	483576.2		299117.3	
1982	<u>522262.2</u>	<u>100000.0</u>	<u>302108.1</u>	<u>20000.0</u>
TOTAL	<u>4075433.7</u>	<u>531000.0</u>	<u>3150174.8</u>	<u>166000.0</u>

* All figures refer to expenditure from general fund only

Difference in Operating Expenditure is over \$925,000,000

Difference in Capital Debt Authorization = \$365,000,000

The attached graphs, Exhibits D and E, portray what I have been saying. In Exhibit D, under private ownership of the oil pipeline, the general fund would be depleted around January of 1978. On the contrary, under State ownership of the line, the precipitate dive to insolvency would stop in 1976 at a general fund balance of \$231 million, and rise to a plateau of \$450 million in the general fund by 1982. Furthermore, as Exhibit B shows, the total expenditure for that year would be approximately \$605 million, and the total revenue \$602 million; a parity between income and expenditure would have been achieved, and a surplus of almost half a billion dollars enjoyed. In actuality, no doubt, were the funds from State ownership available, the administration and the legislature would have expanded the budget faster than the 8% increase portrayed for the years 1977 and beyond so that no such surplus would likely exist at the end of Fiscal 1982.

The private ownership case I have presented to the Committees, Mr. Chairman, necessitates an abrupt and drastic reduction in State services and activities. I cannot tell you with certainty where the administration or the legislature would cut, but I can cite a few startling and likely areas of impingement in each of our program categories:

The State pays approximately 90% of local school district costs, constituting roughly 30% of annual State dollar expenditure. That State aid would be materially reduced; it would be impossible for the local areas to maintain present educational standards through increased property taxes. State Operated Schools and the University

of Alaska would have to radically abate their present service levels.

The welfare or social services activities of the State would experience vast curtailment in the number of eligible cases and the amount of benefits; many people would be compelled to leave Alaska; distress or ^{even} starvation would haunt many who decided to stay. Public health and mental health retrenchments could force the closing of the Alaska Psychiatric Institute, and a diminution or abolishment of the State's work in drug abuse, alcoholism, tuberculosis testing and venereal disease control. The necessitated nullifications of State expenditure in these areas will in turn lose large amounts of federal dollars now enjoyed. Our ability to operate and maintain an effective Pioneers' Homes program will be materially impaired.

No new fish hatcheries would be built. No hunter safety program would be initiated. Salmon yields in Southeast Alaska would remain significantly below maximum sustained yield. Land use planning and the inventorying of our natural wealth would be jeopardized, thus making management of the State's surface and subsurface resources haphazard at best. Added park and recreation sites would be forgotten, and the maintenance of existing facilities lessened. Many Alaska communities would remain without sewage treatment facilities. Programs for coastal zone management, environmental engineering, permafrost and soils engineering would likely be abolished.

In the category of Public Protection, disaster planning, the Public Utilities Commission, the Alaska Transportation Commission,

and other agencies would be impaired or

The State police would experience a great shrinkage in manpower, and the courts and their ancillary agencies could not cope with their workloads.

Tourist promotion would have to be seriously curtailed and our work in research, in community improvement and grant assistance, and at conventions and trade shows would most likely fall by the board. The work of the agricultural loan fund and the small grain incentive program would be enfeebled or eliminated. The Division of Planning and Research and the State Economic Opportunity Office would be crippled or possibly dropped.

Our program of revenue sharing with the local governments, around \$7 million in the current year, would no doubt go out the window. The Marine Transportation System for Southwest Alaska would likely be eliminated, and service in Southeast materially contracted. Airport maintenance in rural Alaska would be severely curtailed, likely forcing the winter closure of those ports, thus isolating a large part of Alaska for five months of the year, denying medical and other critical services. Likewise, winter maintenance of many of our highways would be only a pale reflection of the excellent job being performed today.

The various boards and commissions whereby Alaskan citizens take a direct and active part in the work of the State government would be minimally funded, or in some cases, unfunded. I am speaking of activities like the Western Interstate Conference on Higher Education, the Athletic Commission, the Status of Women Commission, the International Development Commission, the Pioneers'

Advisory Board, the Yukon Taiya Commission, the Rural Affairs Commission, the International North Pacific Fisheries Commission. Our Youth in Government program, recently instituted with such great success, would likely be abandoned. A

I do not represent to you, as the view of this administration, that each of these reductions suggested above would come to pass under the private ownership case portrayed in Exhibits A and C. Nevertheless, no one can say that many of the above dire consequences would not eventuate under that case; undoubtedly some would. The economic and social dislocation would be grievous indeed.

The purport of my remarks is that this State has a vital interest in an adequate share of North Slope riches. If we do not realize that share, State expenditures over the next decade will be woefully inadequate to do the job Alaskans expect from their government. The solution we propose to sufficiently fund the budget is the ownership of the crude oil pipeline by the State of Alaska.

Exhibit A

STATE OF ALASKA DIVISION OF BUDGET AND MANAGEMENT

BUDGET PLANNING MODEL

RUN ID RUN 3
DATE MARCH 3, 1972

COMMENTS
PRIVATE OWNERSHIP
7% TARIFF
BASE CASE
DIL IN 77

ASSUMPTIONS

ANNUAL RATE OF INTEREST ON GENERAL FUND = 6.00%
ANNUAL RATE OF INTEREST ON NEW BONDS = 6.00%
MATURITY PERIOD ON NEW BONDS IN YEARS = 20.
% ABOVE G.F. UNENCUMBERED BAL. UNEXPENDED = 0.0%

GROWTH RATES FOR OPERATING EXPENDITURE FROM PRIOR YEAR

1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
6.00	6.00	6.00	6.00	8.00	8.00	8.00	8.00	8.00	8.00

NEW BOND AUTHORIZATIONS IN EACH YEAR

1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
710000.0	0.0	600000.0	0.0	1000000.0	0.0	1000000.0	0.0	1000000.0	0.0

FISCAL YEAR	NON INVESTMENT REVENUE	INVESTMENT INTEREST	TOTAL REVENUE	OPERATING EXPENDITURE	DEBT SERVICE	MISC EXP SHD TAXES GE CAP EX	TOTAL EXPENDITURE	SURPLUS OR DEFICIT	GENERAL FUND END OF YEAR
1972									761268.7
1973	162264.1	42466.7	204730.7	276331.0	24020.8	11358.6	311710.3	-106979.6	654288.4
1974	162367.0	35772.1	218139.0	292910.7	29646.2	11756.5	334313.4	-116174.4	538114.0
1975	190047.0	28146.4	218193.4	310485.1	32973.5	12749.8	356208.4	-138015.0	400099.0
1976	136752.0	18960.8	207712.8	329114.1	33479.2	13200.6	375833.8	-168171.1	231927.9
1977	220569.0	8673.9	229242.8	355443.1	35373.3	13153.0	403969.4	-174726.6	57201.4
1978	229954.9	-2988.6	222966.3	383878.5	39390.5	13719.0	436988.0	-214021.8	-156820.4
1979	314776.0	-14823.9	299952.1	414588.8	42494.9	23358.3	480441.8	-186489.8	-337310.1
1980	329299.9	-26743.6	302556.3	447755.8	46529.0	25105.1	519389.9	-216832.6	-554143.8
1981	332012.4	-41200.4	290811.9	483576.2	47129.4	25167.5	555873.0	-265061.1	-815204.8
1982	344154.7	-58641.5	285513.1	522262.2	52863.3	26698.5	601824.0	-216310.9	-1135515.0
	2490194.0	-10378.5	2479816.0	3816342.0	383899.9	176356.8	4376599.0	-1896782.0	

AGO 530854

Exhibit B

STATE OF ALASKA DIVISION OF BUDGET AND MANAGEMENT

BUDGET PLANNING MODEL

RUN ID RUN 4
DATE MARCH 3, 1972

COMMENTS
PUBLIC OWNERSHIP
7% TARIFF
BASE CASE
OIL IN 77

ASSUMPTIONS

ANNUAL RATE OF INTEREST ON GENERAL FUND = 6.00%
ANNUAL RATE OF INTEREST ON NEW BONDS = 6.00%
MATURITY PERIOD ON NEW BONDS IN YEARS = 20.
% ABOVE G.F. UNENCUMBERED BAL. UNEXPENDED = 0.0 %

GROWTH RATES FOR OPERATING EXPENDITURE FROM PRIOR YEAR

1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
6.20	6.00	6.00	6.00	8.00	8.00	8.00	8.00	8.00	8.00

NEW BOND AUTHORIZATIONS IN EACH YEAR

1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
710000.0	0.0	600000.0	0.0	1000000.0	0.0	1000000.0	0.0	1000000.0	0.0

FISCAL YEAR	MIN INVESTMENT REVENUE	INVESTMENT INTEREST	TOTAL REVENUE	OPERATING EXPENDITURE	DEBT SERVICE	MISC EXP SHD TAXES GF CAP EX	TOTAL EXPENDITURE	SURPLUS OR DEFICIT	GENERAL FUND END OF YEAR
1972									761268.2
1973	162264.1	42466.7	204730.7	276331.0	24020.8	11358.6	311710.3	-106979.6	654288.4
1974	182367.0	39772.1	218139.0	292910.7	29646.2	11756.5	334313.4	-116174.4	538114.0
1975	190047.0	28146.4	218193.4	310485.1	32973.5	12749.8	356208.4	-138015.0	400099.0
1976	188792.0	18960.8	207752.8	329114.1	33479.2	13270.6	375883.8	-168171.1	231927.9
1977	430209.0	15116.4	445325.4	355443.1	35373.3	14482.8	405299.1	40026.3	271954.3
1978	434394.9	16695.3	451090.2	388878.5	39390.5	15217.0	438486.0	12604.2	284558.4
1979	547046.0	19533.7	566579.7	414588.8	42494.9	27485.9	484570.4	82009.3	366567.7
1980	550369.9	23532.2	573902.1	447755.8	46529.0	28343.7	522628.5	51273.6	417841.3
1981	567962.4	26121.0	594083.3	483576.2	47129.4	28359.7	559065.2	35018.1	452859.4
1982	575119.7	27093.4	602210.1	522262.2	52863.3	29787.4	604912.9	-2702.8	450156.6
	3428529.0	253434.8	4011965.0	3816342.0	383899.9	192832.9	4393075.0	-311111.4	

AGD 530855

Exhibit C

STATE OF ALASKA DIVISION OF BUDGET AND MANAGEMENT

BUDGET PLANNING MODEL

RUN ID RUN 3

DATE MARCH 3, 1972

COMMENTS

PRIVATE OWNERSHIP
7% TARIFF
1% GROWTH
GREATLY REDUCED CAPITAL EXPENDITURES

ASSUMPTIONS

ANNUAL RATE OF INTEREST ON GENERAL FUND = 6.00%
ANNUAL RATE OF INTEREST ON NEW BONDS = 6.00%
MATURITY PERIOD ON NEW BONDS IN YEARS = 20.
% ABOVE G.F. UNENCUMBERED BAL. UNEXPENDED = 0.0 %
ANN OPER EXPEND GROWTH RATE AFTER 1ST YR = 1.00%

NEW BOND AUTHORIZATIONS IN EACH YEAR

1972	1974	1975	1976	1977	1978	1979	1980	1981	1982
71000.0	0.0	15000.0	0.0	20000.0	0.0	20000.0	0.0	20000.0	0.0

FISCAL YEAR	NON INVESTMENT REVENUE	INVESTMENT INTEREST	TOTAL REVENUE	OPERATING EXPENDITURE	DEBT SERVICE	MISC EXP SHD TAXES GF CAP EX	TOTAL EXPENDITURE	SURPLUS OR DEFICIT	GENERAL FUND END OF YEAR
1972									761268.2
1973	162269.1	42459.7	204733.8	276232.7	24020.8	11358.6	311612.0	-106878.3	654389.8
1974	182367.0	36208.7	218575.7	278994.8	29646.2	11756.5	320397.5	-101821.8	552567.9
1975	170047.0	29928.1	219975.1	281784.3	32973.5	12749.8	327507.6	-107532.5	445035.4
1976	188752.0	23147.4	211899.3	284601.8	32478.4	13290.6	330390.6	-118491.3	326544.1
1977	220569.0	16735.2	237274.2	287447.4	32921.2	13153.0	333521.5	-96247.3	230296.8
1978	225954.9	10787.1	236741.9	290321.5	33723.5	13719.0	337764.0	-101022.1	129274.8
1979	314776.0	6882.4	321658.3	293224.3	34212.3	23358.3	350794.8	-29136.4	100138.3
1980	329299.9	5394.7	334694.5	296156.1	33837.2	25105.1	355148.3	-20453.8	79684.5
1981	337012.4	4182.2	336194.5	299117.3	31872.0	25167.5	356156.8	-19962.3	59722.2
1982	344154.7	3140.6	347295.2	302108.1	33246.7	26696.5	362053.3	-14758.1	44964.1
	2490194.0	178845.6	2667040.0	2899986.0	319001.6	176356.8	3385343.0	-716303.9	

AGO 530856

Exhibit D
ENDING GENERAL FUND BALANCE
Private vs Public Ownership
Budget Book Expenditure Plan

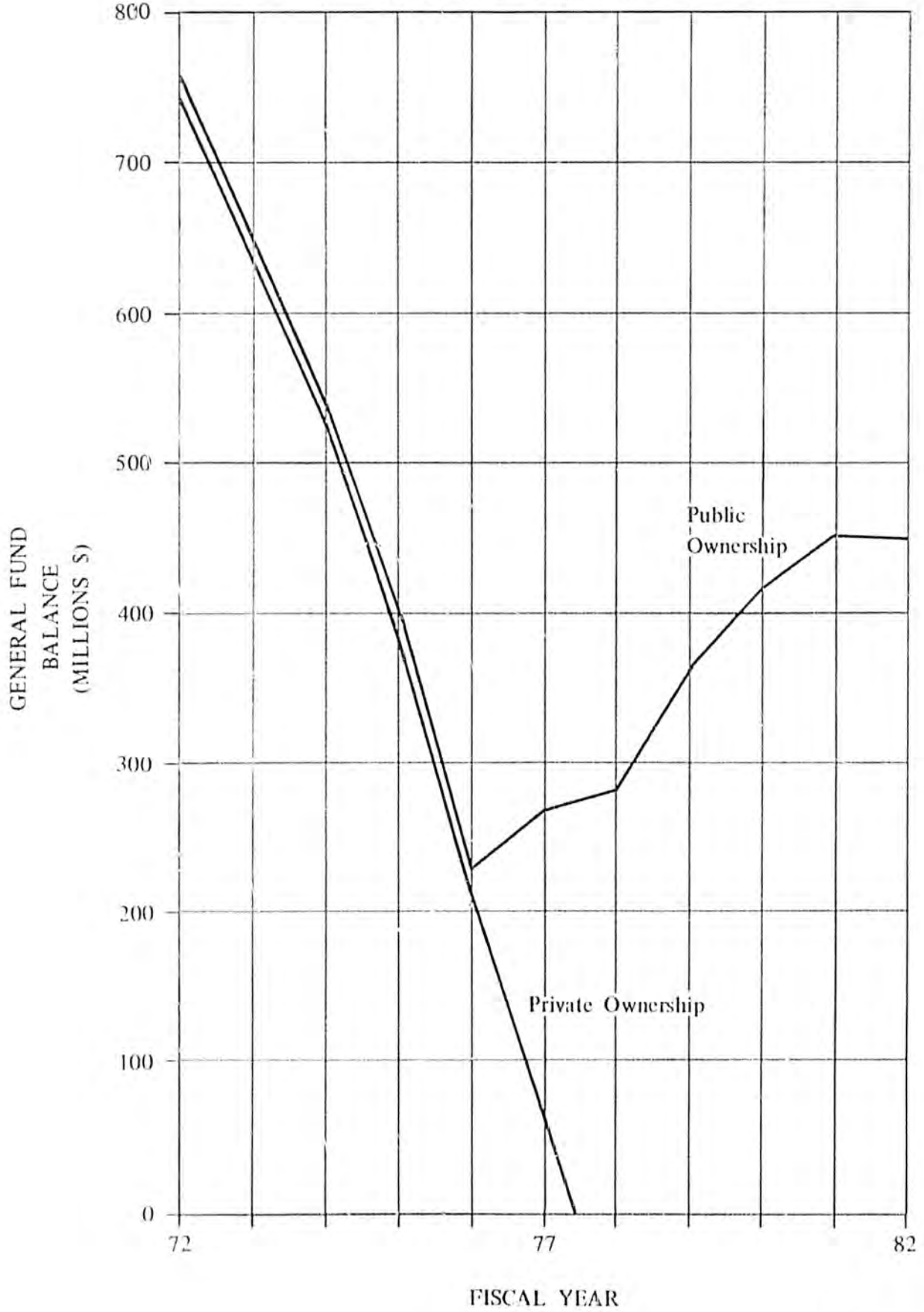
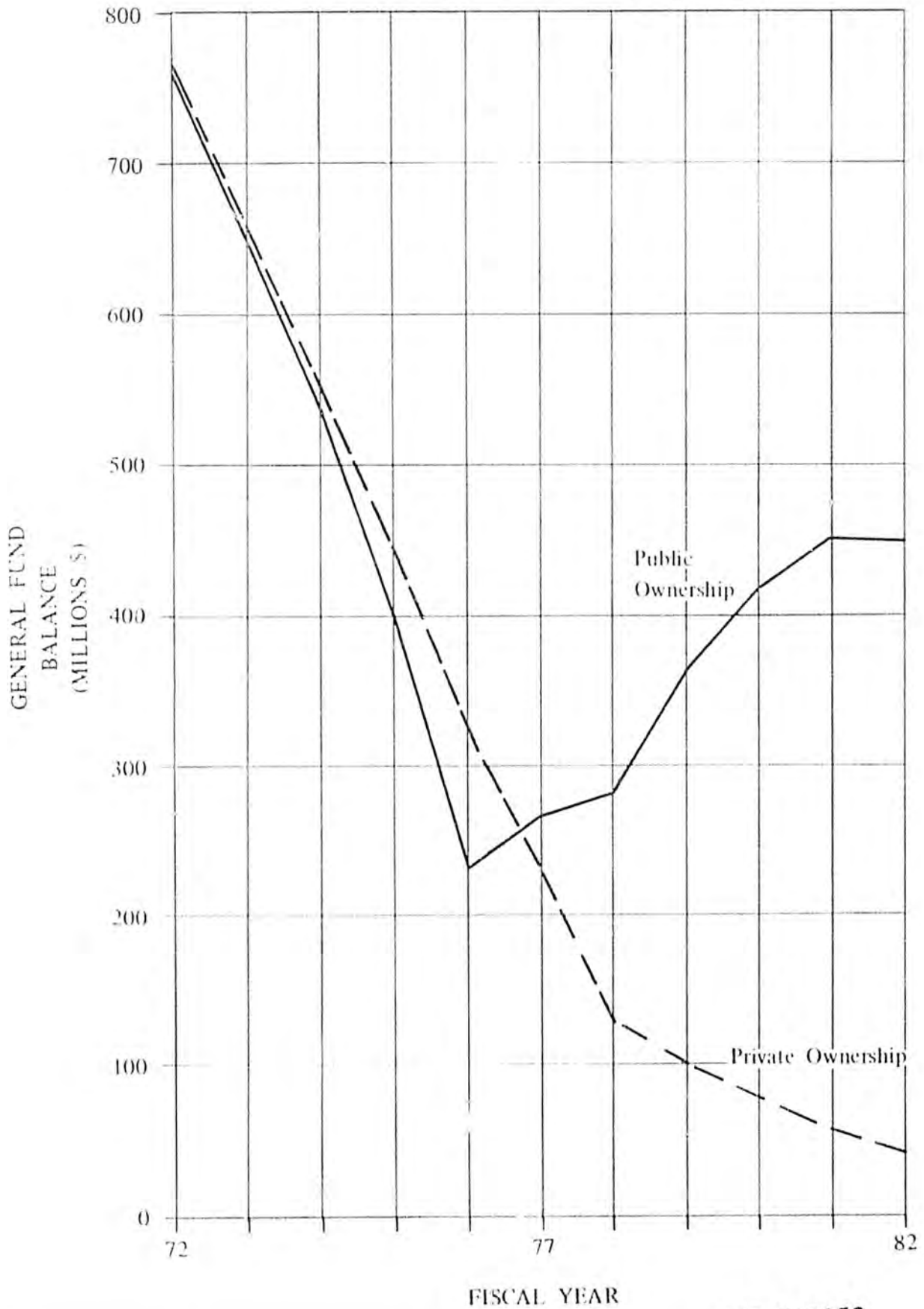


Exhibit E

ENDING GENERAL FUND BALANCE

Public Ownership Budget Book Expenditure Plan
vs
Private Ownership Subsistence Expenditure Plan



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Culetta: ^{8P} for State acquiring money, your testimony, or my interpretation, is that this money is the problem that we face and, if I interpret your testimony correctly, one of the alternatives was the State ownership proposal. With supplementary income from severance and royalties we were going to make up the deficit in monies that we need through the profit that is allowed on the pipeline. Have you looked into any other alternatives?

Henri: Well, Representative Culetta, when you mean alternatives do you mean other natural resource development or just what is the general thrust of this.

Culetta: Yes, either in that field or coupled to the Prudhoe Bay. Is consideration being given to, recently we read in the paper where gas research not taken out of the ground. Have we considered selling our pre-owned, you know approximately 20%?

Henri: Well, right, I think that should be the essence of it is Commissioner Herbert's. But, I would say in general that I have looked at every conceivable possibility for getting income for the State, more or less, I don't mean to tell you that we spent several hundred thousand dollars on each conceivable possibility, ^{is out} We certainly have tried to imagine any income source. There isn't anything, including gas, that is anywhere near like oil. That is the problem. I mean the oil is so far and above the great yield~~er~~ of revenue to the Treasury that there just isn't anything else remotely comparable to it.

Culetta: Mr. Chairman. Again, I was apparently misinformed but it seems that I recall from the news article that between two and five hundred million dollars in one gas sale had been negotiated.

Henri: Well, I don't doubt, Mr. Culetta, that if they sold all the oil in the Prudhoe Slope right today that they could get a figure quite a bit higher than that, obviously, but that is the total figure over many years. My concern, of course, is to funding the budget in 1978 and 1979, not that I am representing to you that I'm going to be the one who's doing it then, but at least we have

to fund the budget then and those are the years, particularly the late seventies, that are so critical to our State.

Culetta: Mr. Chairman. Commissioner, what I am driving at is until the line is on full capacity we seem to be facing the problem . It seems conceivable to me that we should sell some of the future production now to make up the deficit until the line is on stream so that we could solve our problem.

Havelock: If I may answer that for the Commissioner. I have discussed this with a number of people as a prospect, but the effect is, and it is a strategy the State may wish to use at the appropriate point, but the strategy does not change basic lines of the projection. What you can do through the advance sale, lets take sale of oil and gas futures, is to nip off the bottom of the deep part of the V when you hit bottom. You can't sell anything, or you can't sell for any kind of advantageous price until you have the assurance that the product is going to be marketed, otherwise, you are going to be selling a highly discounted commodity. Even if you do sell it, you are selling something that otherwise you would count on in the future. So, the effect is that you can round off the bottom of the V in the bottom of the dip but you don't change the basic trend of the decade by that kind of strategy. As far as other alternatives go, I do call to your attention one of the measures the Legislature may wish to consider, one of measures we had introduced does call for a twenty mill property tax on the pipeline and related oil property as a method of raising revenue and, of course, the legislature may wish to consider the utilization of the property tax as one of the various tax tools that is available to the State in meeting its fiscal problems.

Rettig: In several different ways the question has been posed, why can't we not increase severance taxes to make up for what, otherwise, would be pipeline profit. Perhaps Mr. Wohlforth could explain where most of this pipeline profit really comes from under State ownership. Would you care to do that Eric?

Wohlforth: Yes I would be glad to. The pipeline profit is shown under pipeline income

in the years 1977, 78, and 1979 to some extent, comes from pipeline income, that is to say, in the amount of the charge which the State is entitled to make as the owner of the pipeline.

Rettig: Perhaps I didn't make myself clear. For example,

Wohlforth: as well as the fact that we are not taxable as a pipeline owner.

Rettig: That is the point I was trying make. Out of perhaps four hundred million dollars of pipeline income, perhaps two hundred fifteen million of that ^{MERELY} ~~is~~ ^{is} money that would otherwise go to Uncle Sam for taxes.

Rose: My curiosity is getting the best of me, what is a

?

Henri: It is an example of figures.

Groth: Joe this is the last question and I realize that I am probably being argumentative but I don't mean it. If you refuse to put anything in the budget on the value of the 1.5 million acres on the slope or the seventy seven million acres that the State otherwise has, would you sell it to me for a hundred million dollars? Of course you wouldn't, so you do have a figure on it someplace and it seems to me that that figure has to be put in your revenue projections someplace.

Henri: Senator, you're referring to lands that the State has?

Groth: Yes sir.

Henri: Of course, the lands, whether they are oil bearing lands is question number one. Again, I would have to ask whether Chuck Herbert thinks they are, but even Chuck has missed one or two acres in Alaska as to whether they have oil under them or not. So that in itself seems to be problematical, and then the question of when the oil companies would be interested in taking the oil is the thing that clenches us up. All we are talking about is a ten year period. I think that over the long run of time that we can get through the next ten years probably, our future is particularly bright in this State.

Adjournment until 2 p.m.

McVay: This is a continuation of the hearings on the pipeline proposals of the administration. Our schedule calls for us to go straight through until 6:00 this afternoon and we'll have breaks approximately every hour and fifteen minutes. Mr. Attorney General do you have the next witness?

Havelock: Mr. Co-Chairman and members of the committee, at this time the State would like to call Mr. Charles Kades of Barker, Stella, Field and Wood, special council of the State on public financing. He will discuss the statutory framework of State ownership. In connection with Mr. Kades testimony I have a distribution in line with the previous comments that I have made and other witnesses have made regarding a proposed introduction of the proposed amendment to the constitution of Alaska and with the Chairs permission I would like to distribute that now for your perusal and, in addition, we have to the amendment bill already committed to the committee we have two other proposed amendments to HB 569 which the committee may wish to consider.

McVay: Mr. Kades, when you are ready to begin would you give us a little bit of your background for the records.

Kades: Mr. Co-Chairman, my name is Charles L. Kades. I am a partner in the firm of Barker, Field, Stella and Wood of New York City. I have been a partner for some twenty some odd years. Prior to that I was overseas during WW II until about 1942. In an earlier period I had been Assistant General Council of the United States Treasury in Washington from 1933 or 1934 until 1940. After we were retained to advise the Attorney General and other members of the administration in connection with the ownership of the, or possible ownership of the pipeline by the State, we conferred at length and concluded that the device that was best adapted to providing the State ownership of the pipeline would be public authority. The authority device is not a new device. It is not untried and, at its best, under competent members, it has advantages of full private and public management. It must pay its way and usually it has no access to the public treasury. It has no stock; it is operated under Government and after its debt is paid it properly belongs to the State and to the people. Although there

has not been any project of which I am aware of comparable size to the pipeline under consideration here, there have been authority financings amounting to billions of dollars. For example, the Port of New York Authority now has outstanding about one and a half billion dollars worth of bonds and it has retired about an equivalent of that amount of bonds. The Los Angeles Power and Light Authority has outstanding about a billion dollars worth of bonds. The Power Authority of the State of New York has outstanding a billion and a half of bonds. The New York State Thruway has a billion in principle amount of bonds outstanding. The New Jersey Turnpike Authority has approximately three quarters of a billion; Illinois Turnpike Authority has over six hundred million; and the Nebraska Public Power Agency has a half a billion dollars in bonds outstanding. All of these projects have been financed without any recourse whatever to tax revenue. These projects have been self-liquidating, self-supporting, and are managed by the authority as an autonomous, independent, separate corporate legal entity. That is the purport of H5 number 569 which creates the Trans-Alaska Authority as an independent corporate entity. Its membership is appointed by the Governor with the confirmation of both houses in joint session of the Legislature. It has all the general powers of a private corporation as well as a public corporation. It has specific powers to issue bonds or notes and to make agreements with the bond holders and note holders for the financing of the project and it can make rates and charges and revise them from time to time without the surveillance of any other regulatory agency sufficient to pay the interest and principal on the bonds as well as its debt service as well as the operating and maintenance expenses. It has the power to acquire the property of any other pipeline company, either by purchase of stocks or by purchase of property, or by physical property or, if necessary, by exercising the right of eminent domain upon payment, of course, of just compensation. The Act is not mandatory. The Act is purely permissive. All it does is set up the framework from which the State can then determine its next move. It is purely enabling legislation. It might never be used or it might be used in part or in whole, but it is indispensable ^{to have} some legal framework if the proposals that there may be State

ownership is to move forward. The hearings, I think, became confused at one point in regard to pledge of credit of the State. An independent public authority such as should be self-supporting. All of the authorities that I have mentioned are self-supporting. Sometimes it has been desirable, although I only know of one case, to guarantee the bonds, although no recourse has ever been had to that guarantee. That is in the case of the New York State Throughway, where some bonds were issued guaranteed by the State, after a constitutional amendment was adopted authorizing the guarantee, but the project has been completely self-liquidating and there had never been any of payment of any of the interest or principals out of the revenues. Did one of the amendments that the Attorney General introduced or offered to the committee at the opening of this session eliminates from this act the recittal or from this bill, the recittal in the legislative findings that it is clear to be in public interest for the State to guarantee the principal and interest on bonds issued to finance the facility. The other amendment eliminates the section which provided to the extent that the constitution permitted the bonds might be guaranteed. Now, that section was pure surplus and really doesn't belong in the bill because the constitutional amendment provides that, if it is adopted by the people, then the Legislature is authorized by an act to guarantee the bonds but, first of all, the constitutional amendment is required to pass the people and, secondly, another Legislature must act to pass a law before any of the bonds are guaranteed. So there (Its redundant) for anything of that character to be in this bill, thats why it has been eliminated. As it stands, the bill authorizes an authority to make plans and to proceed with the project but doesn't require the authority to do anything, and doesn't in any way pledge directly, or indirectly, the credit of the State or the taxing power of the State. I may say of this connection that the project, as defined in the Act, is much broader than the pipeline. There are many other things that are required to be built which would be revenue producing. For example, port facilities, airports, docks, wards, storage

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

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

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

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

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

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

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

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

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

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

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

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

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

Kades: The House joint resolution?

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

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

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

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

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

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

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

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

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

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

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

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

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

Kades: Yes. For this purpose, the ^{of the, its limited for the purpose of} purpose of securing the payment of bonds and notes of a public enterprise or a public corporation of the State. ^{without any provision}

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

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

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

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

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

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

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

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

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

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

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

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

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

Kades: I am not clear on the question.

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

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

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

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

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

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

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

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

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

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

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

are the States also, with adequate protection of course, for the bond holder, then the interest on the bonds should be exempt. Now on that we would, because this is a grey area, it would be necessary for us to secure a ruling from the Commissioner of Internal Revenue. Last November, when the Attorney General first raised this point with us, we prepared an opinion to Governor Egan that was agreeable to the Attorney General, I think it is complicated. . .
 perhaps one might say . . .

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

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

McVay: Mr. Barber.

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

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

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

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

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

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

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

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

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

Kades: That's true correct.

Rose: Thank you.

Kades: Mr. Holm

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

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

How: I didn't know if this ^{you} was field now

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

Holm: Now you people are bond counsels?

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

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

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

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

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

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

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

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

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

Holm: Mr. Rettig has another question.

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

the possible non-taxable status, of the bond?

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

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

Kades: Such as the severance tax.

Rettig: Correct

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

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

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

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

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

Joe Bryson

March 6, 1972

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

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0179.0 Miller/Temple
0182.5 Rose/Temple
0185.3 Radar/Temple
0187.5 Bowman/Temple
0188.5 Josephson/Temple
0191.5 Swanson/Temple
0193.5 Mike Colletta/Temple
0196.5 Farrow/Temple
0198.0 McVeigh/Temple
0198.3 Rettig/Temple
0203.0 Temple - End of statement
0203.8 Recess -- reconvened
0204.0 Bruce Campbell statement
0212.3 End of Campbell statement/Rettig
0213.3 Holm/Campbell
0214.3 Rose/Campbell
0218.0 Christiansen/Campbell/Havelock
0220.5 Rettig
0221.8 Havelock
0222.3 Recessed until 8:00 a.m. tomorrow.

March 7, 1972

0224.0 Reconvened
0224.3 Rettig intro. Wohlforth.
0225.0 Rettig
0226.0 Wohlforth statement
0269.5 End of Wohlforth to Havelock
0271.0 McVeigh "can everyone hear...."
0273.0 Larry Eppenbach statement

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0284.0 McVeigh
0284.3 Groh
0285.8 Wohlforth
0287.5 Groh/Wohlforth (McVeigh "speak up, etc.")
0288.3 Christiansen
0289.0 Havelock
0290.5 Holm/Eppenbach
0294.0 Wohlforth answers
0299.0 Havelock "May I comment." Holm
0297.8 Havelock
0306.5 Christiansen (McVeigh chairing during
question and answers)
0307.5 Wohlforth
0308.5 Havelock
0309.0 Young/McVeigh
0310.8 Rettig/Wohlforth
0312.8 Eppenbach
0315.0 Palmer
0316.3 Wohlforth
0317.5 Eppenbach
0318.5 Wohlforth
0319.0 Rettig
0320.3 Havelock
0322.0 Recess for ten minutes

(From this point to the noon recess is a bad tape and you
will have to go to the Department of Revenue transcript
to take your transcript. I will give what I have down on
my log anyway.)
0322.0 McVeigh
0324.5 Havelock intro Henri
03226.3 Henri

0368.0 End of Henri statement
0368.3 McVeigh chairs - Groh/Henri
0378.0 Young/Henri
0380.0 Wohlforth
0386.8 Eppenbach
0388.3 Holm/Henri
0394.0 Hubert/Henri
0396.0 Barber/Henri
0398.0 Thomas/Henri
0401.5 McVeigh/Josephson/Henri
0404.0 Palmer/Henri
0407.8 Rettig
0408.5 Eppenbach/Palmer
0411.5 Palmer/Havelock
0414.8 McVeigh
0415.8 Colletta/Henri
0420.0 Havelock
0422.8 McVeigh/Rettig/Wohlforth
0425.3 Groh/Henri
0429.3 McVeigh - recess.
(End of bad tape)
0428.5 Reconvened McVeigh
0430.5 Havelock intro Kades
0433.0 McVeigh
0433.5 Kades statement
0450.8 End of statement
0451.0 Groh/Kades
0455.0 Christiansen/Kades
0468.5 Young/Kades

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0478.0 Havelock/Kades
0489.8 Barber/Kades
0494.8 Rose/Kades
0501.0 Holm/Kades
0507.3 Rettig/Kades
0519.8 McVeigh/Havelock
0520.5 Kades
0521.3 McVeigh/Havelock
0522.0 Kades
0523.0 Rose/Kades
0525.5 Recess until 3:15
0527.8 Reconvened
0532.5 McVeigh
0532.8 Havelock/Wohlforth
0535.3 Havelock intro Gildehaus
0536.0 Gildehaus statement
0568.0 End of statement
0568.5 Groh/Gildehaus
0572.3 Rose/Gildehaus
0575.8 Wohlforth
0578.3 Rettig/Gildehaus
0589.5 Havelock/Gildehaus-Rettig
0594.0 McVeigh/Gildehaus
0600.8 Eppenbach/McVeigh
0604.3 Gildehaus
0611.0 Rettig/Gildehaus
0612.0 Eppenbach
0612.5 Wohlforth

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0684.8 Havelock

0686.0 Groh/Rettig

0687.5 Havelock intro

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0687.5 Havelock introduced Hellen
0688.8 Hellen statement
0704.0 End of statement
0704.5 Rettig/Hellen
0713.0 Holm/Hellen
0714.0 Holm/Havelock
0717.3 McVeigh/Hellen
0774.3 Groh/Hellen
0726.3 Havelock/Groh
0727.3 Rose/Hellen
0734.8 Hubert/Hellen
0738.8 Rettig/Havelock
0741.0 Holm
0741.5 Christiansen/Rettig
0743.5 Wohlforth
0743.8 Rettig - adjourn until 8:00

March 8, 1972

0745.0 Reconvened
0746.0 Sen. Croft statement
0778.3 End of statement
0779.0 Groh/Croft (Rettig chairing)
0786.5 Radar/Croft
0789.0 Rose/Croft
0792.0 Hubert/Croft
0797.5 Barber/Croft
0802.5 Croft statement
0805.0 Rettig/Croft
0807.3 Rose/Croft
0810.0 Hubert/Croft

AGO 530713

1028.3 Radar/Williamson
1032.5 Donaldson/Radar
1036.3 Hubert/Rettig/Donaldson
1041.3 Croft/Williamson
1047.0 Barber/Williamson
1048.0 McVeigh
1052.8 Palmer/Williamson
1056.5 Croft/Williamson
1058.0 Radar/Williamson
1060.0 Donaldson
1061.3 Thomas/Donaldson
1068.5 Donaldson
1063.0 Recess for 10 min. - Reconvened
1066.0 Donaldson intro net three witnesses.
1068.0 Harry Jones statement
1097.5 End of Statement
1098.0 Rose/Jones
1100.3 Miller/Jones
1106.3 McVeigh/Jones (Rettig chairing)
1112.5 Groh/Jones
1116.5 Hubert/Jones
1124.5 Holm/Jones
1130.5 Donaldson intro Markham
1131.5 Markham statement
1196.5 End of Statement--recess
1197.00 Reconvened - Rettig
1200.0 Holm/Spahr
1200.8 Groh/Spahr
1206.3 Palmer/Spahr
1210.3 Donaldson/Palmer

1213.8 Hubert/Spahr
1222.5 McVeigh/Spahr
1229.5 Rose/Spahr/Donaldson (we'll try to get an answer...)
1242.8 Mr. Spahr left.
1244.0 Recess

End of Tape #1

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

OUTLINE OF PROPOSED TESTIMONY
BEFORE
THE SENATE COMMERCE COMMITTEE
HON. RON L. RETTIG, CHAIRMAN
AND
THE HOUSE LOCAL AFFAIRS COMMITTEE
HON. RICHARD C. McVEIGH, CHAIRMAN
3:00 p.m., March 6

1. The Concerns of State Policy
Statement of Governor (Lt. Gov. Red Boucher)
2. Alaska's Stake in North Slope Oil
leases, royalty, severance and netback (Charles Herbert,
Commissioner of Natural
Resources)
3. The Federal Role in North Slope Oil
I.C.C. regulation - how it works,
federal pre-emption (John E. Havelock,
Attorney General,
Pipeline Coordinator)
4. The Cost of Building the
Trans-Alaska Pipeline System (Bruce Campbell,
Commissioner of Highways)
5. The Impact of Costs on Revenue (Eric E. Wohlforth,
Commissioner of Revenue)
- Methodology - Comparison of State
and Private Ownership Cases (Larry Eppenbach,
Department of Revenue)
6. Impact of State Revenues on the
State Budget (Joseph R. Hemi,
Commissioner of
Administration)
7. The Advantages of State Ownership
Issues and Answers (H. M. Temple III,
Temple, Barker & Sloane)
8. The Statutory Framework for
State Ownership (Charles Kades,
Hawkins, Delafield & Wood)
9. Arrangements for the Public
Financing of Pipelines (Tom Gildhaus,
Temple, Barker & Sloane)
10. The Marketing of Public
Pipeline Issues (Robert Macy, Kuhn,
Loeb & Co.)

1000 No. 6
Mr. Rettig: Now at this time we will proceed with the administration witnesses,
Attorney General John Havelock.

Mr. Havelock: Thank you Mr. Chairman. The opening witness we present for the Committee here today is the Honorable Eric E. Wohlforth, Commissioner of Revenue, who will speak generally to the impact of pipeline costs on revenue. Commissioner Wohlforth.

(Mr. Rettig)

Before Mr. Wohlforth commences his testimony, I would like to point out just a slight kink in our plans. We ~~are~~ ^{are} going to commence questioning from/^{committee} members and legislators immediately following testimony of all out-of-town witnesses. It would be helpful if you do have questions, ^{concerning} the administration staff and others who reside in Juneau to save your question, certainly make notes of them so that you can ask those questions at a later time at the individual committee meetings when these measures are being considered.

(Mr. Wohlforth)

Thank you, Mr. Chairman, members of the committee, let me first point out one of those unhappy events which happens in the course of preparing documents and that is for these two years 1980 and 1981 some typist made a reversal of some of the figures. The figure 3397 should be under state taxes, the figure ³⁷⁰⁵ ~~3305~~ should be under state taxes, that's conversely taxes should be in the other column. I think that we see readily from the sequence of figures that that typing reversal did occur and I'm very much indebted to ^{gentlemen} the unidentified/who called it to my attention at 7 o'clock this morning.

The figures which are, although done graphically, are hard to see from, by any of those who are sitting in back of the room or any person who doesn't happen to be ^{fairly} ~~forsighted~~, are depicted in a hand-out entitled, Exhibits to Support Testimony Before These Committees, with yesterday's date. Committee members have those exhibits now and they will see ~~XXXX~~ little tick marks after the two places where the unfortunate figure ^{is} reversal occurred. My job this morning/to summarize past projections of North Slope revenues and those presented today based upon private ownership and to contrast the effect of private ownership case with the case of the pipeline owned by the State of Alaska. The most recent public North Slope ^{oil} revenue projections before those which

Governor referred to last week were made by the Division of Oil and Gas in cooperation with the Department of Revenue as part of the State's contribution to the Federal impact statement which was released by Governor Egan in July of 1971. These projections were developed from a computer model which was based on the information then available to the State of Alaska and showed various and numerous economic cases on differing assumptions again, based on facts then assumed to be ascertainable. The July 30 report which is contained in the State's contribution to the impact statement states, ^{ON} page 166, that "the originally estimated \$900,000,000 cost of the pipeline has already increased considerably, present cost estimates range from one million to 2.1 billion, that will occur I am sure, frequently, to 1 billion to 2.3 billion dollars. These revenue projections use the assumption of one billion dollars, as the lowest ^{installed} cost of the pipeline and 2.5 billion as the highest estimate. A footnote to this statement gives backup for the State's then cost estimates. This footnote notes that as late as July 19, 1971, Aleyska furnished the State Department of Revenue an estimate of \$969 million dollars as the cost of the entire contract, and the footnote concludes with a reference to a statement from Interior Secretary Rogers C. Morton, in the late spring of 1971, that (environmental regulations and) environmental precautions are contributing to a higher price tag of about 2.3 billion dollars. So it was this figure of 2.3 billion dollars which was used on the State's most likely estimate of North Slope revenues. ~~The revenue estimates included in the State's report developed from this estimates of total cost; the revenue estimates most likely estimate of North Slope revenue.~~ The revenue estimates included in the State's report developed from this estimate of total cost assumed refinery value in the year, fiscal year 1975, ^{which} was the then estimated start-up year, that is refinery value on the West coast of ^{\$}3.37 a barrel, marine transportation costs of 44¢ and pipeline tariff initially of 80¢ per barrel, giving a wellhead value of ^{\$}2.12 per barrel. From these figures it was estimated that total royalties and taxes would amount to \$164,000,000 a year in fiscal year 1976. The first year, then assumed, of pipeline operations. In the second year of operations fiscal 1977, the total revenue was estimated at 278,000,000, the third year,

\$282,000,000, in the fourth year \$311,000,000. In the then-estimated, and I repeat then-estimated, fifth year of operation, fiscal year 1980, pipeline tariff was calculated at \$.47 a barrel with marine transportation costs of \$.52 leaving a wellhead value of ~~2.56~~^{2.56} per barrel. In that year, fiscal 1980, we showed then, a total of \$348,000,000 in total royalties and severance taxes from the pipeline. And we didn't stop with one set of assumptions. Other assumptions were run with different assumptions. Estimates were run with different assumptions. For example, one set the pipeline cost \$1 billion again with the initial production year 1976. A wellhead value of \$2.75 with lower marine transportation and tariff, ~~showed~~^{produced} fifth \$212,000,000 in revenues the first year of production and the ~~XXXXX~~ year of production on this optimistic, optimistic ^{from} on the point of view of the billion cost of the pipeline, was assumed to capture, ~~the State~~^{the State} was assumed to capture in that year \$412,000,000 in pipeline revenues. A then pessimistic case which assumed a pipeline cost of 2.5 billion showed a wellhead value of \$1.76 in the initial year of 1976 and royalties and taxes of \$136 million in that year. In 1980, however, at a wellhead/^{value} of \$2.20 a barrel, royalties and severance taxes reached the figure of \$297,000,000. Incidentally, and obviously, in all these case, one of the main reasons wellhead value increases over the years is that transportation costs go down as the volume of oil/increases. Now several important events have come to light which have required the State to revise downward drastically its revenue estimates. The first indication of the fact that the State was incorrect in assuming as it did, in July, 1971, for its contribution to the Impact Statement, the first indication that the State was incorrect at that time in making ^{a n -} ~~an~~ ^{flow} assumption that a production/starting at 600 barrels per day would reach 1.7 million barrels per day in the second year of production was disclosed in the summary ^{description} ~~project~~ of the transalaskan pipeline system received by the State this fall. On page 55 of ~~the~~^{that} document it is stated the pipeline will be brought to full capacity in ~~XXXXX~~ stages. In the initial phase of operation the system will have the ability to transport 600,000

barrels a day, and I'm paraphrasing page 55 of the summary impact statement. The reports goes on to state that the second phase is tentatively scheduled to be completed approximately 2 years after initial start-up. In this phase the report states the system will have the designed capacity of 1.2 million barrels per day. The final phase so says the report, is expected to be completed approximately seven years after initial start up, that is a pumpage flow at which time the pipeline will reach its ultimate capacity of 2.0 million barrels per day according to the description in the statement. In other words, ^{there} ~~it~~ will be, according to the statement, at least five hundred thousand barrels per day less production in the second year of operations and each year thereafter for the initial seven years. The next shock to the State was ~~xxx~~ disclosed by the S.E.C. Registration Statement filed by British Petroleum Company *Ltd.* ~~submitted~~ on October 12, 1971. In the offering circular accompanying that registration statement the following statement is made on page 24, "the initial construction phase of the pipeline is expected to provide a minimum aggregate throughput capacity upon completion of 600,000 barrels per day. This capacity is designed to be expanded in two stages. The first stage resulting in a total capacity of 1.2 million barrels per day, and the second a ^{total} capacity of 2.0 million barrels per day. Parenthetically, no reference to the time of build-up. It is presently estimated that the cost of the pipeline upon completion to the 600,000 barrels per day capacity would be approximately 2.3 billion and that increasing the capacity to 2 million barrels per day would increase the cost by \$400,000,000. On November 10, 1971 Atlantic Richfield, together with the City Service Company, filed a registration statement with the Security and Exchange Commission stating that "the cost of the system upon completion ^{to} the 600,000 barrel per day capacity is presently estimated to be approximately 2.4 billion of which the company will be responsible for approximately \$675,000,000. The additional costs to all participants of increasing the capacity to 2 million barrels per day is estimated to be at least \$400,000,000. Thus by mid-November, 1971, the total pipeline costs ^{had} ~~were~~ escalated to 2.8 billion, or \$500,000,000 over the average case assumed in July when the State made its revenue estimates. In fact, it increased \$100,000,000

in less than one month between two SEC filings by companies involved in the North Slope pipeline. This dramatic increase in pipeline costs, revealed in official documents at the time of Governor Egan's first announcement on State ownership, made it urgently necessary that the State finally determine independently the likely magnitude of the pipeline costs. Commissioner Campbell has already indicated the independence study which the State has made through its consulting engineers, Tibbets, Evan, McCarthy and Stratton, and the foundation for the present estimate of 3.5 billion. These figures have been recently developed, along with an independent evaluation of operating costs, so that for the first time the State can make a reasonable projection of the probable amount it can expect to capture from North Slope revenue. And incidentally, in the hand-out of exhibits there is a breakdown in addition to the comparison of public and private ownership of the construction costs table which Mr. Campbell ~~referred~~ referred to yesterday. We will make additional copies of those available if they are in short supply, ^{if other} _____ senators, representatives or members of the public desire to see them. The base case shown today in graphic form assumes the total pipeline cost of 3.5 billion financed 90% by debt, at an interest rate of 8%. It conforms to the Aleyska throughput assumption of full production only in the 7th year of pipeline operation. It shows the same ICC permitted rate of return as shown in the State's projection in July. In the fourth year from the beginning of construction or the first year of operation, for 1977 we now show a negative well-head value or no state revenues. This was the year comparable to that in which it was earlier shown that the state would capture at least \$164,000,000 in total revenues consisting of royalties and severance fees. The fifth year, 1978, the second assumed year of operation we earlier estimated \$278,000,000 in State revenues. In these two years alone the net revenue loss to the State over earlier estimates amount to \$442,000,000. By the sixth year, or 1979, the new projection shows \$84.6 million ~~in~~ in oil severance and royalties revenues. Earlier we estimated \$282,000,000 for that year. The net loss by that year over earlier estimates is \$640,000,000. Not until the 15th year of pipeline operation do royalties and severance taxes amount to near the amount shown in ^{our} ~~the~~ previously made estimate before the second calculated year **AGO 530722**

In that 15th year we show severance and royalty revenues of \$277 million. Now the question ~~is~~ ^{it} has been asked, and not only has been asked, it has been asserted that this is the most pessimistic of all/cases ^{possible} which can be produced by the State for its revenue picture in the late 1970's and 1980's. I'd say that the answer to that is clearly no, for three reasons. In the first place the revenue loss figure mentioned above is no effect to our expectations now of first pipeline operation in the year 1977 whereas in July we assumed the full year of revenues ^{starting} on July 1, 1975. That is to say we show a \$640,000,000 loss comparing three years of operation regardless of start. In the second place we show state taxes in each year of operation of approximately \$33,000,000. For these first three years of operation ~~the~~ ^{state} income taxes are estimated to total approximately \$100,000,000 or 3 times the \$33,000,000 a year. This assumes full state ^{income tax} ~~income~~ on pipeline profits. Experts have indicated that this itself may not be ^a realistic assumption. Even, however, with the most optimistic income tax estimate, net revenue loss from earlier projections amounts to \$540,000,000 during the critical first three years of operation. Thirdly, calculation of the 7% permitted rate of return on valuation may err on the low side. This was alluded to yesterday by Mr. Temple as the legalities of the possibilities were discussed by Attorney General Havelock. I can only say that the leading text on the ~~XXXXX~~ subject which is Petroleum Pipelines and Public Policy by Arthur Johnson, cites numerous instances of the slowness of the ICC to actually evaluate pipeline costs and its heavy reliance on figures supplied by industry. And its well known to the Committee and ^{to} the public at large that the Cook Inlet pipeline valuation itself took nearly three years to complete. The 7% figure again is not high when it is remembered that there are seven separate proposed pipeline owners, each of whom may aggregate earnings of each of its other pipelines when the 7% rate is considered. We will hear further expert testimony on this later. The point here is that is entirely possible that higher return rates ^{may} ~~will~~ be permitted at least until the valuation of the pipeline is complete and possibly ^{there} after when earnings of other pipeline companies are aggregated to arrive at a total rate of return for a particular pipeline company. The next case shown on the chart and to some, seeable on the wall, assumes the case

of the economic effect of State ownership of the pipeline. Financing is assumed in the amount of \$1 billion dollars in each of the first two years of construction at 8%. \$900,000,000 in the third year, ^{of construction} at 6.5%, \$215,000,000 at 8% in the first year of operation and \$310,000,000 in the second year of operation, and I may say that Mr. Eppembach who will follow me will give you some more precise detail on the assumptions that went into the assumed case of public ownership I'm now discussing. This case also assumes the same ICC permitted rate of dividend payoff as assumed for the private case. ^{mainly} The 7% percent which is a cash ~~XXXXX limited~~ ^{dividend} payout limitation in each year of the projection. In arriving at the State's net cash flow which is indicated at the top of the chart assuming public ownership, pipeline income, royalty and production payments, in arriving at the State's net cash flow operating expenses, amortization and interest on bonds, are deducted ~~XXX~~ from gross income. During the first year of operation net cash flow to the state ^{through} ~~tariff~~ is, as you can see from the chart, \$230,000,000 and royalty and severance taxes amount to \$15.7 million for a total of \$245,000,000 ~~XXXXX~~. Obviously, in State ownership no Federal or State income taxes are calculated ^{on} ~~in~~ pipeline income. Mr. Kades will speak to ^{this} ~~us~~ later today, explaining ~~XXXXX~~ in detail the assumption legal rationale for that statement. In the fifth year from the beginning of construction, or the second year of operation, net cash flow is \$228,000,000 which together with royalty and severance taxes of \$17,000,000 produce a total ^{of} \$245,000,000 for the State. In the sixth year from the beginning of construction and the third year of operation, net cash flow amounts to \$227,000,000 through the tariff and total royalties and severance taxes amount ^{to} \$123,000,000 for a total \$350,000,000 or for those who are farsighted, ^{calculator} \$350.94 as shown on the chart. In the 15th year cash flow is reduced to ^{\$183,000,000} ~~\$180,000,000~~ by reason of the fact that the pipeline has depreciated but total royalties and severance taxes amount to \$297,000,000 for a total to the State Treasury of \$480,000,000. Now let me emphasize that this case makes almost identical assumptions to the private case described before. It should be

emphasized that net income to the State is computed after debt service on State bonds.

To avoid a speculative argument on the ^{possible} differential between interest rates on the State's debt, which may be tax exempt, versus taxable interest on private borrowing, we show all but \$900,000,000 in state bonds at the same 8% rate as shown in the private case. I think the 8% can be, we could spend the day arguing 8%, 7% or 9%, we all know the trend of interest rates in recent years, the fact that double ~~AA~~ corporate ~~XXX~~ bonds are selling today at about an interest rate level of 7.23 gives me comfort that 8% is as good an estimate of interest on both state and public borrowing and indeed conservative on state borrowing ^{as} which can be arrived at today. The main differences between the assumptions lie of course as I have stated before, ^{in the fact,} ~~is~~ that the State is not subject to Federal income tax and obviously will receive no State income taxes from the pipeline since ^{it} ~~XXX~~ is assumed to be the owner. The timing of the bond issues for both the public and the private cases is the same, although the term of the public bond issue is ^{shorter} ~~short~~ 25 years, indicating heavier debt service loads and the state of course is assumed to finance the pipeline 100% ~~and~~ on a step basis. Now we ~~can~~ ^{could} make numerous additional assumptions, and we have made additional assumptions, ^{on} the question of the matter of public financing, the manner of private of private financing, the assumed debt equity ratio of private financing, the rate of return permitted either to the State or to private pipeline owners, interest rates payable by the State and private pipeline owners, the effective tax rate in private ownership, to mention only a few. We know and the Committee knows, and I believe ~~that~~ each Senator and Representative in this room knows, that estimating the effect of a project of this size and magnitude based on events three to seven years away, must rest on ~~an~~ assumptions which are to a degree speculative and you will hear testimony that our assumptions are probably incorrect. The point is that no one can say with absolute certainty what our revenue picture will be with the pipeline in private ownership. We have now, however, tested ^{prior} ~~XXXX~~ assumptions based on new and in two instances, official information before us. I refer to the Aleyeska Impact Statement and the more recent SEC

filings of ~~the~~ two of the member companies. This effort and this information has convinced the administration that it must attempt to do now what it can to remove the uncertainty of the revenue picture in the late 1970's and the late 1980's and this attempt to remove the speculation and to give the State the tool to move forward in this regard is the thrust of the bills that are here before ~~you~~ you today. The details of the bills, the theory and rationality ~~XXXXXXXXXX~~ will be addressed by other members to come before you, but I see it in the context of State's effort to remove the degree of speculation about which we are in when the pipeline ^{starts} ~~is~~ to flow and when State revenue's can, to some degree begin to be hoped for.

Mr. Larry Eppenbach, L. E. Eppenbach, will explain to you now how our projections were made ⁱⁿ ~~and~~ some additional details, and some of the detail on the chart before you.

Thank you.

Thank you Commissioner.

Mr. Havelock. A little comments, perhaps, about now to explain the methodology used in discussing with Commissioner Wohlforth, Mr. Chairman, he acknowledged recognition that there is considerable complexity to the testimony as presented by himself and Mr. Eppenbach and if the Chairman wishes that...so that details are not lost in the minds of those

END TAPE 6

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Date of meeting: March 7, 1972

MR. EPPENBACH: Mr. Chairman, Committee Members: In testimony already presented, you have heard a great deal about revenues, talks of pipelines, calculations of royalties and production taxes, and permitted dividends. Rather than to add more numbers, more formulas, more calculations, I think it would be prudent now to pause and develop perspective on the numbers already given to you about the many charts. To do this I should like to talk first about how the State brought all of its pipeline information together, to calculate what is ^{really} the most important piece of information thus far--that is, the new estimates of total annual income from the North Slope. As has already been indicated, we employed a computer model which simulated each year the economic operation of the pipeline, the various conditions regarding ownership, financing, taxes, and earnings limitations. In a sense, an income statement was prepared each year for the owner of the line. This income statement does not appear so very different, at least in terms of these expressions, from that of any other income statement. Gross revenues to the pipeline are derived from its tariff charge in barrels of oil transported through the line. That gross revenue less the cost of operating and maintaining the line less depreciation less interest cost of financing the line will produce the net income figure. From that we deducted any Federal or State income taxes paid to calculate a net-after-taxes income. Similarly, the cash flows to a pipeline company is much like that of any other business, is equal to the net-after-tax income plus any additional cash flows which may be generated because the depreciation charge that is provided for in the income statement happens to be greater than the volume of bond retirements made by the company. The only place the pipeline operation appears different economically to that of the ordinary company is in the dividend payout allowed each year by the pipeline company to its owners. Again, as was discussed yesterday and this morning, that dividend is not some percentage of equity or some rate of return on capital investment,

but is a percentage dividend allowed on the valuation of the pipeline as determined by the ICC. The ICC valuation approach takes into account many issues: original cost of the line, depreciation, percentage increases for going concern value, and additional percentage increases for inflation. Our computer model had to also simulate this ICC valuation. In very general terms, during the first year of operation we calculated ICC valuation to be about \$3.25 billion. In the following years it decreased and increased slightly as additional phases of operation were under way providing for a higher throughput and eventually decreased in value as the line began to depreciated.

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

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

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

Under conditions of private ownership, a very different case develops. Here in the initial year a total of about \$37 million should accrue to the State. Where does it come from? Three million two hundred thousand dollars of it only comes from the North Slope in the form of gas royalty and production tax payments. This is gas that is assumed to be shipped in a trans-Canadian gas pipeline. The remaining \$34 million comes from State income taxes. In the 7 per cent dividend case displayed here there is no positive wellhead value for oil during the first two years of operation under private ownership. In this case, for there to begin to be some positive wellhead for oil during those first two years, the dividend payments must be no greater than 4.75 per cent, and even if the dividend was lowered to zero during those two years, the State's income of approximately \$53 million under those conditions would be, of course, less than one-third of that estimated as recently as last year.

I shall present at the close of the testimony this afternoon a series of cases for the Committee to study that explore this question of taxation and dividend limitation. For the present, however, let us return to these two cases that we have displayed before you. Again, they provide a legal 7 per cent ICC dividend. In the private case, even though a negative wellhead value is indicated for the first two years, it is quite possible that the oil companies would still pump oil as their true cost of shipping their own oil through their own pipeline may be different from their calculated cost of shipping the State's oil through their own pipeline. Not only is the dividend permitted legal, but together with the

costs and throughput capacity limitations as stated in the Impact Statement, this case of private ownership of the line appears quite possible. So are the revenues it generates.

That finishes my testimony. I believe now questions are in order.

CHAIRMAN: We'll take questions from the Committee, Senate group, Senate Commerce Committee; Senator ^{Groth} Groth?

^{Groth} SENATOR GROTH: At one time when the legislative oil consultant testified before the Legislature he indicated that it would be possible that the oil companies may hasten the date on which the 2-million-barrels-per-day capacity goes into the line. Assumptions here, as I understand you, are based on the premise that ^{throughput} 2 million barrels per day will not be achieved for a period of seven years. My question is: Have you inquired of the companies as to whether they intend to hasten that throughput arrangement to sometime earlier than seven years?

WOHLFORTH: We plan to answer that, Senator ^{Groth} Groth. The official document which came to the State is dated August 1971, and received and analyzed about in the September-October time frame. We made reference as recently as Friday directly to the main impact Statement itself to determine where that seven-year throughput date was ^{the one} in the official Impact Statement. Commissioner Brewer called the several officials in Washington who could make that determination, and he has assured us that that is the figure that's there. I feel it's a figure we have to live with, and we may hear testimony from oil companies later that indeed that is not the correct assumption, but I really think that's a matter for them to ^{spack} see to and perhaps Mr. Sparr, himself, whom I understand is the lead-off and direct witness.

GROTH: Eric, I understand that if you've looked at the Statement, but insofar

as a direct inquiry then, gentlemen, do you intend to do this sooner than seven years? That discussion, I gather, has not taken place.

WOHLFORTH: We've had discussions. I, personally, have not discussed it with any oil company official. Others have, may have, discussed it. I do not know what their direct answers may have been to that statement.

~~GROTH~~
GROTH: Thank you.

CHAIRMAN: Thank you. Are you through? Senator Christiansen. Please stand up and speak up as loud as you can, please, so they can hear in the back.

CHRISTIANSSEN: Mr. Chairman, yesterday just before we left I asked a question and I believe Mr. Havelock said that I would be answered later on. As a matter of fact I think you answered part of it when I asked the question came out where this bond, in case it didn't pass, then what would happen? Would we still have the pipeline or what would we do?

HAVELOCK: I think I indicated, Senator, that we are not now proposing that a bond issue be proposed to the people, but we do have a constitutional amendment to propose that will allow State guarantee. That question would be an academic one. There is always the question of whether the people or the Legislature of the State of Alaska wants to do something, and if the Legislature does not wish to do something, then ~~something~~^{nothing} will happen. The wishes of the people, the wishes of the Legislature are binding on the State.

CHAIRMAN: Are there any other questions? Senator Meland? Members of the, Senator Holm.

HOLM: Perhaps you can tell me why you only made it a ten-year projection or an eleven-year projection on this chart. What happens if project it to maybe 20 years?

EPPENBACH: For reasons of room and also time here, and having our ^{computer} results transmitted from Massachusetts to here in Alaska, we confined the analysis to specific years--first five years and then the eighth, tenth, and fifteenth year of operation. We have the ability to make a longer term estimate. We have analyzed ten years of operation with fifteen years of time periods overall. A more direct answer to your question--~~we tried~~ ^{the trend} to establish in a graph to about 1988 within stock since you would be in Phase Three Operation at that point. They would tend to level off a bit. There may be some marginal increases but on the whole we would expect the effects of inflation to just about equal both in costs and in higher refining prices of oil.

HOLM: So then you expect the next ten years the distance would level--would start to narrow.

EPPENBACH: That's right. The capacity of the pipeline, as we understand it now, will not be increased ^{during those} ~~in another~~ ten years. It would take an increase in capacity to have those charts continue to move up right off the paper.

HOLM: Then one further question. If I were the Alyeska Pipeline Company and knew I wasn't going to get any additional profit from ownership and operation of the pipeline, I doubt if I'd contract with you to build at the same price that I would build if I were building for my own use. Now, are you assuming that they will build at the same price for you as they would build for themselves?

WOHLFORTH: Well, I think we try to achieve comparability in the suit cases. I indicated in my testimony (I hope I sufficiently indicated) that we had now achieved something which we felt was a great deal firmer in concept than we had certainly last July. To achieve comparability in the one case versus the other the \$3.5 billion total landed cost of the figure was assumed. It may be, indeed, that that is not the ultimate price. It may be, indeed, that some of the \$3.5 billion cost is not an allocable, ascertainable cost of the State or some slight

amount may be more, but as a gross, and I should say perform an economic projection, we thought it would do the Committee a service to stay with the basic landed at stall cost figures.

HOLM: I also assume that you have not considered any other contractor for the construction of this pipeline because they are already the owners of all this pipe and a lot of construction so far.

WOHLFORTH: Mr. Campbell is far better--is he here this morning?

CHAIRMAN: Yes, he's here.

WOHLFORTH: Far better to speak to the composites of the \$3.5 million (\$3.5 billion --I guess I'll do that every five minutes for the next couple of days) which are set forth in the chart which is here before you and indeed there is a figure here which shows costs to date before start of construction and makes component references to costs thereafter. I defer anything further on that to Commissioner Henri.

? With your permission, may I comment first?

HOLM: I just wanted to assume (1) that Alyeska is the only party that you considered as being the contractor for this, and that they then will probably build in a little bit extra cost to the pipeline because they are almost a captive contractor.

HAVELOCK: First of all, Mr. Holm, the State ownership of the pipeline does not mean that there is no interest or profit available to the industry. Their interests and our interests basically identical in one respect--that we all expect to enjoy a substantial benefit to getting that pipe, that oil underground, and moving it to market, and the fact that the incidence of their benefit shifts from the profits obtained from the pipeline to other aspects of the chain of commerce

doesn't seem to me reduces their incentive. As to the particular incentives in operation, if the pipeline is owned by the State of Alaska and they are a contractor to build that pipeline, they have a particular incentive to operate with maximum efficiency in that construction because under the ICC rule the contractual costs will become the valuation base which we will in turn charge back to the shipping companies for the cost of transportation. So they would then have an incentive which in fact does not exist now to keep costs down. Thirdly, you touch upon a question, or applied in a question which I believe Senator ^{Crosby} ~~Groth~~ commented on yesterday or addressed you yesterday, which is: What if the pipeline owner/company just don't cooperate? And I think there are three responses to that. First of all, the first response that comes to my mind is: What if the sovereign State of Alaska doesn't cooperate? This is not exactly a situation where the State is without bargaining position. Not only do we have bargaining position, but we also have a substantial interest. This is a situation where the private interest involved vastly exceeds the interests of the public of the State of Alaska.

I may say that in our discussions with the industry we have given some consideration to alternative contractors, but in our discussions have mainly assumed with the industry that in the event that public ownership was deemed to be in the public interest that in fact they would be willing and agreeable to contract. Once they get by the hurdle of public ownership in the first place, as a question of State public policy, I don't believe that we would expect their non-cooperation. There has been no sign in the hundreds of man hours we had in talking with various representatives of the industry that they that they in any ultimate sense, that ^{the industry} ~~they~~ would refuse to cooperate. They approach our negotiations with the most--we have had occasional confrontations--type of meetings where tempers where tempers have got up, which is expectable under the circumstances, but they have approached it by and large as a gentleman and

responsible businessman. I have not heard anybody speak in the terms used as to noncooperation. Which reminds me of Commodore Vanderbilt's famous line: "The public be damned--ain't it my railroad?" Nobody has said to us: "The public of Alaska be damned--ain't it our pipeline?" So in the discussions we had, rather than and the people of the State of Alaska, our discussions have pretty well worked themselves out based upon feasibility and the desirability from the point of view of the public policy of the State, and the extent of the commitment or sacrifice that we might be calling upon the industry to make in adjusting these new arrangements. And it is not only a question of sacrifice, of course, but of benefit to the industry. We have not asked them to give up, without compensatory advantages, which we can see for the industry in these arrangements.

The last point I might make on it is that we aren't really going to find out where we are until we have the tools, that is, the permissive legislation which would enable us to go forward and talk with them and move into the next stage of negotiation with the industry based upon an authority bill that the Legislature might adopt. I think it is first for the Legislature of the State of Alaska to decide whether it is the public policy of the State, or should be the public policy of the State, to have public ownership of the line and then to ask questions as to what the attitude of the industry is and whether they are willing to go along rather than the other way around.

Sorry to have talked at such length, but that does meet some of your points.

CHAIRMAN: Are there any other questions on State affairs? Senator Christiansen.

CHRISTIANSEN: Mr. Chairman, I hate to keep asking this question, but talking about \$3.5 billion, and if we don't bond outsel^{ves}f, where are we going to get that \$3.5 billion to build the pipeline? Then if we do build it, are we going to use

this first revenue to pay it back, or?

WOHLFORTH: I may just point out that the pipeline income here is shown under public ownership. This income is after debt service, Senator. Debt service is off before you get to this, that's been calculated. On the assumptions we've made so far, the debt service is shown as a deduction from gross income and this is net income, and I think that may answer a tiny portion of your question. It is assumed that the money would be borrowed in all events.

CHAIRMAN: The next three witnesses will be addressing themselves to the question you raised as to the market situation. Senator Young.

YOUNG: Will we be allowed to call any of these witnesses back again?

CHAIRMAN: That's the plan. The reason we're departing from the regular procedure is that because this witness will probably not be available at that time. Address questions to the administrative or administration officers. Mr. Rose.

ROSE: Only one question Mr. That's on the difficulty on our payment during the initial payment statement. First revenue starts going in. Now, I assume that the bonds require a yearly net interest payment, and how would that be met?

WOHLFORTH: Again, we'll address more specifically than the case of authority bond issue by Mr. Kades. As with other public authority issues, interest is borrowed or capitalized during the construction period.

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

RETTIG: Question to Mr. Wohlforth. You referred to the first table in the income from the pipeline under "Private and State Ownership." In the year 1988 you called our attention to the sharp drop in pipeline income from \$235 million

in 1983 to \$183 million in 1988, and I believe you attributed that to the impact of depreciation that had then taken place. Recalling Mr. Temple's testimony of yesterday, it indicated that pipeline valuation, which is the base ICC permitted profit, you stated, I believe that this valuation was based on replacement costs. Well, what effect would this depreciation have then, if that be the case?

WOHLFORTH: First, let me say, Mr. Chairman, I'm going to turn this over to Mr. Eppenbach who will have the full text of Mr. Temple's testimony before you hopefully within an hour or so, and you take it away on that basis, Larry.

EPPENBACH: Senator, replacement cost is clearly a function of replacement from original cost. The higher the value of the line, then, the larger the dividend, assuming a constant rate of dividend, whether it be 5.5 or 7 per cent, or higher. Now, ^{Palmer} ~~Herbert~~ Temple did testify that replacement cost was a significant component of the ICC valuation formula. In developing this model to simulate what ICC valuations would be in any particular year, we did include a percentage inflation factor to estimate replacement costs. We found, however, that the formula was quite complex, and in later years it was also ~~component~~ of the formula, we'll call that depreciation, so that the net effect was yes, inflation was there ~~it was~~ ^{it was} ~~adding~~ up the value of the pipeline for a period of time, but then eventually using the ICC's own table for depreciation. The value of the pipeline fell off. Now, I can't tell you more than that right now other to say what we did--what will happen--how the ICC will value the pipeline. As far as I'm concerned, it is a matter of great uncertainty right now. Thank you.

RETTIG: That's all I have.

CHAIRMAN: Are there any questions now from other members of either the House or the Senate? Senator Palmer.

PALMER: Yes, Mr. Chairman. Perhaps this information has already been given

and, if so, please forgive me, but I do have four questions--they are all related. We will all hope, of course, that there will be many more structures found on the North Slope that will use the pipeline. On the other hand, we have to assume that there may not be. Therefore, what figures do you ^{have} for ~~first of all for total~~ ^{Prudhoe} Bay Reservoirs and then the amounts recoverable? We did think of that yesterday, I think, but I would like to know what figures you used.

WOHLFORTH: Really, Mr. Herbert is the expert witness on this subject. We know, Senator Palmer, that 9.4, which is the de ^{Galle} Gaulle, or 9.6 billion, which is the de ^{Galle} Gaulle-McNaughton proven reserve estimate, has been variously assumed to have been increased to \$14 billion, and in a Canadian magazine referred to as 50 billion in the total field and adjoining field. The figures that we used, very frankly, showed enough oil to flow for 25 years to amortize at the rates of, amortize a \$3.5 billion bond issue.

PALMER: Do you have that figure?

I don't have the figure

EPPENBACH: No sir. We made that assumption that given the ^{9.6 billion, oil} 9.6 billion barrels proven today that there would be additional ^{reserves proven} (cough) ^{by the time} (cough) ^{either the first or} the last bond issue was issued to support a 25 year debt. They contrasted that on private financing, that is, ownership of the line by private industry. We calculated 30-year debts assuming they would also ^{pledge} their credit ^{behind} on their bonds.

^{Will that you're} PALMER: You are basing the debt service on the assumption that there will be a reserve found? The pipeline will be utilizing those reserves in addition to the Prudhoe reserve?

WOHLFORTH: That's correct.

^{Follow} : That answered my group of questions

CHAIRMAN: Are there any further questions? Senator Rettig.

RETTIG: Just one item of clarification to Mr. Havelock. Perhaps in your

in reference to your comments that the State does have a certain amount of bargaining power because its , ah

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AS A UNIT IN THE ORIGINAL DOCUMENT.

TAPE # 8

Senator Rettig: The oil that we are speaking about, have we not already sold the 7/8th interest in that oil and is not that now ^{the} a right to the 7/8ths of the oil invested in the oil companies, doesn't this perhaps give them some sort of a weighted vote in these matters:

Havelock: Well I think that certainly in our discussions Senator, we have attempted to weigh and recognize the private rights that are involved, and I don't mean by any means to suggest that the private rights of the industry should not be given all the considerations appropriate. While the oil is in the ground, my understanding is that it is the oil of the people of Alaska and if the leases are not exploited it will revert to the people of Alaska, but certainly you are quite correct that 7/8ths that one, as the oil comes out of the ground, it's theirs and it is entitled to be given recognition as we recognize any body else's right to private property in the State.

Senator Rettig: Are there any other questions now? (Ten minute break)

The State of Alaska would like to call the Honorable Joseph Henri, Commissioner of Administration who will testify as to the impact of State revenues on the State budget and related issues. I ^{may} state as Mr. Henri has found, that in discussion with him he has indicated that he would like to have the opportunity to get full presentation before the committee in advance and that ~~if~~ he has no objections to questions relating to his testimony when he concludes his remarks. I would like further to say with regards to, I said the later witnesses would be answering Senator Christianson's questions, I was really referring to Mr Kades, Mr. Gilderhouse, and Mr. Macy who are the witnesses that follow Commissioner Henri.

Joseph Henri: Written Testimony

TESTIMONY OF JOSEPH R. HENRI
Commissioner of Administration, State of Alaska,
Before the Senate Commerce Committee
And the House State Affairs Committee
At Juneau, Alaska, 6 March 1972,
Regarding Income From North Slope Oil and Gas,
And How it Affects the State Budget

Mr. Chairman and Members:

I am Joseph Henri, Commissioner of Administration. This part of the State's presentation deals with budget expenditures vis-a-vis income to be derived from North Slope oil and gas extraction. The essential questions are:

1. Will we be able to maintain our current level of services, adjusted for population growth and inflation?

2. Will we be able to increase our level of service to meet compelling needs recognized by this administration, the legislature and the citizens of Alaska? ✓

3. Will we have to reduce our level of service, and if so, what are the activities affected?

The answers to these questions rest in the amount of dollars the State can expect as its share of the Prudhoe Bay oil basin. Once upon a time, the Department of Administration felt much more certain about future State income than it does today. When will the

pipeline begin? What extraordinary man-caused interruptions will delay its completion? What will be the first year capacity of the line? The second year? The third? What is the maximum extraction rate the basin structure will prudently allow? What volumes of oil can be expected in any of the first seven years of the pipeline? What will be its final cost?

All of these variable factors, well known to each of us in this room, make budget planning extremely difficult, because the major part of Alaska's State revenue has come and will come from the North Slope resources. In the budget now pending before the legislature, we have recommended a total general fund expenditure of \$311.7 million; ^{these are state dollars.} of this sum, \$97 million will have to come directly from the Prudhoe Bay bonus money, the principal, and \$52 million more from interest earnings on the investment. As we dip heavily into the corpus - invade the principal - interest earnings diminish, compounding the revenue problem. Our present or anticipated recurring revenues are simply too low to fund our present and anticipated expenditures. We are depleting our savings account. As the following year's budget figure increases, more of the principal will have to be spent; the interest yield will dwindle further. Obviously, we will soon hit the bottom of the barrel. Only large and new revenues from the North Slope can allow us to continue our present budget growth rates.

What is the growth rate we have recommended for Fiscal Year 1973? For the general fund, it is 3.5%; for the total budget, 4.6%. We have had to slash so dramatically the rate of increase because pipeline delays and cost escalations have darkly influenced

our future revenue projections. With ~~such~~ a small increase in the budget, a number of programs have already felt the chill winds of dollar scarcity. The proposed Fiscal Year 1973 budget contains such unpalatable things as holding school foundation funding to the current year's level, regardless of enlarged student population; keeping the University's ^{of Alabasca} increase to \$800,000 in the face of a claimed need for an addition of over \$5 million just to maintain current activities; a limitation of nursing home care and general medical relief; foregoing general obligation bonds for lengthening two more ferry boats, ^{and} for a larger program of airport construction. There are many more "pinches" in the budget, besides ^{those I have mentioned.} Nonetheless, so far we have not jeopardized any State activity essential to health and safety. These painful adjustments herein noted were recommended in spite of the fact oil was projected on stream in July 1976; now another year's delay - or more - seems probable. The consequences are obvious.

Our budget book for Fiscal Year 1973 projects a growth rate of 6% compounded annually through 1976, and 8% thereafter through Fiscal Year 1981; covering a ten-year period. Further, it envisions capital improvement bond authorizations of \$60 million in 1974, and \$100 million in the next biennial election, and each one thereafter. I can only characterize these projected budgets as "modest." They are very little more than maintenance figures. Program dollars will still be limited. Careful budgeting and allocation will still be required, New starts and new programs will be exceedingly selective. The 6 and 8% growth rates ^{now on our budget pages} most likely mean a shortage of funding for the school foundation plan, and for the revenue sharing program with local governments. Yet, I express to you, ^{as (No. 1000)} the gravest concern that actual receipts in the State treasury during the next ten years may be pitifully shy of the sums needed even to maintain our austerity.

Previously, in the testimony of Commissioner Wohlforth and the Department of Revenue, test cases have been articulated regarding revenue to be derived under (A) private ownership and (B) State ownership of the crude oil pipeline. All of us realize that a multitude of variations in revenues and expenditures are possible under each heading, that is under private ownership or ^{public} ~~public~~ ~~ownership~~ ownership. Nevertheless, for purposes of comparison we have presented two likely cases and their dollar results: Both examples entail the seven-year oil volume build up delineated in the Department of the Interior Environmental Impact Statement submission by Alyeska, a 7% dividend to the owner, a line cost of \$3.5 billion, and oil on stream in July 1977.

Exhibits A and B, attached at the conclusion of these remarks, portray the figures - and the story - for the decade 1972 - 1982.

We might just pause, Mr. Chairman, and refer the committee to those for a second if I may. Exhibit A is the computer run on private ownership, and you can see the assumptions that go into these calculations, the debt service for each year on these bonds, the growth rates of the budget for each year, and so forth. Then Exhibit B, are the same assumptions, identical assumptions based on private ownership. I beg your pardon, Mr. Chairman, Exhibit A is the private ownership and Exhibit B is the public ownership. As you can see the bottom column of the right hand side in exhibit A that is the general fund at the end of the fiscal year 1982, has a deficit of \$1,135,000,000 under the private ownership case, whereas in exhibit B, the general fund in the lower right hand column at the same year at the ~~end~~ end of fiscal 1982, has a surplus in it of \$450,000,000. Those runs of course need to be carefully studied and I shan't take up your time this morning with them.

Under the private ownership case, Exhibit A, were Alaska to continue to increase its budget expenditures at the 6 and 8% rates, mentioned earlier, the first year of

deficit would be Fiscal Year 1978, wherein we would experience a shortfall of over \$156 million. This shortage would increase so that by Fiscal Year 1982 the deficit would be \$1,135,000,000. Of course, deficits for operating expenditures are in fact impossible under our State constitution; instead of experiencing a billion dollar deficit ten years from now, we would in actuality have to reduce State expenditures radically.

Under the private ownership case the State could have in its treasury at the end of Fiscal Year 1982 the sum of \$45 million if, and only if, its operating expenditures in every year of the planning decade rose annually by only 1%. Now an increase of 1% equals in fact a huge cut in all programs, and the elimination of many. And what the figures look like in that case are portrayed in Exhibit C which is the computer run showing budget increases of 1% annually over that period. And, the assumptions there are the same, the assumptions as of the first two exhibits; when the line will start and through what volume and so forth.

The dollar crunch is graphically portrayed by the following paradigm. Under the private ownership operating budget column, increasing annually at 1%, the available dollars, are, recorded. And there, Mr. Chairman, if I may direct the committee's attention to the following page of my testimony, page 6, to the paradigm which is also available, I thought they were in big figures, they are when you try to see them on the wall over Mr. Weiner's head. In the charts called "Comparison of Funds Available, Private vs Public Ownership, and I might say all these figures are in thousands so that actually the figures on the paradigm are in millions of dollars. It addresses itself only to our operating budget. Now this year for a base of reference in our budget book is \$276 million. This figure is referenced in my testimony under fiscal year 1973. So getting into the 1974 budget, which is the one the legislature will be considering just next year, you already begin to see a difference in available dollars under public and private ownership, whereas under public ownership in 1974 we would have available to spend approximately \$293

million, under the private ownership plan there would only be available \$279 million. And so forth on up where you get into very dramatic areas. Let's compare, for instance, fiscal year 1978 which isn't too many years away, under State ownership of the pipeline in the example we furnished you here, the state would have to spend on operations, that's not the total budget, just the operating portion, \$384 million whereas under private ownership the state would have to spend in the same ^{YEAR} for operations, \$290 million. Almost \$100 million difference in that year. And as we say at the end of the column of figures the difference ^{the difference} /over the planning decade, in operating expenditure ^{OPERATING DOLLARS} the State would have available to it ^{IS} would be \$925 million. The difference in ^{CAPITAL} debt authorizations, that is ^{the number of buildings and other improvements} capital improvements, ^{what we could afford} what the legislature and the people would authorize, ^{THAT} is a difference of \$365 million, ^{WORTH OF BUILDINGS} worth of buildings.

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

if private ownership budget column would be

The Contrast ¹ ~~these with the operating budget under public ownership, the first~~ column on the left. ~~The figure~~ shows that if the State of Alaska owned the pipeline there would be sufficient dollars in each of the next ten years to meet our planned 6 and 8% annual increases. In fact, the revenue would be sufficient to raise the budget from these maintenance or austerity levels so that expansion of present services and the addition of new ones could be handily realized. Were the oil line privately owned the State would have almost a billion less dollars ^{to spend} over the next ten years. ^{and} We would be able to authorize 365 million fewer dollars for capital improvements.

I might say, Mr. Chairman that the 6% and 8% increase in the budget ^{THATS} which is portrayed in our budget books ^{SUBMITTED} presented to you in January, ^{by the GOVERNOR} those increases were projected on the State Revenue Projections figures which Commissioner Wohlforth and Mr. Eppenbach ^{TO THE COMMITTEE EARLIER} discussed in great detail ¹ this morning. Now the projections are not valid because the revenues will not materialize at the dollar amounts portrayed to you in the revenue book. Going on to page 7.

HAVE

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

The attached graphs, Exhibits D and E, portray what I have been saying. Exhibit D is on the front of the room and ^{BEHIND THE CO-CHAIRMAN - behind MISS BRIGGS} it shows in graphic form what we have just testified to, that if the budget went up at the 6 and 8% rates under the private ownership example here, the general fund would be depleted, completely depleted in January of 1978, in the middle of fiscal year 1977, that is the blue line on the left of the chart. Whereas under public ownership, State ownership of the pipeline, the State general fund would dip to a low of \$231 million in the fiscal year 1976 and go up at the end of the decade we're speaking of, 1982, to about \$450 million in the Treasury. That's exhibit D, Exhibit E is the graph portrayal of Exhibits B and C. In other words Exhibit B is the public ownership case raising the budget at 6 and 8% and Exhibit C is the private ownership case, you might say the subsistence case, whereby the State budget would go up 1% annually. And if the State budget were to go up only 1% annually under the factors given in our private ownership example here the State treasury would have \$45 million dollars ^{with} by 1982. But as I say, all of the programs we have believed in would have been decimated thoroughly.

In Exhibit D, under private ownership of the oil pipeline, the general fund would be depleted around January of 1978. On the contrary, under State ownership of the line, the precipitate dive to insolvency would stop in 1976 at a general fund balance of \$231 million, and rise to a plateau of \$450 million in the general fund by 1982. Furthermore, as Exhibit B shows, the total expenditure for that year would be approximately \$605 million, and the total revenue \$602 million; a parity between income and expenditure would have been achieved, and a surplus of almost half a billion dollars enjoyed. In actuality, no doubt, were the funds from State ownership available, the administration and the legislature would have expanded the budget faster than the 8% increase portrayed for the years 1977 and beyond so that no such surplus would likely exist at the end of fiscal year 1982.

The private ownership case I have presented to the Committees, Mrs. Chairman,

necessitates an abrupt and drastic reduction in State services and activities. I cannot tell you with certainty where the administration or the legislature would cut, but I can cite a few startling and likely areas of impingement in each of our program categories:

The State pays approximately 90% of local ~~xx~~ school district costs, constituting roughly 30% of annual State dollar expenditures. That State aid would be materially reduced; it would be impossible for the local areas to maintain present educational standards through increased property taxes. State Operated Schools and the University of Alaska would have to radically abate their present service levels.

The welfare or social services activities of the State would experience vast curtailment in the number of ^{SP}eligible cases and the amount of benefit dollars; many people would be compelled to leave Alaska; distress or even starvation would haunt many who decided to stay. Public health and mental health retrenchments could force the closing of the Alaska Psychiatric Institute, and a diminution or abolishment of the State's work in drug abuse, alcoholism, tuberculosis testing and venereal disease control. The necessitated nullifications of State expenditure in these areas will in turn lose large amounts of federal dollars now enjoyed. Our ability to operate and maintain an effective Pioneers' Homes program will be materially impaired.

No new fish hatcheries would be built. No hunter safety program would be initiated. Salmon yields in Southeast Alaska would remain significantly below maximum sustained yield. Land use planning and the inventorying of our natural wealth would be jeopardized, thus making management of the State's surface and subsurface resources haphazard at best. Added park and recreational sites would be forgotten, and the maintenance of existing facilities lessened. Many Alaska communities would remain without sewage treatment facilities. Programs for coastal zone management, environmental engineering, permafrost and soils engineering would likely be abolished.

In the category of Public Protection, disaster planning, the Public Utilities Commission, the Alaska Transportation Commission, and most consumer protection programs would be impaired or fatally weakened.

The State police would experience a great shrinkage in manpower, and the courts and their ancillary agencies could not cope with their workloads.

Tourist promotion would have to be seriously curtailed and our work in research, in community improvements and grant assistance, and conventions and trade shows would most likely fall by the board. The work of the agricultural loan fund and the small grain incentive program would be enfeebled or eliminated. The Division of Planning and Research and the State Economic Opportunity Office would be crippled or possibly dropped.

Our program of revenue sharing with the local governments, around \$7 million in the current year, would no doubt go out the window. The Marine Transportation System for Southwest Alaska would likely be eliminated, and service in Southeast materially contracted. Airport maintenance in rural Alaska would be severely curtailed, likely forcing the winter closure of those ports, thus isolating a large part of Alaska for five months of the year, denying medical and other critical services. Likewise, winter maintenance of many of our highways would be only a pale reflection of the excellent job being performed today.

The various boards and commissions whereby Alaskan citizens take a direct and active part in the work of the State government would be minimally funded, or in some cases, unfunded. I am speaking of activities like the Western Interstate Conference on Higher Education, the Athletic Commission, the Status of Women Commission, the International Development Commission, the Pioneers' Advisory Board, the Yukon-Taiya Commission, the Rural Affairs Commission, the International North Pacific Fisheries

Commission. Our Youth in Government program, recently instituted with such great success, would likely be abandoned.

I might say, Mr. Chairman, that I notice a certain aura of disbelief when I recite these cuts here, but I can tell you from my own experience as chairman of the budget review committee, that each one of these representations I have made, is made with a lot of insight and forethought, and I am absolutely confident that if the revenues materialize as projected under the private ownership case, very many of the exact programs I have mentioned will have to be severely cut or even abolished. There is no other way to do it, our State does not have the ability to, as you know, _____ with huge annual deficits. We have to make our budget balance. I do not represent to you as the view of this administration, that each of these reductions suggested above, would come to pass under the private ownership case, where trade in Exhibits A and C. Nevertheless, no one can say that many of the above dire consequences would not eventuate under that case. Undoubtedly some would. The ~~re~~ economic and social dislocation would be grievous indeed.

The purport of my remarks is that this State has a vital interest in an adequate share of North Slope riches. If we do not realize that share, State expenditures over the next decade will be woefully inadequate to do the job Alaskans expect from their government. The solution we propose to sufficiently fund the budget is the ownership of the crude oil pipeline by the State of Alaska.

I thank you for your attention.

Mc DHE

Croh: May we have questions now from the members of the Senate.

COMPARISON OF FUNDS AVAILABLE

PRIVATE VS PUBLIC OWNERSHIP

(ALL FIGURES IN 1000)

FISCAL YEAR	PUBLIC OWNERSHIP		PRIVATE OWNERSHIP	
	OPERATING BUDGET *	DEBT AUTHORIZED	OPERATING BUDGET *	DEBT AUTHORIZED
1972	260186.5	71000.0	260186.5	71000.0
1973	276232.7		276232.7	
1974	292910.7	60000.0	278994.8	15000.0
1975	310485.1		281784.3	
1976	329114.1	100000.0	284601.8	20000.0
1977	355443.1		287447.4	
1978	383878.5	100000.0	290321.5	20000.0
1979	414588.8		293224.3	
1980	447755.8	100000.0	296156.1	20000.0
1981	483576.2		299117.3	
1982	<u>522262.2</u>	<u>100000.0</u>	<u>302108.1</u>	<u>20000.0</u>
TOTAL	<u>4075433.7</u>	<u>531000.0</u>	<u>3150174.8</u>	<u>166000.0</u>

* All figures refer to expenditure from general fund only
 Difference in Operating Expenditure is over \$925,000,000
 Difference in Capital Debt Authorization = \$365,000,000

Exhibit A

STATE OF ALASKA
DIVISION OF BUDGET AND MANAGEMENT

BUDGET PLANNING MODEL

RUN ID RUN 3
DATE MARCH 3, 1972

COMMENTS
PRIVATE OWNERSHIP
7% TARIFF
BASE CASE
OIL IN 77

Private

ASSUMPTIONS
ANNUAL RATE OF INTEREST ON GENERAL FUND = 6.00%
ANNUAL RATE OF INTEREST ON NEW BONDS = 6.00%
MATURITY PERIOD ON NEW BONDS IN YEARS = 20.
% ABOVE G.F. UNENCUMBERED BAL. UNEXPENDED = 0.0 %

GROWTH RATES FOR OPERATING EXPENDITURE FROM PRIOR YEAR

1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
6.20	6.00	6.00	6.00	8.00	8.00	8.00	8.00	8.00	8.00

NEW BOND AUTHORIZATIONS IN EACH YEAR

1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
71000.0	0.0	60000.0	0.0	100000.0	0.0	100000.0	0.0	100000.0	0.0

FISCAL YEAR	NON INVESTMENT REVENUE	INVESTMENT INTEREST	TOTAL REVENUE	OPERATING EXPENDITURE	DEBT SERVICE	MISC EXP SHD TAXES GF CAP EX	TOTAL EXPENDITURE	SURPLUS OR DEFICIT	GENERAL FUND END OF YEAR
1972									761268.2
1973	162264.1	42456.7	204730.7	276331.0	24020.8	11358.6	311710.3	-106975.6	654288.4
1974	182367.0	35772.1	218139.0	292910.7	29646.2	11756.5	334313.4	-116174.4	530114.0
1975	190047.0	28146.4	218193.4	310485.1	329731.5	12749.8	356208.4	-138015.0	400099.0
1976	136752.0	18960.8	207712.8	329114.1	33479.2	13200.6	375833.8	-168171.1	231927.9
1977	220569.0	8673.9	229242.8	355443.1	35373.3	13153.0	403969.4	-174726.6	57201.4
1978	225954.9	-2988.6	222966.3	383878.5	39390.5	13719.0	436988.0	-214021.8	-156920.4
1979	314776.0	-14823.9	299952.1	414588.8	42474.9	23358.3	480441.8	-180469.8	-337310.1
1980	329299.9	-26743.6	302556.3	447755.8	46529.0	25105.1	519389.9	-216833.6	-554143.8
1981	337012.4	-41200.4	290811.9	483576.2	47129.4	25167.5	555873.0	-265061.1	-815204.8
1982	344154.7	-58641.5	285513.1	522262.2	52863.3	38.5	601824.0	-316210.9	-1135515.0
	2490194.0	-10379.5	2479816.0	3816342.0	383899.9	175356.8	4376579.0	-1896782.0	

AGO 530752

Exhibit B

STATE OF ALASKA
DIVISION OF BUDGET AND MANAGEMENT

BUDGET PLANNING MODEL

Public

RUN ID RUN 4
DATE MARCH 3, 1972
COMMENTS
PUBLIC OWNERSHIP
7% TARIFF
BASE CASE
OIL IN 77

ASSUMPTIONS
ANNUAL RATE OF INTEREST ON GENERAL FUND = 6.00%
ANNUAL RATE OF INTEREST ON NEW BONDS = 6.00%
MATURITY PERIOD ON NEW BONDS IN YEARS = 20.
% ABOVE G.F. UNENCUMBERED BAL. UNEXPENDED = 0.0 %

GROWTH RATES FOR OPERATING EXPENDITURE FROM PRIOR YEAR

1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
6.20	6.00	6.00	6.00	8.00	8.00	8.00	8.00	8.00	8.00

NEW BOND AUTHORIZATIONS IN EACH YEAR

1972	1974	1975	1976	1977	1978	1979	1980	1981	1982
71000.0	0.0	50000.0	0.0	100000.0	0.0	100000.0	0.0	100000.0	0.0

FISCAL YEAR	NON INVESTMENT REVENUE	INVESTMENT INTEREST	TOTAL REVENUE	OPERATING EXPENDITURE	DEBT SERVICE	MISC EXP SHD TAXES GF CAP EX	TOTAL EXPENDITURE	SURPLUS OR DEFICIT	GENERAL FUND END OF YEAR
1972									761268.2
1973	162264.1	42466.7	204730.7	276331.0	24020.8	11358.6	311710.3	-106975.6	654288.4
1974	182367.0	35772.1	218139.0	292910.7	29646.2	11756.5	334313.4	-116174.4	538114.0
1975	190047.0	28146.4	218193.4	310485.1	32973.5	12749.8	356208.4	-138015.0	400099.0
1976	188752.0	18960.8	207712.8	329114.1	33479.2	13270.6	375883.8	-168171.1	231927.9
1977	430209.0	15116.4	445325.4	355443.1	35373.3	14482.8	405299.1	40026.3	271954.3
1978	434394.9	16675.3	451090.2	383878.5	39390.5	15217.0	438486.0	12604.2	284558.4
1979	547046.0	19533.7	566579.7	414588.8	42494.9	27486.9	484570.4	82009.3	366567.7
1980	550369.9	23532.2	573902.1	447755.8	46529.0	28343.7	522628.5	51273.6	417841.3
1981	567962.4	26121.0	594083.3	483576.2	47129.4	28359.7	559065.2	35018.1	452859.4
1982	575119.7	27090.4	602210.1	522262.2	52863.3	29787.4	604912.9	-2702.8	450156.6 +
	3428529.0	253434.8	4011965.0	3816342.0	383899.9	191111.1	4393075.0	-311111.4	

AGD 530753

Exhibit C

STATE OF ALASKA DIVISION OF BUDGET AND MANAGEMENT

BUDGET PLANNING MODEL

RUN ID RUN 3
DATE MARCH 3, 1972

COMMENTS
PRIVATE OWNERSHIP
7% TARIFF
1% GROWTH
GREATLY REDUCED CAPITAL EXPENDITURES

Budget
Revenue
Annual

ASSUMPTIONS

ANNUAL RATE OF INTEREST ON GENERAL FUND = 6.00%
ANNUAL RATE OF INTEREST ON NEW BONDS = 6.00%
MATURITY PERIOD ON NEW BONDS IN YEARS = 20.
% ABOVE G.F. UNENCUMBERED BAL. UNEXPENDED = 0.0 %
ANN OPER EXPEND GROWTH RATE AFTER 1ST YR = 1.00%

NEW BOND AUTHORIZATIONS IN EACH YEAR										
1971	1974	1975	1976	1977	1978	1979	1980	1981	1982	
71111.0	0.0	15000.0	0.0	20000.0	0.0	20000.0	0.0	20000.0	0.0	

FISCAL YEAR	NON INVESTMENT REVENUE	INVESTMENT INTEREST	TOTAL REVENUE	OPERATING EXPENDITURE	DEBT SERVICE	MISC EXP SHD TAXES GF CAP EX	TOTAL EXPENDITURE	SUPPLUS OR DEFICIT	GENERAL FUND END OF YEAR
1972									761268.2
1973	162264.1	42469.7	204733.8	276232.7	24020.8	11358.6	311612.0	-106878.3	654389.8
1974	162367.0	36208.7	213575.7	278994.8	29646.2	11756.5	320397.5	-101821.8	552567.9
1975	170047.0	29928.1	219975.1	281784.3	32973.5	12749.8	327507.6	-107532.5	445035.4
1976	188752.0	23147.4	211899.3	284601.8	32498.4	13290.6	330390.6	-118491.3	326544.1
1977	220669.0	16705.2	237274.2	287447.4	32921.2	13153.0	333521.5	-96247.3	230296.8
1978	225954.9	10787.1	236741.9	290321.5	33723.5	13719.0	337764.0	-101022.1	129274.8
1979	314776.0	6882.4	321658.3	293224.3	34212.3	23358.3	350794.8	-29136.4	100138.3
1980	329299.9	5394.7	334694.5	296156.1	33687.2	25105.1	355148.3	-20453.8	79684.5
1981	332012.4	4182.2	336194.5	299117.3	31872.0	25167.5	356156.8	-19562.3	59722.2
1982	344154.7	3140.6	347295.2	302108.1	33246.7	26698.5	362053.3	-14758.1	44964.1
	2993194.0	178845.6	2669040.0	2899986.0	319001.6	170000.0	3385343.0	-716303.9	

AGD 530754

Exhibit D
ENDING GENERAL FUND BALANCE

Private vs Public Ownership
Budget Book Expenditure Plan

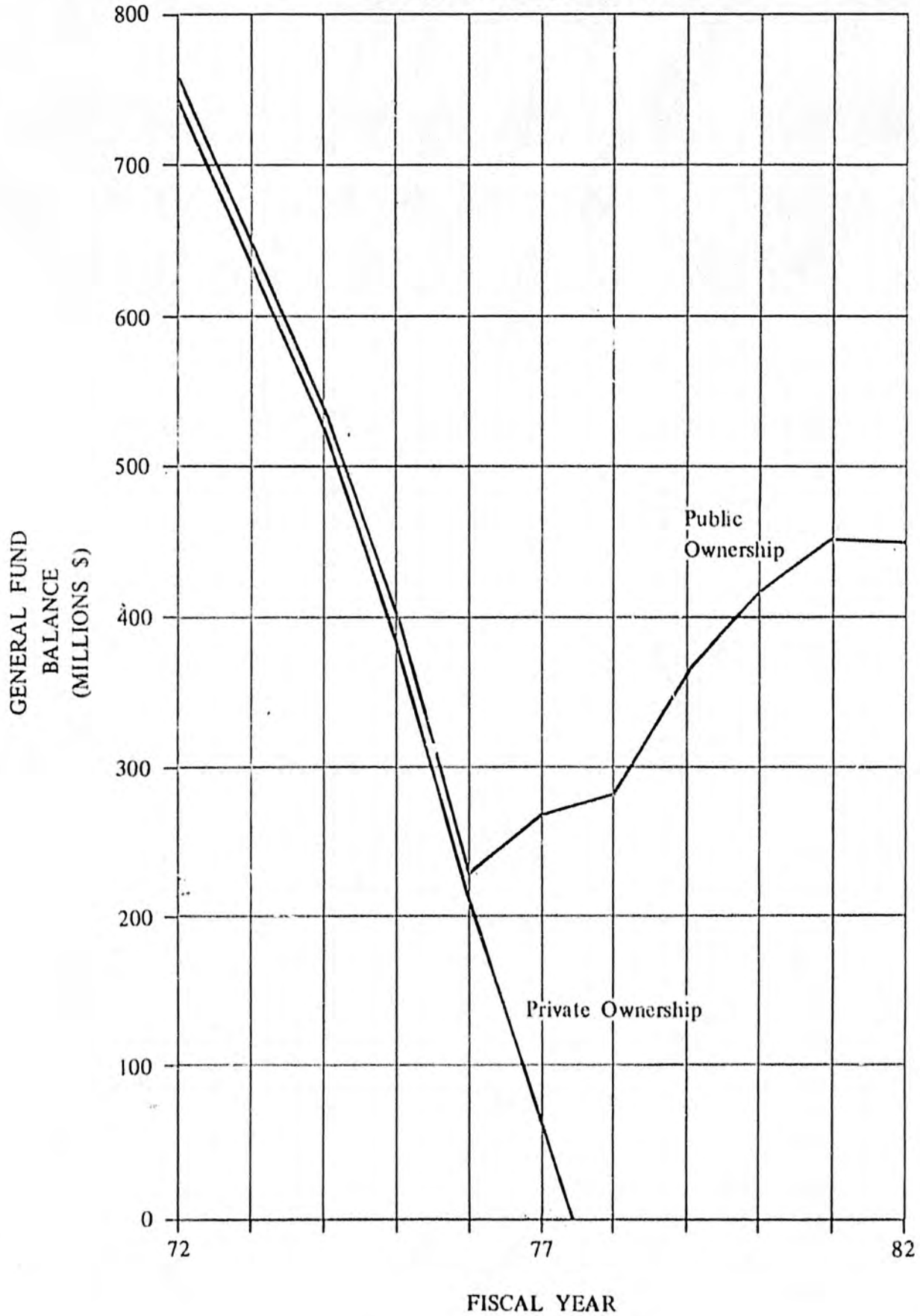
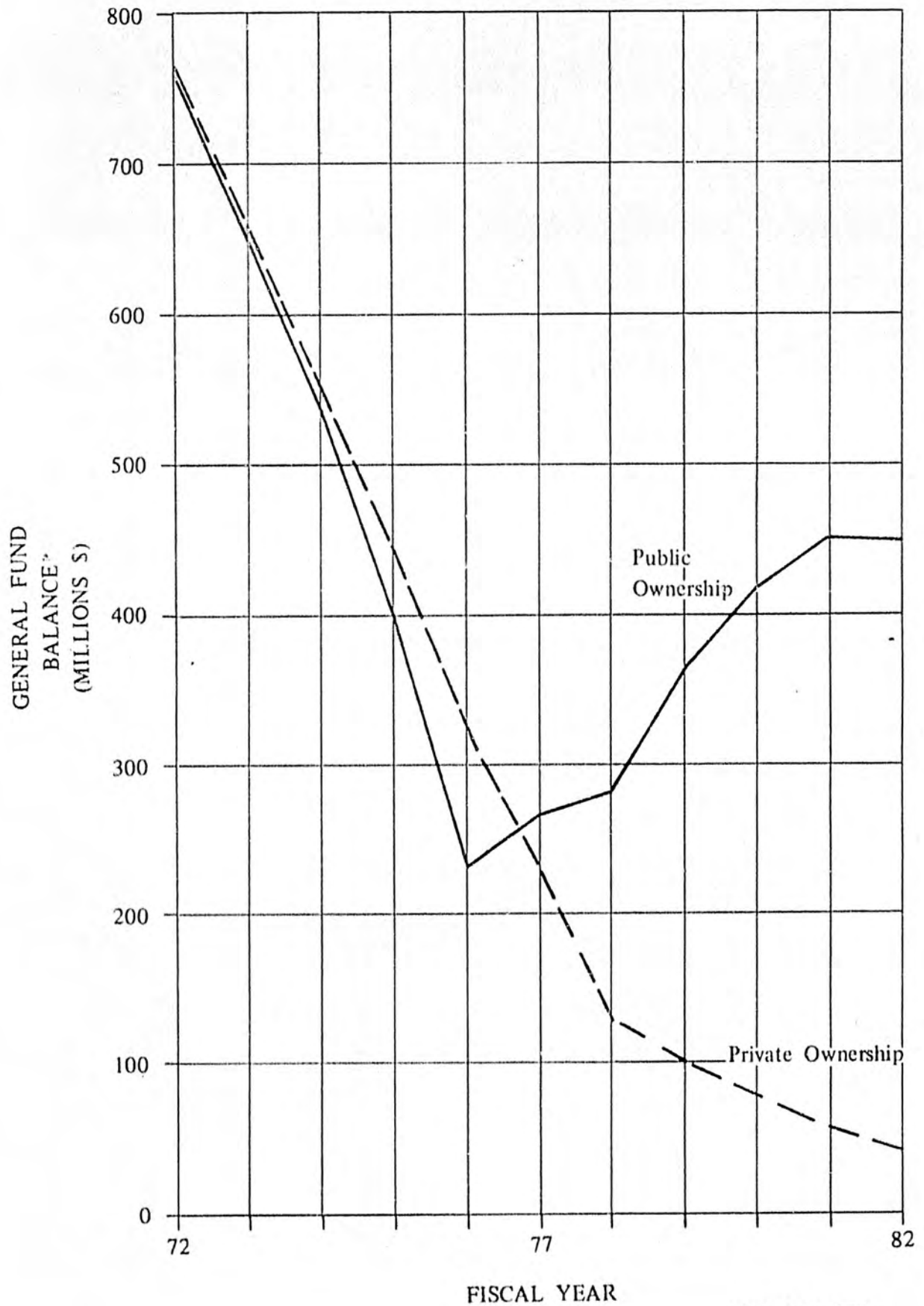


Exhibit E

ENDING GENERAL FUND BALANCE

Public Ownership Budget Book Expenditure Plan
vs
Private Ownership Subsistence Expenditure Plan



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

TAPE # 9

... Groth: ... selected land less valid federal leases, and just the other day here within the last couple of months we have selected another 77 million acres. You anticipate no revenues from any of these places?

Henri: Senator, the examples I have given you, A and C on the private case do not contain any private ownership, any further income of the ownership case but I'd like to fortify or expand on that observation by saying the amount we are spending over income right now is about \$150,000,000 over this year and as the budget increases, the dollars over income will expand rather dramatically and so except for the Prudhoe Bay oil in those huge volumes there would be no way in my estimation to lift further bonus sales ^{or some} from other economic development to make up the dollars we need to increase the budget even by 6% to say 8%, so let me say that just by general allusions of possible sales and possible income we analyze ~~the dollar volume~~ those possibilities the dollar volume is not there.

Groth: It still remains inconceivable to me ^{if you can} to make \$900,000,000 out of 400,000 acres which is what we did, you have a million and a half acres ^{right} there in round figures, I don't know what the correct figure is, but that is what Chuck testified to, and if you've got 77 million acres of additional land or at least in that portion ^{if it} which we're going to get out under the Statehood act, whether that's 77 million acres is it or not, I don't know how you can conceivably say that that is going to produce zero money. And in the case of the public versus private ownership of the pipeline you say that that is going to produce zero money in order to argue for the public ownership, it just doesn't seem reasonable. I can't conceive that nothing is going to come out of that.

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Henri: Senator, I am addressing my remarks for the next planning decade not presume for the next 50 years and I ~~assume~~ that once the environmental business is settled satisfactorily for this country, that leases will be valuable again, but I am very doubtful that any oil company is going to go up and lease further land until they are pretty sure about whether they know what the government is going to do about their present holdings. I don't believe that it is prudent at all to anticipate income up there ^{in reasonably} ~~is~~ the ~~recent~~ near future. And further on the amount of dollars if we were to find a taker for our lease offering, you will notice that Commissioner Herbert's testimony covered, i think it was almost a million dollars sold before the September, 1969 sale which brought in hardly a tenth of that. *In other words, there may have been a ^{unique} sale.*

Groth: Mr. Chairman, I understand Joe, my problem is that i can't conceive that in these projections that you have, did not feed 'anything in on these estimates on the basis that all of the other lands that the State owns, and all of the other ^{the State} interests/~~it~~ has , and the ^{the} boom and zoom here is to what is going to happen to get into public ownership of the pipeline is the inevitable result without putting in any bucks at all for all of these other assets. And that is where I have the problem.

Not to be argumentative, believe me I am not going to be or trying to be
HENRI: My references from a budget point of view , now there is an underlying conviction that we have here from the Governor on down, and that is that the budgets of the state should be increasing steadily and systematically, in other words you shouldn't have a budget that high rise then next year cut off a lot of people who have been depending on these expenditures, so unless we can pretty clearly say that out there somewhere ~~that~~ at the end of the ten year period that there is going to be some more money coming in, if we can't ~~some~~

say that with some certainty then we have to adjust this years spending and next years spending as if there wern't that money there because it is too speculative, ~~it~~ too remote, and that, what I am addressing myself to is the budget and if we can't reasonably calculate some money out there then I think the budget has to be adjusted each year now as if ~~we are~~ ^{we weren't} going to get the money. Now that's based on one thing that is different since 1970, and that is that we are spending beyond our income, in this State for the first time. We ^{would} have ^{anywhere near} no trouble/like that if our expenditures were equivalent to our ~~income~~ income, but it is not, as I say we are spending almost twice as much as we are taking in which means that our savings account will be depleted, and then where are we if these new revenues do not materialize.

Groth: Without being argumerative Joe, you presume those to sign in zero value to all that other land and that 77 million acres and I respectively suggest to you that it may have some value greater than zero, and if you ~~xxx~~ ^{feed} that into the projections then all of the alcoholism, VD control, programs athletic commissions and youth commissions might still continue.

Senator Young: ^{I think we should have my remarks read at the hearing} Mr. Chairman, first let me say that some of the proposed ^{if the presentation} state transparency game protection testimony taken place at the present place is the administration time right now.

But one thing bothers me, Mr. Henri and this is if we build this pipeline we have to go into debt or a guaranteed debt of 3-1/2 billion dollars, what effect is this going to have on proposed bond issues already before the legislature, for instance 6 million for highways, sewers and waters, etc. According to my latest figures it will be so far in debt for guarantees that there will be no market for the bonds

they are putting before the legislature now.

Henri: Senator, I would like to refer the answer to that if I may to Mr. Macy, who is here from Kuhn, Loeb and also Commissioner Wohlforth who I think can do a better job.

Wohlforth: I think the basic answer to that question is that, as I represented of in New York as I stated about a month ago, a North Slope bond issue ~~is~~ would ~~have~~ necessity have to be so well secured and so able to stand on its own feet that it would ^{not} jeopardize ordinary State bonding programs, that the essential security of state/obligation ^{general} bonds are recurring revenues of the State ^{of the State} ultimate power on to tax/an ad valorem basis its 2.7 million assessed valuation. What we are talking about here and what ^{is} will be described in detail by Mr. Gilderhouse and Mr. Macy is a bond issue which is essentially self liquidating and does not reflect adversely and therefore would not reflect adversely on the State's general obligation bonding power. It would be I believe a separate sustaining utility type bond issue, as compared to our general obligation bond ~~is~~ issues each of which do encumber our States credit and each of which are assessed in the bond rating communities on a per capita debt basis, on the basis of assessed valuation to total bonded indebtedness. In addition it is pointed out to me that as said previously that we, the bond issue ~~is~~ of this size can have a positive effect on Alaska bonds of necessity it would reach a broad market of new investors and create interests in Alaska, those, a range of investors in Alaska that are growing now but who have not yet nearly reached the number we had hoped for, and of course the net income which we show to available after debt service in the public case, is income ~~from~~ the State

treasury.

Young: O.K. Let's carry this thing a little further. Lets say the pipeline to build, if the state builds the pipeline, we're dealing with a world energy here and if they find that other oil companies or companies find a cheaper source of power for world energy, now true they have to produce a certain amount, but what if they are not competitive what does that leave the the State. In paying their bond issues off.

Wohlforth: To a certain extent I have ~~an~~ analogized this with the question which was posed yesterday, there was a replacement found for ~~possible~~ Fossil Fuels, we expect a replacement from Fossil Fuels maybe in the year 2010. The existing indications are that there is a need for North Slope oil and that will continue. The refinery price on the west coast has escalated and indeed it is much higher on the east coast, so that there are projections underlying projections that are used, just as there are in other financings based on utility type self liquidating financing which give, it seems to me, the degree of confidence necessary to finance the pipeline itself. And indeed no bond investor is going to put monies at debt, and at risk unless he ^{similarly} ~~simply~~ is assured the State that the oil will flow in the estimated quantities. It to a certain extent has to be and will be a test of the market.

Young: Commissioner Henri, another thing, Senator Groth hit upon, that you geared our whole income into the ownership of the pipeline of the North Slope Oil. Entering the projections of the other testimonies given today is there any thought given to the possibility of revenues generated by the ^{gas} ~~gap~~ field that is on the North Slope, the monies that will be generated to the mid west states, that the pipeline will possibly go through Canada?

Wohlforth: I think Mr. Eppenbach can answer that.

Eppenbach: Yes sir. They are fully included in our estimates. We assume that in 1977 the price of gas at the wellhead will be about 20 cents. Obviously the production of gas is the function of the production of oil. We've made those consistent and we assume the price of gas at the wellhead will increase ^{assuming} about 1 cent every five years, ~~and~~ that gas will be transported through Canada

through a Trans Canadian pipeline into the mid western markets in the U. S.

Holm: Commissioner Henri, as I read the figures, the first chart up to the left there, and I added them all up, if my arithmetic is correct, we are saying that State ownership will total a billion and one half dollars net increase to the State over the next 10 or 11 years. That is if everything goes right. Presuming that the States bargaining position is good now and might be a little bit worse in the coming years without _____ ^{or coercion} by the State, after all any oil company worth ^{it} salt can see that we are going to desparately need money due to the testimony that has been given. What is going to happen to our future oil lease sales and the net income to the ^{state} city; have you built this in; what is going to happen as the oil companies see this localization or parallel to nationalization of the oil industry in the State of Alaska and as they contemplate this couldn't we ~~lose~~ lose more money that way by investments in the State in the oil leases , by investments in the State in the oil industry than we would gain theoretically by taking over the pipeline ownership.

Henri: Representative Holm, Senator Groth referred to additional oil lands in the North, I would like to speak a little bit further on that latter, but , there are more as we all know than 7 oil companies. Now if there were other oil companies that wanted to get these future oil lease lands I think that State ownership ^{of the} ~~along these~~

lines would enhance the desirability of those leases because they would know the State, as a public agency would allow them to use the line, whereas if the line were dominated by the owner who had the existing discovery *of the oil* it may not be that way. So I think the ownership would not be a hindrance, it would be a help.

Holm: Well, aren't we presuming, at least this has been my understanding it is going to be a public carrier either way?

Henri: Yes, but I will defer to Mr. Hellen and others about how that concept works under ICC regulations of private ownership. My impression is, simply saying ^{that} it is a public carrier does not give all the answers. Furthermore in the State's case of private ownership Mr. Temple clearly brought out yesterday that there is going to have to be a voluntariness, what ever you want to call it, between the oil companies and the ~~State~~ State if the State is ever going to own the pipeline, at least under the sale of bonds, municipal bonds and I would think that if the package were not fairly palatable to the oil companies that somehow they are not going to do it anyway.

Holm: Well then you are presuming in all of your figures, projections, that the State take over the pipeline, will not depress the market for our future sale of oil leases?

Henri: I think that would be something that we ^{have} ~~need~~ to guard against very carefully. We obviously would not want to do that. I think we all agree with Senator Rettigs' remarks that we want the state to be a favorable place for investment. But nevertheless we have a great stake of getting something out of our resources to?

Huber: Mr. Chairman, Commissioner Henri, on Page 3 of your testimon v

Joe, you project about, rounded off, \$50,000,000 a year general obligation bonding programs for State capital programs. Now what ~~ix~~ retirement term is anticipated on those bonds, and ~~can~~ ^{has} the interest from principal payments ~~has~~ been included in the public ownership draft line on exhibit E?

Henri: The term, Mr. Chairman, Mr. Huber, is 20 years, and debt service has been included in the run and if I may Mr. Huber, refer ~~x~~ you to exhibit B where it that information is given there. Exhibit B in the computer run/gives the interest assumptions, the annual rate of ~~interest~~ in the general fund, in other words what we have earned in the Bank of America funds of 6% and so forth, is all spelled out, and your answer is the debt service was included for 20 year ^{etc.} payoff.

Huber: Well what concerned me was the debt service in the initial bonding.

Barber: Mr. Henri, through the Chairman, the Committee it ~~is~~ has always been my assumption that we are currently using up our North Slope \$900,000,000 to the extent of the State ~~is~~ sharing in local government and in other ^{endeavors} efforts. In other words of our normal budget is running somewhere between 220 and 240 million dollars and we're using up somewhere between 60 and 80 million dollars a year out of our North Slope fund. Now are those figures approximately correct?

Henri: I think the, we are using this year, Mr. Huber, the Governor's budget proposed ~~is~~ taking 97 million of the principal of the North Slope Fund and of that almost entirely used for local government.

Barber: That was my understanding. Thank you.

Senator Thomas: Mr. Chairman, I have the impression that they haven't really explored all of the alternatives, and I would like to ask, since we may not have a chance to ask later on, if they have looked into the alternative of increasing

the severance tax or / and at the same time possibly substituting the cents per barrel for the severance tax; if it is so to what extent would each of those have to be changed to forestall this down the road based upon your 3.5 billion dollar figure.

Henri: Mr. Chairman I will defer a full rounded explanation of that, Senator Thomas, I do have two observations if I may. One, the severance tax as it exists, is as you know a percentage of the value of the oil ~~is~~ per barrel of the wellhead. Obviously, under the private case that he's giving you the wellhead has no value the first few years, so would produce no severance income. If the severance tax were amended to ^{be amended} instead of an ad valorem item, to be a cents per barrel item, there is no magic to making up the deficiency in our budgetary income because no government is allowed to tax to confiscation. I haven't actually calculated that out, I would say that the, to equal the throwoff of ownership of the pipeline which is a legal, valid receipt of money, to equal that to heist up the severance portion would probably be confiscatory, I don't know. I suspect it would be a God awful amount of cents per barrel.

Thomas: Mr. Chairman, could I just ask would it be possible by using the cent barrel arrangement to persuade industry not to take such great profits out of the operation of the pipeline.

Henri: I couldn't answer that. They own their line and I presume they ^{have a right to} ~~like~~ to take a dividend from it.

McVay: Mr. Chairman, one more, ~~if we had a chance~~ when we have a chance to hear their response during these hearings, the pipeline committees have proposed a lease sale arrangement.

Josephson: Someone mentioned that ~~was the~~ the most alarming thing about

your three r's is Joe, that we might be able even to increase legislative salary.

Henri: I carefully avoided that.

Josephson: Commissioner, have you predicated the impact of the Native Land Claim Settlement in your revenue projections, how do they fit into your revenue projections?

Henri: Yes sir, they are in there, I am going to ask Larry Eppenbach to tell you exactly how they are in there, but the impact of the native 2% over-rise is in the figures.

Josephson: No, I meant the additional economy or impact, favorable impact of the economy generated by economic activities.

Henri: Again I'd like to get Larry... My impression is that we haven't tried to estimate what the ^{pending} ~~future~~ money of these native corporations will mean to the States economy. There again it is so speculative, and I'd just like to re-emphasize Mr. Chairman, my point of view in these hearings, it comes as chairman of the budget review committee and from a convention which is probably shared by many in the room, that the budget shouldn't be at a certain level one year then come into a cleft so to speak and fall off. I think you have to calculate your budget increases or decreases if they are necessitated gradually over a period of years. In other words at least, ^{what} while we have now given to you, the legislature, a 5 year planning projection and we have tried to avoid the very speculative incomes in the future so as to keep our budget ^{steady and} study reliable.

Palmer: Mr. Henri, you have mentioned this matter of ^{speculative} ~~the~~ items of the budget several times, this was a response, as I understand it, as Senator Irsh mentioned,

has not been
additional land sales, plugged into future revenue projections because it was to speculate ~~for~~ a few weeks ago, before the Senate Finance Committee and then later that week before the resource committee we had the same type of commentary testimony from the people in charge of the Division of Oil and Gas, Mr. Burrill and Mr. Gilbreath. When it was pointed out that the revenue projections for North Slope Oil would decrease in the 1980's because of the 9.6 million recoverable barrels, or billions rather, and that this would be decreasing in the mid 80's, I believe it is ^{characterized} ~~rated~~ 2 billion barrels a day and ~~in~~ about 14 years those reserves would be ~~exhausted~~ exhausted. Now in response to the question of, Mr. Burrel said that it was too speculative as far as any other reserves up there to slug any other values into revenues. That they could not because they had to be prudent, come up with any other figures for production through that pipeline and therefore revenues would decrease in the 1980's. And yet you are saying, as I understand it, that it will require 25 years of production rather than 12 or 13 years of production, to amortize the cost of the construction of the pipeline. If the State builds it, it is our gamble, if the company builds it, it is their gamble. I don't understand how we cannot afford to ~~not~~ be speculative in one instance and we can in the other.

Henri: Well Senator, you have spoken to two sides of the budget, income versus expenditures. My remarks on speculation were primarily about the level of expenditure and as to the ingredients of the revenue side of the budget I defer ~~that~~ it to Mr. Eppenbach who has those computer runs and why he thinks they are valid.

Rettig: Mr. Henri just to verify Senator Palmer's question, his question was a very good one, he did refer to the speculative nature of the possible lease sales, on

the other hand the State ~~has~~ in suggesting State ownership and the 3-1/2 billion dollar debt is speculating that there is a lot more ^{oil} than we now know is in the Prudhoe Bay field. Is that your point Senator?

Palmer: Yes sir.

Eppenbach: Senator, when revenue estimates were prepared and discussed with you by Mr. Burrell and Mr. Gilbreath they were referring to 9.6 billion barrels of Prudhoe Bay reserves. We based our reserve figures here for purposes of financing State ownership of the pipeline from the total of the reservoirs on the North Slope already leased. And I would defer further questions on this to Commissioner Herbert. Now have I... In terms of State financing of the lines we were not speculating on it, future reserves, we were planning that additional reservoirs would come onto line, those reservoirs already located in the lease area. Their timing may be characterized as a form of *intuitive* judgement, but *we have looked at* nevertheless we expect over the 10-20 years that there would be additional reserves of oil coming from new reservoirs that have not yet been estimated to contain reserves but are nevertheless there, that would provide oil to the Trans Alaska pipeline. That is oil in addition to the 9.6 billion barrels that Mr. Burrell talked about.

Palmer: *10 to 20 years* Would we have the assurance *that* of these reserves that will be recoverable from the Division of oil and gas, ~~the existing~~.

Eppenbach: Commissioner Herbert already testified on that point, that there are no assurances to date, he did imply that right now it would take perhaps ~~to~~ another year to get those assurances but he did *indicate* ~~communicate~~ about 100 million barrels of oil were available at least in one of the pools. I for one would like to hear the

oil companies respond to this ^{question} in some detail.

Palmer: A second question if I may then, it was stated that an increase in severance tax, this is a response to ^{Senator Thomas' questions} questions, in order to reach the income required by the State it might reach the confiscatory level and therefore be impossible, but it seems to me that there is a given amount of money to come from this resource regardless ^{if} whether it ~~is~~ from the pipeline or whether it is severance tax or regardless of where it comes from, that there is still X number of dollars that will be available. I don't understand how it would be confiscatory if take it through severance tax and it would not be if we take it through a pipeline profit.

Havelock: If I may comment ^{to that} at this point Senator, I think that a cent per barrel tax ~~is~~ is one of the alternatives/~~or~~ the legislature can consider among other tax possibilities. I don't think it is our intent to say that it is not an appropriate tax. There are a number of reasons ^{why} why it has economic disadvantages, and the man who ~~should~~ probably testify most on this would be Walter Levy. The cents per barrel tax is a little bit like a lot of complaints we've heard about the gross receipts tax, apply to the cents per barrel tax, that is it does not ^{necessarily} relate to economic realities in the oil industry. But it certainly is a possibility as providing a floor shall we say to revenue, I think the industry, the ^{comments} economics they've made to us about it, is they would rather pay taxes in other _____ through the cents per barrel formula. That is my impression. But it certainly is one of the tax avenues that the legislature can consider.

Palmer I might add that Walter Levy

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

Tape #12

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

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Tape #12 (continued)

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

(Mr. Rettig)

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

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

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

Mr. Havelock: May I respond to that?

Mr. Rettig: Please do.

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

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

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

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

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

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

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

Tape #12 (continued)

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

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

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

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

Mr. Rose: Thank you

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

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

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

Tape #12 (continued)

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

Mr. Havelock: Mr. Chairman, Members of the Committee, at this time we would like to call Mr. Tom Guilderhouse of the firm Temple, Parker & Slone, Economic Consultants to the State. Mr. Guilderhouse. . . . He will speak about the arrangements for public financing, various alternatives for public financing available to the State, public financing and pipeline. Mr. Guilderhouse

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

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

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Tape #12 (continued)

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

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Tape #12 (continued)

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

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Tape #12 (continued)

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

Tape #12 (continued)

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

Tape #12 (continued)

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

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Tape #12 (continued)

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

Tape #12 (continued)

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

Tape #12 (continued)

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

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

Sp

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

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

_____: Is this on?

_____: Yes sir.

GROTH

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

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

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

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

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

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

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

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

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

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

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

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

McVeigh: Senator

Rose: Mr. Whelan

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

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

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

Guilderhouse: I'm not quite sure what, okay. Well, I would say what the study shows here is just a variety of possible interest rates because until you go to market and the underwriters finally bid on your INSTRUMENT you really don't know what the interest rate is going to be. I think that one, I'm not familiar with this particular study here, but I would say that if the interest rate is judged to be higher in the early issues than it is in the later issues the assumption is that the risk is greater and it would be a harder sell on the first issues of the ^{7150 11000 28 10550 100 1000 1000 1000 1000 1000} bonds, when people are more accustomed to the flow of the bonds and they just won't have to pay as much money to get the money.

Rose: Say if you have to ^{1500 15} _____ which would be the last one and the smallest, not the smallest, ⁸⁰⁰ almost the smallest one, second smallest ~~one~~ is also indicated at eight per cent but the thing that I don't understand if we were to qualify for tax exempt status which would appear to be the case on the assumption of issue number three then why would not that assumption hold as well on the other four issues?

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

Wohlforth: Issue three is a gross assumption of those facilities which would be conventionally tax exempt without question, gross etc., and ⁷or would qualify under the environmental exceptions to Section 1023 of the Internal Revenue

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

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

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

McVay: The Senator Rettig has a question?

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

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

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

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

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

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

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

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

Guilderhouse: Yes sir.

Rettig: What would the State do with this?

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

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

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

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

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

Guilderhouse: Yes sir.

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

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

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

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

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

_____ : Thank you. ^{VERY MUCH}

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

_____ : Yes, sir.

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

_____ : PRETTY CLOSE

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

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

_____ : And we're talking about maybe 1 or 1.5 per cent?
YES, SIR.

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

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

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

_____ : Should have a run..... ^{we can do it} more specifically

_____ : ^{lets} Lets do it, ~~it can be done~~ ^{it's} done/ ~~very quickly~~ somewhere, but lets say that it costs three billion dollars, and the State lets say in the first year will pay ...well in the first year the whole debt issue, ^{costs 270 million} in the State, would pay 7% interest on that, so you are ~~talking~~ ^{in interest} 210 million dollars/, and if the oil companies lets say had 100% financing, ^{or we} you said that they had a cost associated with ~~it~~ ^{that}, of lets just say for argument's sake ^{which I think is} 9%/lower than the oil companies would like it, ^{to} they earn on their assets, you've got 2% difference there, thats essentially 60 million right there, I guess. And ^{of} of the income tax, thats a year,

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

TAPE 13, page 17

They are, the first year, 33.73 million dollars in State income taxes; ^{BUT} 158.8 million dollars Federal income taxes.

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

Moving on to the third year of operation, the Federal income tax and State income tax ^{5,100} remain roughly the same - 34 million in State, 158 million dollars in Federal.

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

_____ : Third year. Yes sir.

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

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

_____ : You are right.

_____ : Now, that 200 million dollars, /a substantial piece of money going to be distributed? Wouldn't the oil companies benefit in part because ^{75c} say for example if it takes ~~50c~~ to ship a barrel of oil from Prudhoe to Valdez, but you don't have to pay tax on it, you could say, then ^{now?} in rough figures, say then it only cost them 50c a barrel....is that right?

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

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

_____ : Yes.

_____ : In other words they would save a quarter a barrel if its ~~1/4~~

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

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

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

can make. ^{Its} /that simple a calculation, 7% of 3 billion dollars. Now the profit - if you're going to use the 7%, is 210 million dollars. Equate... ^{AND}

use these numbers and we come up to around 200 million dollars. Well, in terms of the cash position of the oil companies, its a ^{POSSIBLE} foot. ^{BUT IF} I could say something....I'll make it quite clear that this is a T.S.S. (?)

sort of an opinion and nobody else really has anything to do with it, its strictly ours. That there might be a way to make this concept more feasible

and engender the environment in which cooperation might take place, by suggesting to the oil companies that under state ownership it might not chose to build its tariff structure around a 7% return. Say perhaps the State not only would

provide this type of savings but ~~could~~ ^{could} conceivably develop its tariff structure on a basis/less than the maximum. Again I want to emphasize that

this is TEMPLE, BARBER & SLOAN speaking. As a suggestion for consideration, if you ever reach the point where you are ^{TRY TO ENGAGE} driving _____ this is favorable

climate TO TRY TO COME TOGETHER ON THE VARIOUS ISSUES

_____ : Right, that was sort of what I was thinking, ^{in terms} /of each having a benefit, not one at the expense of the other.

_____ : I heartily recommend that.

_____ : Only one other thing that bothers me - the oil companies of course would have the right to depreciate the pipeline as ~~xxx~~ an asset, I assume.

_____ : Yes sir.

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

Now, how does that gear into that?

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

_____ : ~~xxxxxxxxxxxxxxxx~~ Okey.

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

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

_____ : Yes, sir.

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

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

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

_____: So they'd get a substantial advance, I would think.

~~Under~~ ^{I THINK SO, YES, SIR, UNDER} the right circumstances I think there are tremendous advantages to the oil companies, both in reduced costs and in reduced financing burdens. (P)

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

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

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

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

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

Rettig: thank you.

Wohlforth: Senator Raider has a question,

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

Guilderhouse: Well, mines just an opinion, I happen to believe that ownership of the pipeline will enhance the states ability to issue general revenue bonds. I think that ownership of the pipeline increases the security of the states total income package. I think, first of all, I think the pipeline is a good business, and because its a good business , or a sound business, and lets say it would be operated in a sound fashion. The ability to protect the states well head and protect the states royalties and severences, generate lets say a moderate ^{state} surplus or even a large surplus, however

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

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

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

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

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

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

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

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

Guilderhouse: To the cost of the bonds? ah,

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

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

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

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

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

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

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

Farrow: Thank you

Guilderhouse: Mr. Farrow,

Farrow: The point you brought up in response to this

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

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

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

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

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

Guilderhouse: Yes sir, in my opinion it would.

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

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

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

McVay: ^{the state assumed} Like to call Robert Macy, ^{of NY} _____ Company of N.Y.

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

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

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

XXXXX

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

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

XXXXX

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

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

Macy: Senator Groth, One of the difficulties I think we all encounter in answering questions like this and one of the reasons ~~XXX~~ why I really outlined what we considered the major risk to the investors in such an issue, is that to satisfy any one of these risks ~~XX~~ there's a whole variety of different guarantees, different methods, that could be used to satisfy the risk element to the investor. I think that perhaps it would be, I think it is pre-mature, if I may say so, to try to dissect one risk, or one method. And say well if we provided this then this would make it feasible, because frankly, I think until the legislation has been passed to set frame. And some feasible plan, or some mode of cooperation has been established with the oil ^{companies} ~~company~~. That you cannot come up with sufficient pieces of a plan to satisfy, ^{these risks} to really make any meaningful judgment,

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

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

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

McVay: May I recognize that you're not the ~~XXXXX~~ person for me to ask that question.

I haven't had any other questions. Thank you.

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

Macy: I believe it is.

Barber: The prime factor in initial negotiation.

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

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

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

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

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

Barber: Senator Rettig

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

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

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

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

Rettig: Thank you.

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

Rettig: I understand.

McVay: Any other questions - Mr. Farrow

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

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

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

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

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

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

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

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~~for, as stated~~

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

RETTIG,

We have, ~~perhaps~~ perhaps as you are no doubt aware, /one of the highest/ ^{per capita of bond} indebtednesses of any state at this time, and I am aware that many of the bond underwriters

LOOK AS IF ITS ON THE BOOKS already to be authorized.
ALL READY

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

MACY

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

Thank you.

MCVAE

Any further questions? Mrs. Fisher?

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

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

AND IF THE OIL COMPANIES AGREE
ALL CONCERNED
IF YOU WILL
the oil companies SO IT BECOMES, given that that is reached, and that with suitable inputs from the investment community, that this agreement can be brought up to.....the investment bankers judge to be a satisfactory level of investment grade, I would assume that within three

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to six months after that, the bonds ^{you could} ~~could~~ ~~would~~ begin to sell the bonds. (974)

Now we also have conditions over which none of us have control. It is not only as I understand it _____

^{NOT ONLY} it's a question of whether you can sell the bonds ^{AS HOW MUCH YOU CAN} ~~you might be able to sell~~ the bonds, how much ^{OF THE BONDS} you can sell ~~the bonds for~~ ^{AND} at what cost. ^{AND} these are subject to market conditions, which we have relatively little control over.

MCVARE:

Other questions? Mr. ~~Groves~~? ~~Mr. Grohst~~

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

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

GROH:

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

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

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

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

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

(much hilarity)

HOLM:

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

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

HOLM : Approximately how much less?

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

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

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

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

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

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

HOLM : No, I UNDERSTAND, BUT ITS

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

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

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

MACY : That is correct.

HOLM : Thank you.

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

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

Mr. Rose?

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

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

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

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

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

not being bond counselor.

BETTIG : Are there any other questions?

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

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

Wohlforth: ~~I am afraid I cannot any improvement as unfortunately I was~~ ^{there}
~~some~~
~~in~~ conversation at my table.

~~W~~: Can you rephrase it?

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

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

RETTIG: Are there any other questions?

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

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

MCVAE: Its not on a minimum fee schedule?

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

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

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

are you ready to proceed?

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

abouthe couldn't understand why we hadn't approached the oil companies

To find out

~~about~~ this preliminary question of whether they were willing to.....if I may answer this in sort of an analogy.....I suppose if possible that I could get

up from this table and go and ask the attractive girl at the end of the table whether she's willing , and I'm sure she'd tell me to go jump in the lake. On

IF I did so.

the other hand, if I invited her out ^{TO DINNER} I might get a good deal more information, whether she was willing.....start looking in store windows, I would

ABOUT AT FURS & DIAMONDS

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

^{GROH} Groh is probably quite aware of the answer to this. (laughter) This is

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

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

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

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

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

RETTIG : The answer was "no."

GROH : Then, what are we doing here?

RETTIG : He is still taking them out to dinner!

GROH : I SEE. ^{Havelock: before Mr. Helkin starts}

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

committee, ^{BUT} which will relate to the subject matter generally which will be

testified ^{to} before other committees, which is the so-called 20 mill property tax

^{law on the oil} pipeline ^{OIL} transportation, which is very much related to the subject ^{EQUIPMENT}

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

Testimony of Eric E. Wohlforth
Commissioner of Revenue

March 6, 1972

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

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

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

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

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

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

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

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

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

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

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

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

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

between SEC filings. This dramatic increase in pipeline costs revealed in official documents at the time of Governor Egan's first announcement on State ownership made it urgently necessary that the State finally determine the likely magnitude of pipeline costs. Commissioner Campbell has already indicated the independent study which the State has made through its consulting engineers, Tibbets, Abbott, McCarthy and Stratton, and the foundation for the present estimate of \$3.5 billion. These figures have ^{been} just recently developed along with an independent evaluation of operating costs so that for the first time the State can make a reasonable projection of the probable amount it can expect to capture from North Slope oil revenues. /

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

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

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

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

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

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

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

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

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

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

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

JOINT HEARINGS ON PROPOSED PIPELINE LEGISLATION

MARCH 6 THROUGH MARCH 9, 1972

WITNESS REGISTER

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

MARCH 6 THROUGH MARCH 9, 1972

WITNESS REGISTER

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

MARCH 6 THROUGH MARCH 9, 1972

WITNESS REGISTER

<u>NAME</u>	<u>AFFILIATION</u>	<u>REPRESENTING</u>
1. S. C. SANDUSKY	DIVISIONAL MANAGER	MARATHON OIL COMPANY
2. DON DICKEY	GENERAL MANAGER	STATE CHAMBER OF COMMERCE
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BY THE RULES COMMITTEE BY
REQUEST OF THE GOVERNOR

1 IN THE HOUSE

2 HOUSE JOINT RESOLUTION NO.

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 SEVENTH LEGISLATURE - SECOND SESSION

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

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

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

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

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

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

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

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

Page 2, line 26:

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

Page 19, line 12:

Delete all of AS 44.58.260.

Statement of Charles F. Herbert
Commissioner of Natural Resources

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

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

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

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

Bonuses received from the sale of State leases on the

North Slope:

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

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

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

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

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

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

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

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

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

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

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

not begun to run.

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

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

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

3% on the first 300 barrels per day

5% on the next 700 barrels per day

6% on the next 1,500 barrels per day

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

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

Derivation of State income from royalty and severance tax is:

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

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

3/6/72

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

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

SCHEDULE OF JOINT HEARINGS ON PROPOSED
PIPELINE LEGISLATION

COMMITTEES:

SENATE COMMERCE COMMITTEE, RON L. RETTIG, CHAIRMAN.

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

LOCATION: GOLD ROOM, BARANOF HOTEL

BILLS TO BE CONSIDERED:

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

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

SB 315 - Creating Alaska Oil and Gas Transportation Commission.

SB 294 - Creating Alaska Leasing Board.

HB 569 - Establishing Trans-Alaska Authority.

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

MEETING SCHEDULE:

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

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

Testimony of Lawrence Eppenbach
State Investment Officer

March 6, 1972

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

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

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

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

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

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

AGO 530840

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

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

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

under conditions of public ownership.

Under conditions of private ownership, a very different case develops. Here in the initial year a total of about \$37 million should accrue to the State. Where does it come from? \$3.2 million of it only comes from the North Slope in the form of gas royalty and production tax payments. This is gas that is assumed to be shipped in a trans-Canadian gas pipeline. The remaining \$34 million comes from state income taxes. In the 7% dividend case displayed here there is no positive wellhead value for oil during the first two years of operation under private ownership. In this case, for there to begin to be some positive wellhead for oil during the first two years, the dividend payments must be no greater than ^{2/4}4.75% and even if the dividend were lowered to zero the State's income from royalty and severance tax of approximately \$53 million would be less than one third of that estimated as recently as last year.

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

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

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

TESTIMONY OF JOSEPH R. HENRI
Commissioner of Administration, State of Alaska,
Before the Senate Commerce Committee
And the House State Affairs Committee
At Juneau, Alaska, 6 March 1972,
Regarding Income From North Slope Oil and Gas,
And How it Affects the State Budget

Mr. Chairman and Members:

I am Joseph Henri, Commissioner of Administration. This part of the State's presentation deals with budget expenditures vis-a-vis income to be derived from North Slope oil and gas extraction. The essential questions are:

1. Will we be able to maintain our current level of services, adjusted for population growth and inflation?
2. Will we be able to increase our level of service to meet compelling needs recognized by this administration, the legislature and the citizens of Alaska?
3. Will we have to reduce our level of service, and if so, what are the activities affected?

The answers to these questions rest in the amount of dollars the State can expect as its share of the Prudhoe Bay oil basin. Once upon a time, the Department of Administration felt much more certain about future State income than it does today. When will the

pipeline begin? What extraordinary man-caused interruptions will delay its completion? What will be the first year capacity of the line? The second year? The third? What is the maximum extraction rate the basin structure will prudently allow? What volumes of oil can be expected in any of the first seven years of the pipeline? What will be its final cost?

All of these variable factors, well known to each of us in this room, make budget planning extremely difficult, because the major part of Alaska's State revenue has come and will come from the North Slope resources. In the budget now pending before the legislature, we have recommended a total general fund expenditure of \$311.7 million; ^{those are State \$} of this sum, \$97 million will have to come directly from the Prudhoe Bay bonus money, the principal, and \$52 million more from interest earnings on the investment. As we dip heavily into the corpus - invade the principal - interest earnings diminish, compounding the revenue problem. Our present or anticipated recurring revenues are simply too low to fund our present and anticipated expenditures. We are depleting our savings account. As the following year's budget figure increases, more of the principal will have to be spent; the interest yield will dwindle further. Obviously, we will soon hit the bottom of the barrel. Only large and new revenues from the North Slope can allow us to continue our present budget growth rates.

What is the growth rate we have recommended for Fiscal Year 1973? For the general fund, it is 3.5%; for the total budget, 4.6%. We have had to slash so dramatically the rate of increase because pipeline delays and cost escalations have darkly influenced

our future revenue projections. With ~~such~~ a small increase in the budget, a number of programs have already felt the chill winds of dollar scarcity. The proposed Fiscal Year 1973 budget contains such unpalatable ^{items} ~~things~~ as holding school foundation funding to the current year's level, regardless of enlarged student population; keeping the University's ^{of Alaska} increase to \$800,000 in the face of a claimed need for an addition of over \$5 million just to maintain current activities; a limitation of nursing home care and general medical relief; foregoing general obligation bonds for lengthening two more ferry boats, and for a larger program of airport construction. There are many more "pinches" in the budget, besides ^{those I mention}. Nonetheless, so far we have not jeopardized any State activity essential to health and safety. These painful adjustments herein noted were recommended in spite of the fact oil was projected on stream in July 1976; now another year's delay - or more - seems probable. The consequences are obvious.

Our budget book for Fiscal Year 1973 projects a growth rate of 6% compounded annually through 1976, and 8% thereafter through Fiscal Year 1981, covering a ten-year period. Further, it envisions capital improvement bond authorizations of \$60 million in 1974, and \$100 million in the next biennial election, and each one thereafter. I can only characterize these projected budgets as "modest." They are very little more than maintenance figures. Program dollars will still be limited. Careful budgeting and allocation will still be required. New starts and new programs will be exceedingly selective. The 6 and 8% growth rates most likely mean a shortage of funding for the school foundation plan, and for the revenue sharing program with local governments. Yet, I express to you ^{the} gravest concern that actual receipts in the State treasury during the next ten years may be pitifully shy of the sums needed even to maintain our austerity.

Previously, in the testimony Commissioner Wohlforth and the Department of Revenue, test cases have been articulated regarding revenue to be derived under (A) private ownership and (B) State ownership of the crude oil pipeline. All of us realize that a multitude of variations in revenues and expenditures are possible under each heading. Nevertheless, for purposes of comparison we have presented two likely cases and their dollar results: Both examples entail the seven-year oil volume build up delineated in the Department of the Interior Environmental Impact Statement submission by Alyeska, a 7% dividend to the owner, a line cost of \$3.5 billion, and oil on stream in July 1977.

Exhibits A and B, attached at the conclusion of these remarks, portray the figures - and the story - for the decade 1972-1982. Under the private ownership case, Exhibit A, were Alaska to continue to increase its budget expenditures at the 6 and 8% rates, mentioned earlier, the first year of deficit would be Fiscal Year 1978, wherein we would experience a shortfall of over \$156 million. This shortage would increase so that by Fiscal Year 1982 the deficit would be \$1,135,000,000. Of course, deficits for operating expenditures are in fact impossible under our State constitution; instead of experiencing a billion dollar deficit ten years from now, we would in actuality have to reduce State expenditures radically.

Under the private ownership case the State could have in its treasury at the end of Fiscal Year 1982 the sum of \$45 million if, and only if, its operating expenditures in every year of the planning decade rose annually by only 1% (see Exhibit C). Now an increase of 1% equals a huge cut in all programs, and the elimination of many. A

The dollar crunch is graphically portrayed in the following paradigm. Under the private ownership operating budget column, increasing annually at 1%, the available dollars are recorded. Contrast these with the operating budget under public ownership, the first column on the left. The figure shows that if the State of Alaska owned the pipeline there would be sufficient dollars in each of the next ten years to meet our planned 6 and 8% annual increases. In fact, the revenue would be sufficient to raise the budget from these maintenance or austerity levels so that expansion of present services and the addition of new ones could be handily realized. Were the oil line privately owned the State would have almost billion less dollars to spend over the next ten years. We would be able to authorize 365 million fewer dollars for capital improvements.

(Graph on following page)

COMPARISON OF FUNDS AVAILABLE

PRIVATE VS PUBLIC OWNERSHIP

(ALL FIGURES IN 1000)

FISCAL YEAR	PUBLIC OWNERSHIP		PRIVATE OWNERSHIP	
	OPERATING BUDGET *	DEBT AUTHORIZED	OPERATING BUDGET *	DEBT AUTHORIZED
1972	260186.5	71000.0	260186.5	71000.0
1973	276232.7		276232.7	
1974	292910.7	60000.0	278994.8	15000.0
1975	310485.1		281784.3	
1976	329114.1	100000.0	284601.8	20000.0
1977	355443.1		287447.4	
1978	383878.5	100000.0	290321.5	20000.0
1979	414588.8		293224.3	
1980	447755.8	100000.0	296156.1	20000.0
1981	483576.2		299117.3	
1982	<u>522262.2</u>	<u>100000.0</u>	<u>302108.1</u>	<u>20000.0</u>
TOTAL	<u>4075433.7</u>	<u>531000.0</u>	<u>3150174.8</u>	<u>166000.0</u>

* All figures refer to expenditure from general fund only
 Difference in Operating Expenditure is over \$925,000,000
 Difference in Capital Debt Authorization = \$365,000,000

The attached graphs, Exhibits D and E, portray what I have been saying. In Exhibit D, under private ownership of the oil pipeline, the general fund would be depleted around January of 1978. On the contrary, under State ownership of the line, the precipitate dive to insolvency would stop in 1976 at a general fund balance of \$231 million, and rise to a plateau of \$450 million in the general fund by 1982. Furthermore, as Exhibit B shows, the total expenditure for that year would be approximately \$605 million, and the total revenue \$602 million; a parity between income and expenditure would have been achieved, and a surplus of almost half a billion dollars enjoyed. In actuality, no doubt, were the funds from State ownership available, the administration and the legislature would have expanded the budget faster than the 8% increase portrayed for the years 1977 and beyond so that no such surplus would likely exist at the end of Fiscal 1982.

The private ownership case I have presented to the Committees, Mr. Chairman, necessitates an abrupt and drastic reduction in State services and activities. I cannot tell you with certainty where the administration or the legislature would cut, but I can cite a few startling and likely areas of impingement in each of our program categories:

The State pays approximately 90% of local school district costs, constituting roughly 30% of annual State dollar expenditure. That State aid would be materially reduced; it would be impossible for the local areas to maintain present educational standards through increased property taxes. State Operated Schools and the University

of Alaska would have to radically abate their present service levels.

The welfare or social services activities of the State would experience vast curtailment in the number of eligible cases and the amount of benefits; many people would be compelled to leave Alaska; distress or ^{win}starvation would haunt many who decided to stay. Public health and mental health retrenchments could force the closing of the Alaska Psychiatric Institute, and a diminution or abolishment of the State's work in drug abuse, alcoholism, tuberculosis testing and venereal disease control. The necessitated nullifications of State expenditure in these areas will in turn lose large amounts of federal dollars now enjoyed. Our ability to operate and maintain an effective Pioneers' Homes program will be materially impaired.

No new fish hatcheries would be built. No hunter safety program would be initiated. Salmon yields in Southeast Alaska would remain significantly below maximum sustained yield. Land use planning and the inventorying of our natural wealth would be jeopardized, thus making management of the State's surface and subsurface resources haphazard at best. Added park and recreation sites would be forgotten, and the maintenance of existing facilities lessened. Many Alaska communities would remain without sewage treatment facilities. Programs for coastal zone management, environmental engineering, permafrost and soils engineering would likely be abolished.

In the category of Public Protection, disaster planning, the Public Utilities Commission, the Alaska Transportation Commission, and most consumer protection programs would be impaired or

completely abolished.

The State police would experience a great shrinkage in manpower, and the courts and their ancillary agencies could not cope with their workloads.

Tourist promotion would have to be seriously curtailed and our work in research, in community improvement and grant assistance, and at conventions and trade shows would most likely fall by the board. The work of the agricultural loan fund and the small grain incentive program would be enfeebled or eliminated. The Division of Planning and Research and the State Economic Opportunity Office would be crippled or possibly dropped.

Our program of revenue sharing with the local governments, around \$7 million in the current year, would no doubt go out the window. The Marine Transportation System for Southwest Alaska would likely be eliminated, and service in Southeast materially contracted. Airport maintenance in rural Alaska would be severely curtailed, likely forcing the winter closure of those ports, thus isolating a large part of Alaska for five months of the year, denying medical and other critical services. Likewise, winter maintenance of many of our highways would be only a pale reflection of the excellent job being performed today.

The various boards and commissions whereby Alaskan citizens take a direct and active part in the work of the State government would be minimally funded, or in some cases, unfunded. I am speaking of activities like the Western Interstate Conference on Higher Education, the Athletic Commission, the Status of Women Commission, the International Development Commission, the Pioneers'

Advisory Board, the Yukon Taiya Commission, the Rural Affairs Commission, the International North Pacific Fisheries Commission. Our Youth in Government program, recently instituted with such great success, would likely be abandoned. A

I do not represent to you, as the view of this administration, that each of these reductions suggested above would come to pass under the private ownership case portrayed in Exhibits A and C. Nevertheless, no one can say that many of the above dire consequences would not eventuate under that case; undoubtedly some would. The economic and social dislocation would be grievous indeed.

The purport of my remarks is that this State has a vital interest in an adequate share of North Slope riches. If we do not realize that share, State expenditures over the next decade will be woefully inadequate to do the job Alaskans expect from their government. The solution we propose to sufficiently fund the budget is the ownership of the crude oil pipeline by the State of Alaska.

Exhibit A

STATE OF ALASKA DIVISION OF BUDGET AND MANAGEMENT

BUDGET PLANNING MODEL

RUN ID RUN 3
DATE MARCH 3, 1972
COMMENTS

PRIVATE OWNERSHIP
7% TARIFF
BASE CASE
OIL IN 77

ASSUMPTIONS

ANNUAL RATE OF INTEREST ON GENERAL FUND = 6.00%

ANNUAL RATE OF INTEREST ON NEW BONDS = 6.00%

MATURITY PERIOD ON NEW BONDS IN YEARS = 20.

% ABOVE G.F. UNENCUMBERED BAL. UNEXPENDED = 0.0 %

GROWTH RATES FOR OPERATING EXPENDITURE FROM PRIOR YEAR

1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
6.20	6.00	6.00	6.00	8.00	8.00	8.00	8.00	8.00	8.00

NEW BOND AUTHORIZATIONS IN EACH YEAR

1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
710000.0	0.0	600000.0	0.0	1000000.0	0.0	1000000.0	0.0	1000000.0	0.0

FISCAL YEAR	NON INVESTMENT REVENUE	INVESTMENT INTEREST	TOTAL REVENUE	OPERATING EXPENDITURE	DEBT SERVICE	MISC EXP SHD TAXES GF GAP EX	TOTAL EXPENDITURE	SURPLUS OR DEFICIT	GENERAL FUND END OF YEAR
1972									761268.2
1973	162269.1	42466.7	204730.7	276331.0	24020.8	11358.6	311710.3	-106579.6	654288.4
1974	182367.0	35772.1	218139.0	292910.7	29646.2	11756.5	334313.4	-116174.4	538114.0
1975	190047.0	28146.4	218193.4	310485.1	32973.5	12749.8	356208.4	-138015.0	400099.0
1976	186752.0	18960.8	207712.8	329114.1	33479.2	13290.6	375883.8	-168171.1	231927.9
1977	220569.0	8673.9	229242.8	355443.1	35373.3	13153.0	403969.4	-174726.6	57201.4
1978	225954.9	-2988.6	222966.3	383878.5	39390.5	13719.0	436988.0	-214021.8	-156820.4
1979	314776.0	-14823.9	299952.1	414588.8	42494.9	23358.3	480441.8	-180489.8	-337310.1
1980	329299.9	-26743.6	302556.3	447755.8	46529.0	25105.1	519389.9	-216832.6	-554143.8
1981	337012.4	-41200.4	295811.9	483576.2	47129.4	25167.5	555873.0	-265061.1	-819204.8
1982	344154.7	-58641.5	285513.1	522262.2	52863.3	26698.5	601824.0	-216310.9	-1135515.0
	2490194.0	-10378.5	2479816.0	2816342.0	383899.9	176356.8	4376599.0	-1896782.0	

AGD 530854

Exhibit B

STATE OF ALASKA DIVISION OF BUDGET AND MANAGEMENT

BUDGET PLANNING MODEL

RUN ID RUN 4
DATE MARCH 3, 1972
COMMENTS
PUBLIC OWNERSHIP
7% TARIFF
BASE CASE
OIL IN 77

ASSUMPTIONS

ANNUAL RATE OF INTEREST ON GENERAL FUND = 6.00%

ANNUAL RATE OF INTEREST ON NEW BONDS = 6.00%

MATURITY PERIOD ON NEW BONDS IN YEARS = 20.

% ABOVE G.F. UNENCUMBERED BAL. UNEXPENDED = 0.0 %

GROWTH RATES FOR OPERATING EXPENDITURE FROM PRIOR YEAR

1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
6.20	6.00	6.00	6.00	8.00	8.00	8.00	8.00	8.00	8.00

NEW BOND AUTHORIZATIONS IN EACH YEAR

1972	1974	1975	1976	1977	1978	1979	1980	1981	1982
71000.0	0.0	60000.0	0.0	100000.0	0.0	100000.0	0.0	100000.0	0.0

FISCAL YEAR	NON INVESTMENT REVENUE	INVESTMENT INTEREST	TOTAL REVENUE	OPERATING EXPENDITURE	DEBT SERVICE	MISC EXP SHD TAXES GF CAP EX	TOTAL EXPENDITURE	SURPLUS OR DEFICIT	GENERAL FUND END OF YEAR
1972									761268.2
1973	162269.1	42466.7	204730.7	276331.0	24020.8	11358.6	311710.3	-106979.6	654288.4
1974	182367.0	35772.1	218139.0	292910.7	29646.2	11756.5	334313.4	-116174.4	538114.0
1975	190047.0	28146.4	218193.4	310485.1	32973.5	12749.8	356208.4	-138015.0	400099.0
1976	188752.0	18960.8	207712.8	329114.1	33479.2	13290.6	375883.8	-168171.1	231927.9
1977	430209.0	15116.4	445325.4	355443.1	35373.3	14482.8	405299.1	40026.3	271954.3
1978	434394.9	16695.3	451090.2	383870.5	39390.5	15217.0	438486.0	12604.2	284558.4
1979	547046.0	19533.7	566579.7	414589.8	42494.9	27486.9	484570.4	82009.3	366567.7
1980	550369.9	23532.2	573902.1	447755.8	46529.0	28343.7	522628.5	51273.6	417841.3
1981	567962.4	26121.0	594083.3	483576.2	47129.4	28359.7	559065.2	35018.1	452859.4
1982	575119.7	27090.4	602210.1	522262.2	52863.3	29787.4	604912.9	-2702.8	450156.6
	3828529.0	253434.8	4081965.0	3816342.0	383899.9	192832.9	4391075.0	-311111.4	

ACG 530855

Exhibit C

STATE OF ALASKA DIVISION OF BUDGET AND MANAGEMENT

BUDGET PLANNING MODEL

RUN ID RUN 3

DATE MARCH 3, 1972

COMMENTS

PRIVATE OWNERSHIP
7% TARIFF
1% GROWTH
GREATLY REDUCED CAPITAL EXPENDITURES

ASSUMPTIONS

ANNUAL RATE OF INTEREST ON GENERAL FUND = 6.00%
ANNUAL RATE OF INTEREST ON NEW BONDS = 6.00%
MATURITY PERIOD ON NEW BONDS IN YEARS = 20.
% ABOVE G.F. UNENCUMBERED BAL. UNEXPENDED = 0.0 %
ANN OPER EXPEND GROWTH RATE AFTER 1ST YR = 1.00%

NEW BOND AUTHORIZATIONS IN EACH YEAR

1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
71000.0	0.0	15000.0	0.0	20000.0	0.0	20000.0	0.0	20000.0	0.0

FISCAL YEAR	NON INVESTMENT REVENUE	INVESTMENT INTEREST	TOTAL REVENUE	OPERATING EXPENDITURE	DEBT SERVICE	MISC EXP SHD TAXES GF CAP EX	TOTAL EXPENDITURE	SURPLUS OR DEFICIT	GENERAL FUND END OF YEAR
1972									761268.2
1973	162264.1	42469.7	204733.8	276232.7	24020.8	11358.6	311612.0	-106878.3	654389.8
1974	182367.0	36208.7	218575.7	278994.8	29646.2	11756.5	320397.5	-101821.8	552567.9
1975	170047.0	29928.1	219975.1	281784.3	32973.5	12749.8	327507.6	-107532.5	445035.4
1976	188752.0	23147.4	211899.3	284601.8	32498.4	13290.6	330390.6	-118491.3	326544.1
1977	226569.0	16705.2	237274.2	287447.4	32321.2	13153.0	333521.5	-96247.3	230296.8
1978	225954.9	10787.1	236741.9	290321.5	33723.5	13719.0	337764.0	-101022.1	129274.8
1979	314776.0	6882.4	321658.3	293224.3	34212.3	23358.3	350794.8	-29136.4	100138.3
1980	329299.9	5394.7	334694.5	296156.1	33887.2	25105.1	355148.3	-20453.8	79684.5
1981	332012.4	4182.2	336194.5	299117.3	31872.0	25167.5	356156.8	-19562.3	59722.2
1982	344194.7	3140.6	347295.2	302108.1	33246.7	26698.5	362053.3	-14758.1	44964.1
	2490194.0	178845.6	2669040.0	2889986.0	319001.6	176356.8	3385343.0	-716303.9	

AGO 530850

Exhibit D
ENDING GENERAL FUND BALANCE
Private vs Public Ownership
Budget Book Expenditure Plan

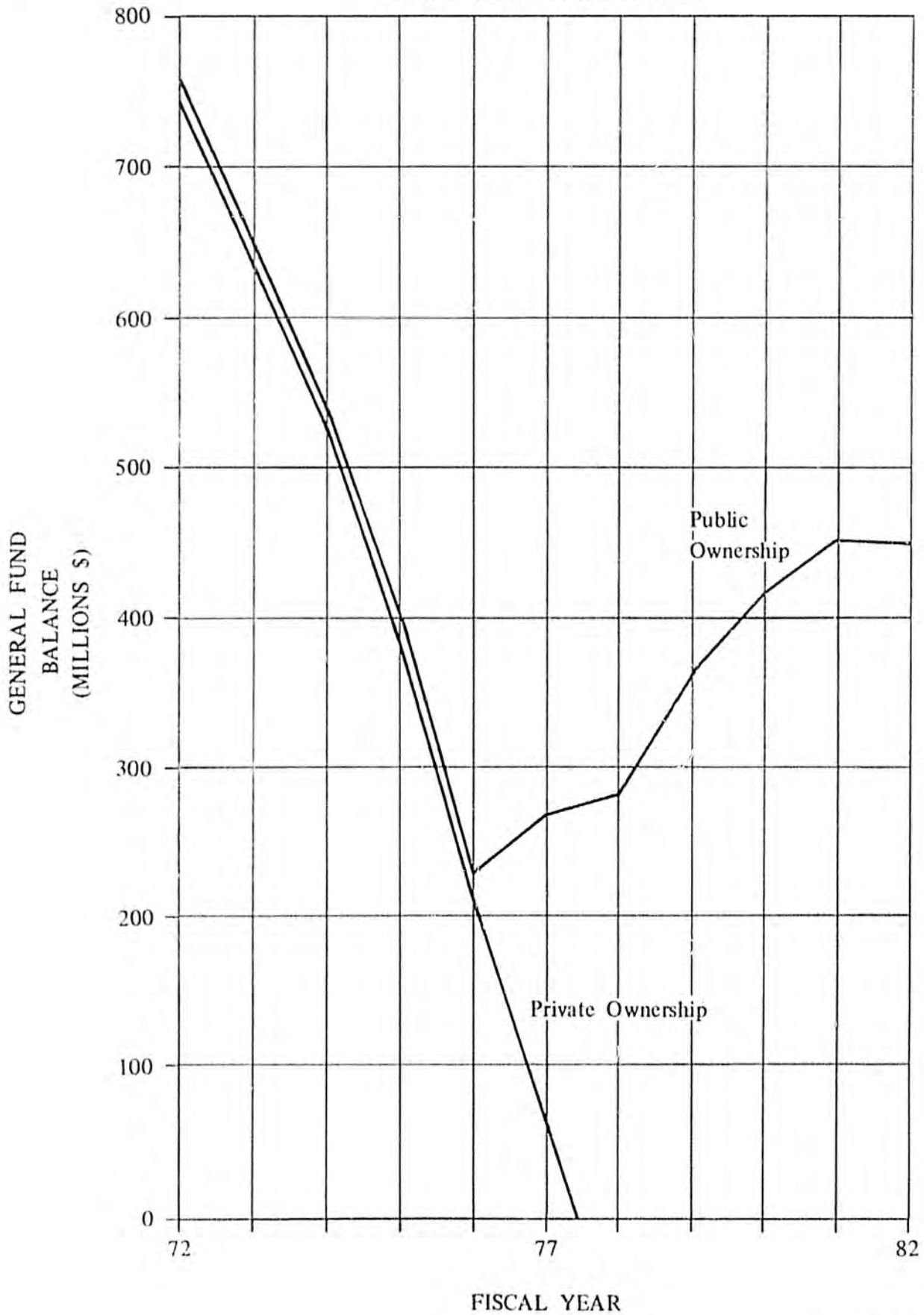


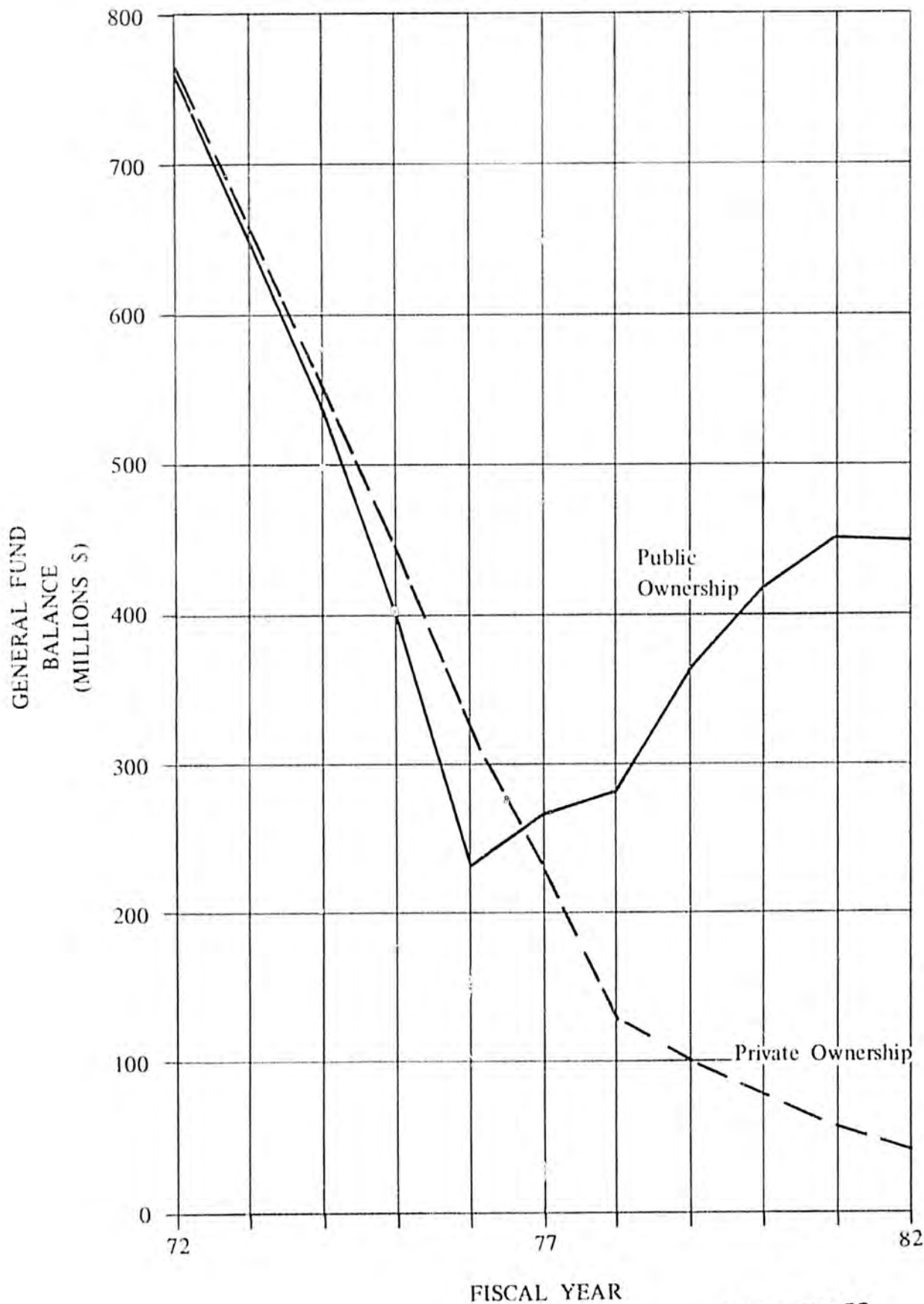
Exhibit E

ENDING GENERAL FUND BALANCE

Public Ownership Budget Book Expenditure Plan

vs

Private Ownership Subsistence Expenditure Plan



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AS A UNIT IN THE ORIGINAL DOCUMENT.