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Roll Call
at 11:00 ?

AGO 530869 +

1 Holm
2 Fischer
3 Christiansen
4 Groh.

1 BARBER
2 FERGUSON
3 YOUNG
4 HARRIS
5 HUBERT
6 ROSÉ
7 MILLER
8 SEN. MELAND

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1. ~~Senator~~ Rep Holm ~~Young~~
2. " ~~Walland~~ Fischer
3. Christiansen
4. Groh

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1. Rep. Ed Barber
2. Frank Ferguson
3. John ~~[illegible]~~ Young YOUNG
4. ~~Helen Fischer~~ Imeland
5. John Nepper
6. Mike Rose
7. Jess Harris
8. Mike Miller

McVeiga
Rolling

AGO 530871

JOINT HEARINGS ON PROPOSED PIPELINE LEGISLATION

MARCH 6 THROUGH MARCH 9, 1972

WITNESS REGISTER

	NAME	AFFILIATION	REPRESENTING
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, specialistin law re Powers of State & localgovt
7.	Raymond B. Gary	Aleyeska Pipeline	Investment Banking, Underwriting & distrib of securities.
8.	George A. Seymour	Aleyeska Pipeline	Mobil Pipe Line Company.
9.	Thomas R. Broussard	Aleyeska Pipeline	Atty. Spec in taxation, Legal Dept. ARCO
10.	Edward L. Patton	Aleyeska Pipeline	Aleyeska President. See 5 above
11.	Joseph R. Cortese	Aleyeska Pipeline	Same as 6 above.
12.	Richard M. Donaldson	Aleyeska Pipeline	V-Pres & Gen Counsel of SOHIO
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JOINT HEARINGS ON PROPOSED PIPELINE LEGISLATION

MARCH 6 THROUGH MARCH 9, 1972

WITNESS REGISTER

	NAME	AFFILIATION	REPRESENTING
1.	S. C. SANDUSKY	DIVISIONAL MANAGER	MARATHON OIL COMPANY
2.	DON DICKEY	GENERAL MANAGER	STATE CHAMBER OF COMMERCE
3.	Phil Holsworth		~~SENATE COMMERCE~~ Pres. of Chamber of Commerce
4.	William Hopkins		
5.	William Allen		
6.	John Cabaniss		
7.	James P. Jamieson		DuPont
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JOINT HEARINGS ON PROPOSED PIPELINE LEGISLATION

MARCH 6 THROUGH MARCH 9, 1972

WITNESS REGISTER

	NAME	AFFILIATION	REPRESENTING
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. M. Temple III	Temple, Barker & Sloane	Administration
9.	Charles Kades	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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TESTIMONY OF WILLIAM H. ALLEN

COVINGTON AND BURLING

WASHINGTON, D. C.

Witnesses for the Administration, particularly the Attorney General in his testimony, have expressed reservations on the question whether the Interstate Commerce Commission would have jurisdiction under Part I of the Interstate Commerce Act to regulate aspects of the transportation of crude oil by way of the Trans-Alaska Pipeline System to Valdez where the oil will be trans-shipped in tanker vessels to ultimate destinations outside of Alaska.

The reservations expressed were a result of my advice. My advice was given in response to a request by the Attorney General that, in connection with possible State ownership of the Trans-Alaska Pipeline, I consider questions relating to the existence, extent and nature of regulation by federal authorities, notably, of course, the Interstate Commerce Commission.

In his written submission on behalf of the owners and in a supplement thereto, Mr. Harry R. Jones has stated the view that, even though physically the pipeline and the transportation it performs will be entirely within Alaska, they are clearly subject to regulations by the Interstate Commerce Commission under Part I of the Interstate Commerce Act. My research and analysis of the pertinent authorities leave me

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unable to express so firm an opinion as Mr. Jones. My view is that there is at the least a substantial doubt whether the Trans-Alaska Pipeline operations are indeed subject to regulation under Part I of the Interstate Commerce Act and reason to believe that they are not.

Let me begin by laying out the ground that is common to Mr. Jones and me.

First, there is no doubt that, if the Interstate Commerce Commission has jurisdiction, it has such jurisdiction regardless whether the pipeline system is owned by private interests or by the State. Cases decided by the United States Supreme Court involving a state-owned belt line railroad leave no doubt on that score.

Second, there is no doubt that the Congress has the power under the commerce clause of the Constitution to provide for regulation of the transportation between the North Slope and Valdez as a part of a continuous movement in interstate commerce.

Many - not all - of the cases cited in Mr. Jones' written submissions are cases defining the scope of the commerce clause and not that of the Interstate Commerce Act. Some of these cases seem to indicate that if a transaction is within the reach of the Congress under the commerce clause it is beyond the power of the states to regulate regardless of the extent to which Congress has exercised its power. That, I believe, can no longer be taken to be the law. The authorities supporting that belief include cases such as Pennsylvania R.R. v. Public Util. Comm., 298 U.S. 170 (1936). As will be seen,

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it is principally with respect to the proper interpretation of that case that my analysis diverges from that of Mr. Jones.

The relevant facts here are famili to all of us. The pipeline will transport crude petroleum the producing areas on the North Slope through Alaska to Valdez, where the oil will be transferred into ocean-going vessels. The vessels, according to Mr. Jones, will be owned by the shippers.

The coverage of Part I of the Interstate Commerce Act, which is the part of the Act applicable to oil pipelines, is delimited in Sections 1(1) and 1(2) of the Act, 49 U.S.C. §§ 1(1), (2).

Section 1(1)(b) of the Act provides that Part I applies to "common carriers engaged in . . . [t]he transportation of oil . . . by pipe line, or partly by pipe line and partly by railroad or by water . . . from one State . . . to any other State . . . or from . . . any place in the United States to . . . a foreign country . . . ." Section 1(1)(a) deals in very much the same terms with common carriage by railroad. Section 1(3)(a) defines the term "common carrier" to include "all pipeline companies." Section 1(2)(a) provides that Part I applies also to "such transportation," i.e., the kind of transportation described in Section 1(1) but not to "the transportation of . . . property . . . wholly within one State and not shipped to or from a foreign country from or to any place in the United States as aforesaid . . . ."

The question whether a particular carrier or a particular operation of a carrier is subject to regulation by the Interstate Commerce Commission under Part I depends,

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analytically, on whether the carrier's operations fit within the descriptions in Sections 1(1) and 1(2). It is obvious that the pipeline subsidiaries of the North Slope producers, which will own undivided interests in TAPS, are common carriers by pipeline engaged in interstate transportation within the meaning of Section 1 and thus subject to ICC regulation. The question is whether the particular transportation by pipeline that we are concerned with here is transportation within the meaning of Section 1. There is a heavy judicial gloss on Section 1, and the decisions, I am bound to say, have been influenced by doctrines relating to when and where through transportation begins and ends for purposes of the commerce clause.

That is, the cases have not always engaged in close analysis of the precise terms of Sections 1(1) and (2).

The cases have been concerned not only with the ultimate origin or destination of goods that, in the hands of one carrier, move only intrastate but also with the nature of the originating or continuing interstate or foreign carriage, whether private or for-hire regulated or nonregulated.

Although no case has been found expressly so holding the ICC has apparently assumed that it has regulatory authority over a pipeline lying wholly within one state, where the product transported by the pipeline is subsequently shipped by ocean vessel to another state or to a foreign country. In Reduced Pipe Line Rates and Gathering Charges, 243 I.C.C. 115, 124 (1940), the Commission noted that some of the pipelines

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whose rates were being regulated ran from origins in Texas to the Texas coast, where the oil was put in tankers for transshipment to east coast refineries or to foreign destinations. The question whether regulation of these pipelines' rates was proper was not raised, and the Commission thus cannot be regarded as having answered it.

In the contexts of other modes of transportation there has been litigation of the question of the permissibility under the Interstate Commerce Act of tacking separate transportation segments together to justify a finding that the kind of transportation with which the Act deals is involved and permit the invocation of federal regulation over a wholly intra-state segment. Subject to qualifications that I will set out later, the cases seem to establish that, where two segments of a unitary transportation scheme are both for-hire carriage, the two segments may be tacked together to permit federal regulation of a segment that lies wholly within a single state. The earliest cases so holding were cases involving segmented transportation to or from foreign destinations. The Supreme Court readily found that intrastate rail transportation, when combined with prior or subsequent for-hire water carriage to or from a foreign port, is subject to ICC jurisdiction. Texas & N.O.R.R. v. Sabine Tram Co., 227 U.S. 111 (1913); United States v. Erie R.R., 280 U.S. 98 (1929).

There is authority, moreover, that despite the apparent limitation contained in Section 1(2)(a) the ICC may regulate intrastate for-hire rail or motor carriage where it is preceded or followed by for-hire interstate carriage and

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where the two transportation segments are in fact (although not in form) merely portions of a single through movement. The motor carrier decisions are under Part II of the Interstate Commerce Act, whose coverage provisions are not identical to those of Part I but into which, as we shall see, the same principles have been worked. E.g., William E. Rush - Common Carrier Application, 17 M.C.C. 661, 673 (1939) (intrastate motor transportation followed by interstate rail transportation); Joseph A. Bisceglia - Contract Carrier Application, 34 M.C.C. 233, 236 (1942) (intrastate motor transportation followed by interstate water transportation); Humble Oil & Ref. Co. v. Texas & Pac. Ry., 155 Tex. 483, 289 S.W.2d 547, 548 (1955) (interstate pipeline transportation followed by intrastate rail transportation).

On the other hand, where for-hire rail carriage occurring wholly within a single state is combined with private carriage across a state line the Supreme Court's decision in Pennsylvania R.R. v. Public Util. Comm'n, 298 U.S. 170 (1936), to which I have previously referred, holds that the for-hire rail carriage is not subject to ICC regulation. In that case a shipper who mined coal in Pennsylvania moved his own product from the mine in Pennsylvania to a railhead in Ohio by means of a combination of private rail cars and private barges. Coal was then shipped via several for-hire rail carriers to destinations within Ohio. The question was whether such intrastate rail transportation could properly command interstate rail rates or only the lower intrastate rates regulated by a state commission. Mr. Justice Cardozo found the answer for the Court in the

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provisions of Section 1 of the Interstate Commerce Act.

> "Not all commerce is transportation, and not all transportation is by common carriers by rail. The question for us here is not whether the movement of the coal is to be classified as commerce or even as commerce between states. The question is whether it is that particular form of interstate commerce which Congress has subjected to regulation in respect of rates by a federal commission.
>
> * * *
>
> "There are limitations, moreover, in respect of the conduct to be controlled in addition to the foregoing limitations in respect of the carriers to be regulated. Even though the activities are those of common carriers by rail, the statute does not apply 'to the transportation of passengers or property . . . wholly within one State and not shipped to or from a foreign country from or to any place in the United States.' § 1(2)(a), (b).
>
> For many purposes, as for example in testing the validity of state taxation, merchandise is deemed to be in interstate commerce when it has started on its journey, though still in the possession of consignor or seller . . . . Not so, however, in determining the application of this act. <u>Transportation begins for that purpose, if not for others, when the merchandise has been placed in the possession of a carrier . . . . And 'wherever the word "carrier" is used in this chapter it shall be held to mean "common carrier"' § 1(3)."</u> 298 U.S. at 174-75 (Emphasis supplied.)

Applying these principles, the Court held that the for-hire rail transportation was exempt from ICC regulation.

Mr. Jones distinguishes the Pennsylvania Railroad case on two grounds in a supplemental memorandum, which is addressed specifically to that case. One ground, as I understand, is that there is an enormous factual difference between

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hauling a few barges full of coal privately along a river from one state to another and there transshipping them by common carrier within the state and the flow of oil ultimately destined for massive out-of-state points that we are concerned with here. Railroad Comm'n. v. Worthington, 225 U.S. 101 (1912), involving a substantial through movement of coal and prohibiting a state from fixing the rate for an intrastate railroad segment, is cited as more nearly in point. I shall return to this point, the force of which I am bound to acknowledge.

The other ground, if I understand, relies upon emphasizing the fact that in the Pennsylvania Railroad case the intrastate movement followed an interstate movement, and that the Court spoke in terms of the transportation's beginning when goods are placed in the hands of a common carrier. In our case, on the other hand, the common carrier intrastate transportation precedes the private out-of-state transportation to destination and obviously begins when the oil is tendered to the pipeline. I find such a restricted reading of the Pennsylvania Railroad case hard to justify under the language of the statute. I am fortified in my tendency to discount the importance of whether the intrastate leg is the first or the last by the fact that a tribunal whose decisions are peculiarly important to our consideration here has not read the Pennsylvania Railroad case so restrictively. I refer to the Interstate Commerce Commission.

Some Commission decisions subsequent to the Pennsylvania Railroad case declined to apply that precedent to

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motor carrier cases arising under Part II of the Act, holding that its force was limited to cases arising under the provisions of Part I. See, e.g., Joseph A. Bisceglia - Contract Carrier Application, 34 M.C.C. 233, 237 (1942), holding that for hire motor carriage entirely within the State of California followed by private water carriage beyond the State was nevertheless subject to ICC economic regulation.

In Motor Transportation of Property Within a Single State, 94 M.C.C. 541 (1964), aff'd per curiam sub nom. Pennsylvania R.R. v. United States, 242 F. Supp. 890 (E.D. Pa. 1965), aff'd per curiam sub nom. American Trucking Ass'ns. Inc. v. United States, 382 U.S. 372 (1966), however, the Bisceglia case was explicitly overruled in this respect, and the principle was established that the Pennsylvania Railroad precedent applies under Part II of the Act as well as under Part I. And that precedent was treated as covering an intrastate common carrier movement either following or preceding a movement in private carriage. In its opinion the Commission explicitly found "that for-hire motor transportation, within the confines of a single State, of property which has moved from, or will move to, points beyond the same state in private motor carriage, is, so far as the for-hire transportation is concerned, not in interstate commerce subject to economic regulation under Part II of the Interstate Commerce Act. . . ." 94 M.C.C. at 551. In reaching that conclusion the Commission offered the following significant interpretation of the Pennsylvania Railroad decision:

> "[W]e think that the Pennsylvania decision does not permit the combination of for hire transportation wholly within a single State

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> with carriage by an owner across a State line for the purpose of subjecting the former to Federal economic regulation. . . ." Id. at 550.

See also L. A. Tucker Truck Lines Inc. v. United States, 215 F. Supp. 261, 263-64 (E.D. Mo. 1963), where the Pennsylvania Railroad principle was cited for a finding that interstate private barge transportation could not be the first leg of an interstate shipment so as to subject subsequent intrastate for-hire motor transportation to ICC regulation.

In Behnken Truck Service, Inc., Extension -- Exbarge Traffic, 103 M.C.C. 787 (1967), the Pennsylvania Railroad principle was extended still further. Relying on a dictum in Mr. Justice Cardozo's opinion, see 298 U.S. at 176-77, the Commission held that even for-hire transportation across a state line cannot be tacked to subsequent intrastate for-hire transportation, so as to subject the latter to ICC regulation, so long as the former is exempt from such regulation. 103 MCC at 794-95. In Behnken the interstate for-hire barge transportation was exempt from federal economic regulation under Section 303(b) of the Act, 49 U.S.C. § 903(b). As a result, the subsequent for-hire motor carriage was also held to be exempt. And see W. J. Holliday & Co. v. Liberty Trucking Co., 53 M.C.C. 22 (1951). The Behnken holding has subsequently been followed in Commercial Carrier Corp. Extension - Salt, 112 M.C.C. 415, 419 (1970).

It may not be necessary to go further along this line since it is said that the forward movement from Valdez will be

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in private vessels. However, Mr. Jones has said that if the oil moved in contract or common carrier vessels the Pennsylvania Railroad principle would not apply. I cannot regard even that as clear. The issue may depend on whether the carriage is regulated, and carriage of oil in tankers between Alaska and the other states seems not to be subject to economic regulation.

I should state at the outset that there is authority for the proposition that, if the forward movement were to a foreign port and even in a private shipper-owned vessel, the pipeline movement to that extent is within the Interstate Commerce Act. Long Beach Banana Distributors, Inc. v. Atchison, T. & S.F. Ry., 407 F.2d 1173 (9th Cir. 1969), cert. denied, 396 U.S. 819 (1969). There is some support for the Banana Distributors holding in the language of Section 1(2)(a) of the Act.

The Interstate Commerce Commission, under Part III of the Act, has broad authority to regulate the activities of water carriers operating in interstate commerce, defined in § 302(i)(1), 49 U.S.C. § 902(i)(1), as transportation "wholly by water from a place in a State to a place in any other State, whether or not such transportation takes place wholly in the United States. . . ." However, in derogation of this general grant of authority, the regulation of water carriage between the State of Alaska and other states in the United States has been specifically entrusted to the Federal Maritime Commission, to the exclusion of the ICC. Section 27(b) of the

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Alaska Statehood Act, 48 U.S.C.A. note preceding § 21, prov[illegible]

as follows:

> "Nothing contained in this or any other Act shall be construed as depriving the Federal Maritime Board [now Commission] of the exclusive jurisdiction heretofore conferred on it over common carriers engaged in transportation by water between any port in the State of Alaska and other ports in the United States, its territories or possessions, or as conferring upon the Interstate Commerce Commission jurisdiction over transportation by water between any such ports."1/

The Federal Maritime Commission does regulate, pursuant to the Shipping Act, common carriage by water between Alaskan ports and the contiguous 48 states. See Alaskan Rates, 2 U.S.M.C. 558 (1941); Puget Sound Tug and Barge Co. v. Foss Launch & Tug Co., 7 F.M.C. 43 (1962). Such regulation consists principally of rate regulation pursuant to Section 18 of the Shipping Act, 46 U.S.C. § 817, and Sections 2, 3, and 4 of the Intercoastal Shipping Act, 46 U.S.C. §§ 844, 845, 845a. The Commission's jurisdiction over rates is, however, clearly limited to common carriers and does not embrace private or contract carriers. See 46 U.S.C. §§ 817, 844; see also Activities, Tariff Filing Practices and Carrier Status of

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1/ In any event, § 303(d) of the Interstate Commerce Act, 49 U.S.C. § 903(d), specifically exempts from ICC regulation under Part III "the transportation by water of liquid cargoes in bulk in tank vessels designed for use exclusively in such service and certified under regulations approved by the Commandant of the Coast Guard pursuant to the provisions of section 391a of Title 46." Under this provision, therefore, the tanker transportation of petroleum from Valdez to ports within the contiguous 48 states would be exempt from Interstate Commerce Commission regulation, even if the Alaska trade were not otherwise removed from ICC jurisdiction.

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Containerships, Inc, 9 F.M.C. 56, 66-67 (1965).

Under the Shipping Acts the term "common carrier" means a common carrier at common law. Containerships, supra at 62; Consolo v. Grace Line, Inc., 4 F.M.B. 293, 300 (1953).

> "[T]he essential characteristics of the common carrier [at common law] are that he holds himself out as such to the world; that he undertakes generally, and for all persons indifferently, to carry goods and deliver them, for hire; and that his public profession of his employment be such that, if he refuse, without some just ground, to carry goods for any one, in the course of his employment and for a reasonable and customary price, he will be liable to an action." Moore, Carriers 20 as quoted in The Wildenfels, 161 Fed. 864, 866 (2d. Cir. 1908).

The common carrier is to be distinguished from the private or proprietary carrier, who merely transports his own cargo in his own ship and does not hold himself out to transport cargo for others. Moreover, effective ownership of a vessel may be acquired not only by purchase but also by "bareboat charter," which amounts to a rental of the vessel, giving the charterer complete control of her navigation and working. The acquisition of a vessel by bareboat charter "is as complete ownership, during the occasion of the charter," as acquisition by purchase. "It follows that in the case of a bona fide bareboat charter there is no carrier-shipper relationship as respects cargo of the charterer transported in the vessel, and that as to such cargo the bareboat charterer is a private carrier." In re Intercoastal Charters, 2 U.S.M.C. 154, 161 (1939). Private carriers are, of course, exempt from regulation by the Federal Maritime Commission. Id. at 160-161.

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The common carrier must also be distinguished from the contract carrier, a term that has been defined to include:

> "[E]very carrier by water which under a charter, contract, agreement, arrangement, or understanding, operates an entire ship, or some principal part thereof, for the specified purposes of the charterer during a specified term, or for a specified voyage, in consideration of a certain sum of money, generally per unit of time, or weight, or both, or for the whole period or adventure described." Intercoastal Navigation, 1 U.S.S.B.B. 400, 458 (1935).

A subsequent Commission decision makes plain that the relation of contract carrier and shipper arises whenever, under a charter, one obtains the exclusive use of a vessel's service, leaving the control and management of the vessel to its owner. In re Intercoastal Charters, supra at 161, 162-63. There is no question that contract carriers are presently exempt from Commission regulation under the Shipping Acts. See Containerships, supra at 66-67.

The law is clear that the existence of the contract carrier relationship does not depend on the duration of the charter. One may be a contract carrier either under a time charter or under a voyage charter. In re Intercoastal Charters, supra at 161. In one early case it was specifically held "that a ship hired for a specific voyage to carry a particular cargo for the charterers, is not a common carrier but a bailee for hire . . . ." The Wildenfels, 161 Fed. 864, 866 (2d Cir. 1908). And see The Fri, 154 Fed. 333, 338 (2d Cir. 1907), cert. denied, 210 U.S. 431 (1907). This precedent has been followed by the Federal Maritime Commission. D.L. Piazza Co. v. West Coast Line, Inc, 3 F.M.B. 608, 612 (1951).

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It is my understanding that the engagement by a shipper of a tanker vessel is typically of its full capacity.

There remains the point to which I promised to return, the other apparent attempted ground of distinction of the Pennsylvania Railroad case -- the comparative triviliaty of the movement of coal there involved as contrasted with the massive flow of oil here from Alaska to out-of-state points. There is no doubt that the Trans-Alaska Pipeline System will be highly visible, and its operation will be a matter of substantial national concern. That might be regarded by some as a reason why Congress should undertake to see that it is regulated in the national public interest. And I cannot deny that views as to what Congress should have done have their influence on decisions that in terms relate to what Congress in fact has done. Certainly no tribunal would be comfortable in deciding against ICC jurisdiction if it were not convinced that there would be regulation of some sort.

I should note in this regard that the case that has been cited as more nearly analogous to the case of the Trans-Alaska pipeline than the Pennsylvania Railroad case, Railroad Comm'n v. Worthington, 225 U.S. 101 (1912), was decided solely on constitutional grounds. That is, the imposition of state regulation on the intrastate coal movement was held to constitute a burden on interstate commerce forbidden by the negative implications of the affirmative grant of power to Congress by the commerce clause itself. The court did not hold that the rates were subject to regulation by the Interstate Commerce

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Commission. Because the court rested its decision on constitutional grounds, it found it unnecessary to decide whether the railroad was correct in its argument that the transportation was not within Section 1 of the Interstate Commerce Act. Id. at 110-11. That approach to decisions relating to the allocation of state and federal powers, as I have suggested above is outmoded.

Today there is forthright recognition that Congress has the power of allocation. Southern Pac. Co. v. Arizona, 325 U.S. 761, 769 (1945). Literally, the Lake Cargo Coal decision left open the possibility that the rates were not subject to regulation at all. That kind of decision is nearly impossible to imagine today. To turn the matter around, it is most unlikely that the ICC or a court would rule against ICC jurisdiction were there no state regulatory regime in existence to assume the responsibility of regulation.

In light of all this, if the petroleum that is carried to Valdez by pipeline is subsequently transshipped to ports in the United States in vessels owned or chartered by the shippers, that water transportation would not be subject to economic regulation by any federal agency. There is reason to believe that in these circumstances the ICC or a court would hold the pipeline operations within Alaska to be free from ICC regulation as occurring wholly within the confines of a single state. That this would be the outcome cannot be predicted with certainty, especially because of the considerations to which I have just adverted, but such an outcome would be supported by the authorities I have cited.

AGO 530890

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

JOINT HEARINGS

SENATE COMMERCE COMMITTEE

HOUSE STATE AFFAIRS COMMITTEE

Juneau, Alaska

March 6-9, 1972

MARATHON OIL COMPANY

My name is Samuel C. Sandusky; I am Division Manager for Marathon Oil Company in Anchorage. I want to thank the Committees for inviting Marathon to participate in these hearings. To my knowledge, the industry has had no input into the legislation being considered by these Committees, and certainly it is fitting and proper that the industry most vitally affected by this legislation should be heard.

Marathon Oil Company produces oil and gas in the Cook Inlet area of the State of Alaska. Marathon is one of the owners of the Cook Inlet Pipeline Company which operates facilities to carry oil produced from west side Cook Inlet fields to Drive River Terminal for tanker loading. We are also one of the owners of the gas pipeline on the east side of the Inlet which gathers gas from the Kenai Gas Field for delivery primarily to industrial complexes north of the city of Kenai. We are presently participating in the construction of a 52-mile casinghead gas gathering system from the west side of the Inlet to the Nikiski area on the east side. We are not one of the owners of the proposed trans-Alaska pipeline.

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Senator Rettig's letter of invitation indicated that he hoped industry representatives would make suggestions concerning the question of how Alaska can help stimulate growth of the petroleum industry in the State, as well as to discuss the proposed legislation. My testimony will consider both problems, as they are certainly interrelated.

First, I am sure there is no pat answer to the question of what Alaska can do to stimulate growth of the petroleum industry. However, it can and must recognize that this is an extremely high cost area in which to operate; that the final product, oil or gas, must compete in the worldwide market; that additional costs, either through monetary payments or operational restrictions, only serve to lessen the economic attractiveness of Alaska production; and finally that Alaska cannot solve all of its economic problems through the oil industry.

Second, I am sure that among the things the State should not do if it expects to stimulate industry, is to pass the type of legislation being considered at these hearings. By discussing these bills from the viewpoint of a healthy business climate, I hope to show you why.

AGO 530892

In my opinion, effective stimulation of industry growth will not be aided by adding an arbitrarily determined and exorbitant right-of-way cost to an already tremendous cost resulting from difficult logistics, high cost labor and transportation, hostile geographical and meteorological conditions, and the rightful protection of a virgin environment. The right-of-way leasing bills create added costs for administrative burden and delay time as well as for the right-of-way itself.

Added costs will be the result ~~of Section 38.40.370 in~~ Senate Bill 294, as well as ~~Section 38.35.020 of~~ Senate Bill 313, which provide for calculating annual rental payments for State right-of-way leases. Both bills, though containing different formulas, generally base rental payments upon the cost of the facility as well as income derived from the facility. Neither of these items has any direct relationship to the value of State lands used for right-of-way. Thus the right-of-way costs proposed in these bills appear to really be a facility tax rather than a reasonable charge for the use of State lands to construct pipelines. In addition, I submit that to compute such costs on the basis of the total system investment, when the amount of State land used for the facility

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may be less, and in some cases substantially less, than 100 percent, is a concept that is both arbitrary and patently unfair, and in my view, is not conducive to the growth of the industry nor the wellbeing of the State.

As an example of the administrative burden, I refer you to Senate Bill 294, ~~Section 38.40.250, Paragraph (b)~~, which requires that all parties, including the designers and builders of the pipeline, join in applications for leases and certificates. It appears that all recourse by the Board will be directed toward the carrier and that the others required to join in the applications have no CONNECTED responsibility. The administrative burden associated with this provision is obviously unnecessary and will do nothing but cause delay and confusion.

Further administrative burden and delay will result from ~~Paragraph (c), Section 38.40.390 of Senate Bill 294~~, which provides that the carrier receive the authorization of the Board for all financing transactions. This is an unnecessary requirement, for if the Board approves a proposed application and issues a certificate therefor, it follows that the carrier should be permitted to proceed with the financing required to permit him to perform under the terms of the certificate.

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Involving the State at this point in time will undoubtedly cause delay costly to both the private and public sectors.

The climate for business growth will be dampened by legislation which predetermines the allowed return on capital at a level which may be inadequate to encourage the overall monetary risk involved in a pipeline project. The alternate computation for lease rental provided by Section 38.40.370, Paragraph (a) (2) of Senate Bill 294, appears to do just that. Moreover, even the formulated basepoint is tenuous since the rental can be increased by the Board pursuant to both Paragraph (c) of the above Section and Paragraph (12) of Section 38.35.020 of Senate Bill 213. Also, the fact that the rental is unknown makes it impossible for a potential carrier to make an economic judgement on whether or not to proceed with an application, therefore, effecting a potential waste of his time as well as that of the Board and the associated public. Furthermore, such flexibility leads to the specter that the Board might require the stated minimum rental from one carrier yet establish a higher rental for another. Such authority to discriminate between one pipeline and another is backed by a statement of policy and purpose broad enough to be the charter for State government itself, and is not conducive to industrial growth.

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Another possibility for discriminatory treatment lies in ~~Section 38.40.440 of~~ Senate Bill 294, which gives to the Board authority to require as a stipulation of the lease, actions by carriers toward achievement of certain social goals which may not be required of other business, industrial, or public enterprises.

Industrial growth cannot be stimulated if the State is unwilling to contract for the use of its land for a time period equal to that for which private enterprise is willing to provide a service requiring the use of such land. The establishment of a finite term inconsistent with the expected life of the pipeline is a serious defect in the bills which could be an obstacle to arranging financing at reasonable cost over the expected life of the project. The five-year term provided in Senate Bill 313 is totally inconsistent with normally expected pipeline life. SB 294 grants a longer term; however, Section 38.40.330 is not clear whether such maximum term is 10 or 20 years, and is still a finite period which probably will be inconsistent with pipeline life.

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In addition, the short term lease places the carrier at the mercy of the State at renewal time since he has already made substantial investment and since renewal of the lease is essential to his continued operation and the ultimate success of his project. Businessmen will be reluctant to accept such terms, and it is my opinion that if the State enacts such legislation it will install a substantial roadblock to industry growth.

Industry will not be encouraged by legislation which does not include among its goals some reasonable protection of the rights of business.

For example, while ~~Section 34.40.020 of~~ Senate Bill 294 sets forth the objective of achieving transportation at reasonable rates, the complementing objective of assuring the carrier of an opportunity to earn a fair return is conspicuously absent.

Another example of failure to temper a mandate with some protection ~~is shown by Paragraph (1) of Section 38.40.350~~ of Senate Bill 294 ~~and Section 38.35.020, Paragraph (2) of~~ Senate Bill 313, which are covenants to assume a position of

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common carrier. Transportation must be furnished without any regard to specifications consistent with the primary usage of the pipeline. Certainly such protection should be available by making this type requirement subject to the tariffs established by the carrier and approved by the appropriate regulatory body. Similarly, ~~Section 38.40.420 of~~ Senate Bill 294 requires the carrier to provide any sort of service which may be demanded, with no protection whatever against unreasonable demands as may be determined by the appropriate regulatory body.

Both Senate Bill 294 and 313 stipulate that as a condition of the right-of-way lease a carrier must agree to the jurisdiction of an appropriate State regulatory body. Since no carrier can choose between State and Federal authority in case of a jurisdictional dispute, he may not be able to perform and thus his lease could be in jeopardy through no fault of the carrier. The provision is obviously unworkable, and thus unreasonable.

It is detrimental to business growth for the State to give itself the option of enjoying the benefits of successful investments without risking unsuccessful ventures and with the help of 20/20 hindsight. ~~Section 38.40.360 of Senate Bill 294~~

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Both Bills ~~and paragraph (11) of Section 38.35.020 in~~ Senate Bill 313 require lease provisions granting the State the right at any time to purchase an undivided interest in a pipeline at a price to be set at the time the lease is executed. In addition to the aspect of choosing its time and place of participation, and perhaps more objectionable from an ethical point of view, is the fact that it puts the State in position of being both the regulator and the benefactor of those regulations. The conflict of interest is obvious.

As to the proposition of State ownership in pipelines per se, I can only state that as a representative of private enterprise and a citizen, I am opposed to this concept. This opposition is predicated upon the historical function of private and public economic sectors, with the latter serving those functions which cannot or will not be accomplished by private enterprise. Certainly it is my observation that the private sector has been more than willing to provide, and in fact thus far has provided, the pipelines necessary to transport Alaska oil and gas resources to such markets as may exist for them. Thus I question the need for such legislative proposals. It is my opinion that such legislation will cause the business environment to deteriorate and that growth of the petroleum industry in particular will be stifled.

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Marathon has no objection to the State receiving reasonable compensation for the use of its land for the installation of pipelines. If legislation is needed to establish a schedule of fees, it should be limited to this proprietary function of the State. However, for the reasons outlined we are opposed to the two bills pertaining to right-of-way leasing. For Alaska to consider such a radical departure from our established system ~~of government~~ should require a need which in my opinion has not been demonstrated, and its ultimate effect will not be to the best interest of the State or its citizens.

I would like to turn now to Senate Bill 315, the pipeline regulation bill. Marathon is opposed to this bill as drawn. In view of the stagnation of development due to circumstances beyond industry control, we also question the need for a crash program to provide such regulation. If it is the conclusion of this Committee that legislation is ~~now~~ needed, we suggest a joint effort by industry and State personnel be directed to the end of writing legislation ~~which~~ will be mutually acceptable to the State and to the industry.

Without going into great detail, I would like to point out several aspects of this proposed bill which causes ~~us~~ concern.

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Section 42.06.141 appears to extend the authority of this Commission to matters subject to Federal regulation. As has been pointed out before, imposing upon the proposed Commission the power as well as the duty to regulate the oil and gas transportation within the State which is subject to paramount Federal regulation is unrealistic and unenforceable.

The proposed bill seems to authorize the Commission to grant a monopoly for transportation where there are competing applications. Traditionally this treatment has not been accorded to crude oil pipelines for the simple reason that it eliminates competition and its attendant benefits which are lower transportation tariffs. In this sense, crude oil pipelines are not "utilities" but are in the free market business of transporting oil at the lowest price. The need for a monopoly for such transportation should be carefully examined.

The bill in several places gives the Commission the power to make determinations requiring additional commitments by the carrier which could very well be to the carrier's detriment. The possibility of issuance of satisfactory initial certificates only to be arbitrarily modified later ~~as provided in Section 42.06.271~~, is clearly an unreasonable possibility.

The concept of authority in the Commission to order service re-instated as is set forth in Subsection (b) of 42.06.261, of the bill, is alarming since if abandonment had previously been authorized, the carrier may have removed the facility altogether and no longer be in existence and couldn't possibly respond to a resumption of service order.

The imposition of criminal penalties for willful violations of any provisions of the Act including regulations or orders of the Commission ~~as set forth in Section 42.06.556~~ is unreasonable and unnecessary. The injunctive and monetary sanctions together with civil penalties imposed by later provisions of the bill should suffice to be an effective deterrent against violations.

We believe that there are areas of conflict between authority contained in this bill and existing State agencies. For instance, ~~in Section 42.06.221, Paragraph (a), a~~ Commission would declare before issuing a certificate for service that "efficient production and marketing" will require the service. This Commission's authority should concern transportation rather than production, as the latter is clearly regulated elsewhere in the Alaska Statutes. We do not understand the

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intent of including the term "marketing" as we see no relationship to the proposed Commission. Gas pipelines insofar as they serve the citizens of Alaska, appear to be adequately controlled by the Alaska Public Utilities Commission. Likewise, involvement in ~~health, welfare, and~~ environmental activities are proper functions of existing agencies. Accordingly, it would seem that careful investigation is warranted as to the interrelationship of this type of legislation with existing authority and commissions. This would determine whether existing agencies could, with modification, handle these matters, and carefully eliminate conflict and duplication in the event a new agency is deemed desirable.

Gentlemen, that concludes my testimony. Thank you again for the opportunity to present our views.

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HOUSE BILLS 569 and 570

STATE OR AUTHORITY FINANCING OF TRANS-ALASKA PIPELINE

LEGAL ASPECTS

Testimony of Joseph R. Cortese, Squire, Sanders & Dempsey, Bond Attorneys, Cleveland, Ohio (by invitation)

Introduction.

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

A. Test Litigation - Substantial Questions.

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

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

(1) That the use of the state credit to finance the pipeline project is unwarranted in view of the availability of private financing, and use of state credit for such a facility in the circumstances would not serve a public purpose as required by Article IX, Section 6, Alaska Constitution.

(2) That the State guarantee of the bonds of the Trans-Alaska Authority provided for in House Bill 569 would create a State debt contrary to Article IX, Section 8.

(3) That the leasing of the pipeline by the Authority to the State as provided in House Bill 569 would result in a State debt under Article IX, Section 8, not qualifying under the exceptions provided in Section 11.

(4) That House Bill 569 would be a local or special act in violation of Article II, Section 19, Alaska Constitution.

(5) That House Bill 569 involves unlawful delegation of legislative powers to the proposed Trans-Alaska Authority and to other executive and administrative officers.

These and other legal aspects of House Bills 569 and 570 will be discussed further below.

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

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B. Independent Litigation - The No-Litigation Requirement for Bond Financing.

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

C. Four Types of Bonds.

House Bills 569 and 570 would authorize what might be depicted as four categories of bonds:

(1) General obligation bonds of the State, backed by the full faith and credit and the taxing power of the State in the normal fashion;

(2) Bonds of the Trans-Alaska Authority guaranteed by the State;

(3) Bonds of the Trans-Alaska Authority backed by the general credit of the State through the device of leasing the pipeline to the State with the State paying rentals from its general funds in sufficient amounts to subsidize any operating losses, pay principal and interest on the bonds and establish and maintain reserves to further secure the bonds.

(4) Bonds of the Authority payable solely out of such net operating revenues of the Authority as might be generated over the life of the bonds, with the bondholders taking the ~~full~~ risk of any inability to pay by reason of inadequacy of revenues resulting from delays or interruption in construction, inadequacy of funds to complete the project, any interruption in operation, or changed economic conditions.

D. Public Purpose Question - Is There A Need For The State To Use Its Credit?

In view of the fact that private capital is ready, willing and able to finance the pipeline project, there is a substantial question whether the use and consequent burdening of the State's credit for this project would be for a public purpose within the constitutional prohibition against use of the credit of the State for other than a public purpose.

Alaska Constitution, Article IX, Section 6, provides:

> "No tax shall be levied, or appropriation of public money made, or public property transferred, nor shall the public credit be used, except for a public purpose."

In Ault v. Alaska State Mortgage Association, 387 P. 2d 698 (1963), the Alaska Supreme Court held that the findings and statement of public purpose in an act of the Legislature did not foreclose determination by the Court of the question of whether the act would serve a public purpose, and the Supreme Court remanded the case to the Superior Court for a taking of evidence pertaining to the question. There, the Alaska State Mortgage Association was to issue revenue bonds to provide moneys in the secondary mortgage market to stimulate housing construction. The Supreme Court said it wanted to see evidence as to the adequacy or lack of private funds in the secondary mortgage market, the effect thereon of termination of a federal program, and how the Association would reduce or eliminate adverse effects.

After the case was remanded to the Superior Court and detailed testimony taken, upon a second appeal the Supreme Court approved the program, two and one-half years after its original decision. Walker v. Alaska State Mortgage Association, 416 P. 2d 245 (1966). The Court ruled that a public purpose existed because there was a need for public financing in view of the inadequacy of private funds, as shown by the evidence, and that the program would not merely compete with private funds because the Association would make moneys available only where financing could not be obtained in the private market.

Likewise, in DeArmond v. Alaska State Development Corporation, 376 P. 2d 717 (1962), The Alaska Supreme Court approved a program for business development loans to be provided by the issuance of revenue bonds, only after determining that private financing was not sufficiently available for long term development loans.

In Wright v. City of Palmer, ~~468 P. 2d 326~~ (1970), the City's issuance of general obligation bonds to construct a plant to be leased to a manufacturer was approved upon evidence that the object and effect would be to encourage industrial development which was urgently needed because the City's economic growth was nil, high year-round unemployment existed, jobs had been lost by the closing of mining and lumbering enterprises, there was no manufacturing in the City, and businesses were moving out of the City. The need for the City itself to take an active role in financing was apparent.

It has been held that industrial development financing serves no public purpose where the facts make it plain that private funds will provide for the project without the injection of public financing; that no public purpose is served by substituting public credit for private funds. Manning v. Fiscal Court of Jefferson County, 405 S.W. 2d 755 (Ky. 1966). There private capital had already been committed to the facility.

That result appears to be consistent with the approaches taken by the Alaska Supreme Court in the cases mentioned above.

From an examination of the proposed statement of legislative findings and policies contained in House Bill 569, it is difficult to perceive any necessity whatever for State financing in order to achieve the objects stated, especially when it is apparent that the planning, development, and expertise represented in Alyeska Pipeline Service Company are essential to the early achievement of the pipeline project consistent with those objectives, and in view of the substantial questions as to the practical ability of the State to finance the project. It should be borne in mind that private capital has already spent or encumbered a half billion dollars for this pipeline ~~project,~~ and is ready, willing and able to provide the balance needed.

In short, the ability to obtain the objectives through private financing and ownership presents a material question of whether the use of the State's credit for this project is unwarranted and impermissible under the Alaska Constitution.

E. State Guarantee of Authority Bonds - Unconstitutional State Debt.

The State guarantee to be placed upon an unlimited amount of bonds of the Trans-Alaska Authority merely upon signature by the Governor pursuant to Section 44.58.260 of House Bill 569, would constitute State debt which is not authorized under either Section 8 or 11 of Article IX, Alaska Constitution.

Section 8 of Article IX prohibits State debt except as ratified by the voters of the State with certain exceptions not relevant here. Section 11 provides an exception for revenue bonds issued by a public enterprise or public corporation "when the only security is the revenues of the enterprise or corporation." The State guarantee clearly would provide security beyond those revenues, and would be inconsistent with this Section 11.

The bill itself acknowledges the creation of State debt. Section .260(e) states, "The state is liable on notes or bonds guaranteed under this section but is not liable on notes or bonds not guaranteed by the state, which may not be debt of the state." It might be noted in this connection that the section would not inhibit issuance of non-guaranteed bonds on a parity with the guaranteed bonds so that revenues could be siphoned off for the non-guaranteed bonds leaving the State with full liability on the guaranteed bonds. No provision is made as to how the State would make good on its guarantees. Perhaps this omission is compelled by the Constitution's prohibition against the dedication of any tax or license to any special purpose. Article IX, Section 7. Thus, the entire financial resources of the State would be obligated. It should be noted that the annual principal and interest requirements on $3.5 billion of bonds would be approximately equal to the total annual revenues of the State at the present time.

House Bill 570, providing for ratification of $3,500,000,000 general obligation bonds of the State to be issued by the State Bond Committee, would not serve to give constitutional authorization for the guarantee of revenue bonds of the Trans-Alaska Authority. Further, it is questionable whether Article IX, Section 8, contemplates any State debt created by way of guarantees. Rather, it may be that an amendment of the Constitution would be needed for that purpose.

In any event, it seems clear that a State guarantee of the Authority bonds could not be given without authorization thereof by vote of the people, and any attempt to vest such powers in the Trans-Alaska Authority and the Governor merely by legislative act would be unconstitutional.

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F. State Lease Rental Commitment - Unconstitutional State Debt.

The provisions of Section .250 of House Bill 569 for the Trans-Alaska Authority to lease the project to the State and for the State to operate or sublease the project pose serious questions as to whether State debt would be unconstitutionally created thereby.

Section .250 would authorize the Governor to enter into such a lease in connection with the Authority's financing of the project, and to agree that the State would pay the Authority sufficient amounts to pay the principal and interest on the bonds, the operating and maintenance expenses of the project, and to provide reserves for debt service and operating and maintenance expenses. No limitation of amount is provided and the lease may be for any agreed term or may be unlimited in time. Under the lease, the Governor may also commit the State to subsidize costs of the project in any amount agreed upon.

No restriction is provided as to the sources of funds of the State which would be needed to pay the rentals.

The only apparent object of these provisions is to place the State in the middle so that purchasers of the Authority's bonds might view the State's credit as standing behind the bonds, and thus obtain the benefit of the State credit without a vote of the people.

Such lease-type financing has been used or tried in other states and has been sustained in some and declared unconstitutional in others as creating a state debt without constitutional authorization. Still other states have adopted constitutional amendments to permit such financing. The validity of such financing has not been determined by the Alaska Supreme Court.

The legal question is clearly presented where a unique single purpose project is involved, such as this crude oil pipeline. For example the Illinois Supreme Court, in Rosemont Building Supply, Inc. v. Illinois Highway Trust Authority, 258 N.E. 2d 569 (1970), held invalid a plan whereby the Authority would issue bonds, which the act said were not to be deemed obligations of the State, to finance highways, bridges and related facilities. The Authority was to pay off its bonds from its own revenues, but its principal source was to be rentals to be received from the State through leasing the projects to the State. The State was not to be committed to pay rentals except as periodically appropriated, and if rentals were not paid the Authority could undertake operation and charge tolls or lease the projects to others.

The Illinois Supreme Court had previously approved that type of financing for various buildings, but here it distinguished those cases as involving the type of facilities which were readily adaptable to other uses so that it could be assumed that other lessees could be found to pay sufficient sums if the State ceased to pay rentals. However, here it was apparent to the Supreme Court that while the State was not legally obligated to continue appropriations, there would be no real alternatives for use of such highway facilities. Thus, the Court concluded that an unconstitutional State debt would be created by such leasing program.

Much the same can be said of the proposed lease commitment of the State of Alaska in connection with the pipeline project; for if at any time the pipeline was not earning enough to cover the debt, there would be no practical way to avoid a burden on the State general fund for there would be no takers for a losing facility which has no other practical use.

Thus with the vast cost, and consequent heavy debt service burden, of this single purpose facility, the type of financing involving a lease commitment by the State poses substantial constitutional questions.

G. Local or Special Law.

House Bill No. 569 should also be considered in light of Article II, Section 19 of the Constitution which provides that "the legislature shall pass no local or special act if a general act can be made applicable. Whether a general act can be made applicable shall be subject to judicial determination." Provisions of the bill pertaining to the issuance of bonds and notes, the State guarantee of such obligations, and the

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entering into of leases and agreements are all limited to the "project", which is defined in Section 44.58.500 as a pipeline from Prudhoe Bay and adjacent areas to the Port of Valdez and other ports and related facilities.

These key provisions of the bill, therefore, relate only to a single pipeline project, which suggests that the bill is a local and special act when a general act providing for pipeline projects anywhere in the State could be made applicable. This point of law has been the subject of litigation which delayed financing for five years. In State, ex rel. Saxbe v. Underground Parking Commission, 155 N.E. 2d 678 (1959), the Ohio Supreme Court held unconstitutional a state providing for the construction and financing of a public parking garage under the grounds of the state capitol building in Columbus under a similar constitutional provision. The applicable provision of the Ohio Constitution, Article II, Section 26, provides in part that "all laws, of a general nature, shall have a uniform operation throughout the state." The court said that the construction of underground parking facilities was a matter which could affect other areas of the state and not just the City of Columbus and that, therefore, the law was a law that dealt with a subject of general nature and was invalid because of its limited application.

Thus, it appears that these important features of House Bill 569 are subject to constitutional challenge and necessitate judicial determination before reliance upon them.

H. Unlawful Delegation of Legislative Powers.

A serious question also exists as to the validity of H.B. No. 569 when considered in relation to Article II, Section 1 of the Alaska Constitution which provides that "the legislative power of the State is vested in a legislature." This bill purports to do more than delegate just rule-making power to an agency or officer, which is a form of permitted delegation of legislative authority, when appropriate standards are provided. Kelly v. Zamarello, 486 P. 2d 906 (1971). This bill is lacking in standards for limitation of rule-making authority, but even more than that, it would take out of the hands of the elected law-making representatives of the people the power to make decisions for the State on matters of the utmost importance concerning State policy and finances.

Consideration of just a few of the more notable examples of attempts to confer unlimited or nearly unlimited powers and discretion upon executive and administrative officers under this bill should suffice to illustrate the manner in which this proposed law might violate Article II, Section 1 of the Alaska Constitution.

1. Section 44.58.055. This section, which is duplicated in identical language in Section 44.58.330, purports to confer on the Authority "sole and exclusive jurisdiction, control and supervision of all pipelines and other transportation facilities for the transportation of oil and natural gas produced in the state," and to authorize the Authority to "do whatever necessary or convenient to carry out its purposes, including without limitation the specific powers enumerated in this chapter." Any such attempt to so regulate and control a pipeline engaged in interstate commerce is clearly violative of the U.S. Constitution. But quite apart from the question whether the State, under the United States or Alaska Constitutions, could assume "sole and exclusive jurisdiction, control and supervision" of the types of facilities named, nowhere in House Bill No. 569 are there to be found any standards or limitations under which the Authority is to be governed in the exercise of this sweeping and all-inclusive grant of power. The entire bill, and this section in particular, would attempt to turn over to an appointed public corporation consisting of three members, which in most matters may act by the votes of two members, power to undertake and carry out, without further action by the legislature of the State, a project which probably would constitute the most massive public works project ever undertaken by any State.

2. Section 44.58.250. This section would authorize the Authority and the Governor, acting on behalf of the State, to enter into leases or agreements for lease of the project by the Authority to the State and for the operation and maintenance of the project by the State. The State could also, acting again through the Governor alone, sublease or enter into any agreement with any person, firm or corporation for the operation and management of the project. A purely permissive provision is made that the amount payable under any lease or agreement between the Authority and the State may include provision for all or any part or share of the amounts necessary to pay debt service on bonds issued to finance the project, to pay costs of operation and maintenance or to

maintain reserves or sinking funds for the purpose of payment of debt service or operation and maintenance. The Governor would also be authorized in such an agreement or lease to commit the State to pay to the Authority, for an unlimited time and in unlimited amounts, the cost of financing the project. No standards or guidelines or restrictions on such leases, subleases and agreements are provided, however, and it would be difficult to imagine a more unlimited grant of discretion to executive or administrative officers than the provision in this section, which is made applicable both to agreements with the Authority and with sublessees or others entered into by the Governor, that "the agreement or lease may be made for a specified or unlimited time on terms and conditions which may be approved by the governor."

3. Section 44.58.260. This section would permit the Authority, by so providing in a bond agreement, to commit the State to guarantee the payment of principal and interest on any bonds or notes issued by the Authority. Even if such a State guarantee were permitted by the Alaska Constitution, this section is of questionable validity in permitting executive and administrative officers, in their unlimited discretion, to make such a guarantee.

These examples of unrestrained power in executive officers are of such vast scope that no truly comparable legislative efforts at delegation of powers can be found in the Alaska cases. Thus, these would appear to be unreliable aspects of the bill in the absence of a court determination addressed directly to them.

Conclusion.

It appears that House Bills 569 and 570 raise many substantial legal problems that could keep a large number of lawyers busy for many years; and there are justifiable concerns that they would do precisely that if enacted. In view of the delays of the project already experienced, and the economic cost thereby to the State, the concerns over legal problems under House Bills 569 and 570 and the further delays they can cause are important considerations for the Legislature. Again it should be emphasized that, as previously testified to, even in the complete absence of any legal question, the patent inability of the State or a public corporation of the State to successfully market such a huge volume of bonds in the short time required, presents a direct, practical, and critical problem which strongly indicates that House Bills 569 and 570 are not practical approaches for achievement of the objectives of the State.

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

REMARKS OF RAYMOND B. GARY
PARTNER, MORGAN STANLEY & CO.
TO ALASKAN SENATE AND HOUSE COMMITTEES
ON PROPOSED LEGISLATION CONCERNING
PIPELINE REGULATION, RIGHT-OF-WAY AND
STATE OWNERSHIP -- MARCH 6, 7 & 8

INTRODUCTION

MY NAME IS RAYMOND B. GARY AND MY BUSINESS ADDRESS IS 140 BROADWAY, NEW YORK, NEW YORK. I JOINED MORGAN STANLEY & CO. IN 1955, FOLLOWING UNDERGRADUATE STUDIES AT YALE, GRADUATE WORK AT HARVARD, AND SERVICE IN THE U. S. NAVY. I HAVE BEEN A GENERAL PARTNER IN THE FIRM SINCE 1964. I AM ALSO A MANAGING DIRECTOR OF MORGAN STANLEY & CO. INCORPORATED, A PARALLEL CORPORATION WHICH CONDUCTS OUR UNDERWRITING AND BROKERAGE ACTIVITIES.

MORGAN STANLEY IS AN INVESTMENT BANKING FIRM ENGAGED IN ALL PHASES OF THE UNDERWRITING AND DISTRIBUTION OF SECURITIES OF INDUSTRIAL CORPORATIONS, PUBLIC UTILITIES, FINANCIAL CORPORATIONS, TRANSPORTATION COMPANIES INCLUDING AIRLINES AND PIPELINES, AND FOREIGN CORPORATIONS AND GOVERNMENTS. WE ARE MEMBERS OF THE NEW YORK STOCK EXCHANGE AND ASSOCIATE MEMBERS OF THE AMERICAN STOCK EXCHANGE. SINCE 1935, THE YEAR MORGAN STANLEY & CO. WAS FOUNDED, THE FIRM, INCLUDING ITS FOREIGN AFFILIATE, MORGAN & CIE

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INTERNATIONAL S. A., HAS MANAGED OR CO-MANAGED A TOTAL OF APPROXIMATELY $60 BILLION OF SECURITY OFFERINGS. IN ADDITION TO ACTIVITIES RELATED TO UNDERWRITING AND PRIVATE PLACEMENTS, MORGAN STANLEY PROVIDES GENERAL FINANCIAL ADVISORY SERVICES ON A WIDE RANGE OF MATTERS INCLUDING LONG-RANGE FINANCIAL POLICY AND PLANNING.

THE $60 BILLION TOTAL FINANCING VOLUME I MENTIONED INCLUDES OVER $2 BILLION OF ISSUES DONE BY OUR FIRM FOR 18 PIPELINE COMPANIES. IT ALSO INCLUDES THE LARGEST PUBLIC CORPORATE BOND OFFERING EVER MADE, $1.6 BILLION OF AMERICAN TELEPHONE & TELEGRAPH COMPANY DEBENTURES WITH WARRANTS ATTACHED, AND THE LARGEST PRIVATE PLACEMENT EVER DONE. WE ALSO HANDLED THE PRIVATE PLACEMENT OF $550 MILLION FOR CONSTRUCTION OF A HYDRO-ELECTRIC PROJECT IN LABRADOR BY CHURCHILL FALLS (LABRADOR) CORPORATION LIMITED, WHICH IS THE LARGEST PROJECT EVER PRIVATELY FINANCED. THESE RECORD-SIZED CORPORATE FINANCINGS EXCEED IN SIZE ANY LONG-TERM ISSUE SOLD BY A STATE GOVERNMENT. THE ONLY LARGER BOND ISSUES HAVE BEEN THOSE OF NATIONAL GOVERNMENTS, WITH THEIR UNLIMITED TAXING POWER AND ABILITY TO ISSUE MONEY.

HENCE, THE PERSPECTIVE FROM WHICH I SPEAK IS THAT OF A MANAGING DIRECTOR OF A LEADING UNDERWRITER WHOSE PRINCIPAL BUSINESS IS THE RAISING OF CAPITAL, WITH EXPERIENCE IN RAISING VERY LARGE SUMS OF MONEY SUCH AS WOULD BE INVOLVED IN THE

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FINANCING OF THE TRANS ALASKA PIPELINE SYSTEM. I AM PLEASED TO HAVE THIS OPPORTUNITY TO SPEAK BEFORE THE COMMITTEE. I SPEAK NOT AS PROPONENT OF ANY FIXED POINT OF VIEW, BUT AS ONE WHO, I BELIEVE, SHARES THE COMMON OBJECTIVES OF ALASKANS AND THE OIL COMPANIES, ALL OF WHOM WISH TO SEE THE PIPELINE CONSTRUCTED IN THE MOST EFFICIENT MANNER, AT THE LOWEST COST, AND AS SOON AS POSSIBLE - IN ORDER TO (1) OPEN UP ONE OF ALASKA'S GREAT NATURAL RESOURCES, (2) HELP MEET THE GROWING NEED FOR ENERGY IN ALL OF THE UNITED STATES, AND (3) MAKE A SIGNIFICANT FAVORABLE CONTRIBUTION TO THE COUNTRY'S BALANCE OF PAYMENTS.

I HOPE THAT BY SHARING WITH YOU MY FIRM'S EXPERIENCE IN FINANCING MANY LARGE UNDERTAKINGS I CAN BE OF ASSISTANCE IN REACHING A SATISFACTORY SOLUTION CONCERNING THE PENDING LEGISLATION.

THE BILLS BEFORE YOUR COMMITTEE, BROADLY SPEAKING, INVOLVE LEGISLATION WHICH WOULD REGULATE THE OPERATION OF THE PIPELINE AND WHICH WOULD PROVIDE FOR POSSIBLE OWNERSHIP OF THE PIPELINE BY THE STATE. I WISH TO DIRECT MYSELF TO DISCUSSING THE POTENTIAL IMPACT OF THESE BILLS UPON THE SUCCESSFUL FINANCING OF THE PIPELINE.

CONVENTIONAL FINANCING OF PIPELINES

I THINK IT MIGHT BE USEFUL IF I TALK BRIEFLY ABOUT HOW JOINTLY-OWNED PIPELINES ARE CUSTOMARILY FINANCED. JOINTLY-

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

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

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

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

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

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

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

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

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

FINANCING OF TAPS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

ABILITY OF THE STATE TO FINANCE CONSTRUCTION OF THE PIPELINE

FINALLY, WE HAVE GIVEN CONSIDERATION TO THE ABILITY

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

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

WE HAVE HEARD THE THEORY ADVANCED THAT THE STATE CAN

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

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

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

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

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

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CONCLUDING NOTE

TO SUM UP, THE PROPOSED LEGISLATION PUTS A NUMBER OF CLOUDS OVER THE FINANCING OF THIS PIPELINE.

IF IT IS PASSED AS IT PRESENTLY STANDS, THERE WOULD BE CONSIDERABLE DOUBT IN THE EYES OF THE INVESTING PUBLIC WHETHER THE OIL COMPANIES COULD MAINTAIN CONTROL OF THE OPERATION AND EARN AN ADEQUATE RETURN ON THEIR INVESTMENT. WHEN DOUBTS OF THIS KIND EXIST, THEY ARE SEVERE IMPEDIMENTS TO FINANCING AND WOULD RESULT IN HAVING TO PAY HIGHER INTEREST COSTS.

WE ARE ALL PAINFULLY AWARE HOW THE COST OF TAPS HAS ALREADY ESCALATED WHILE ITS CONSTRUCTION HAS BEEN DELAYED IN WASHINGTON. I WOULD THEREFORE URGE IN THE INTEREST OF BOTH ALASKA AND THE PRODUCERS THAT THEY AVOID DELAY AND AN ADDITIONAL INCREASE IN COST BY RESOLVING THEIR DIFFERENCES SO THAT THE PROJECT CAN GO AHEAD.

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

ARTICLE 116-2: Compensation of State officers and employees. XIV-16-7439
I. T. 2886

REVENUE ACT OF 1934.

Profits derived by the State of Virginia from the operation of liquor stores by the State are not subject to Federal income tax.

The compensation of employees of the State for services rendered in connection with the operation of liquor stores by the State is subject to Federal income tax.

In G. C. M. 14407 [below], it was held that profits derived by the State of Montana from the operation of its liquor stores are not subject to Federal income tax. In the light of the conclusions reached in that memorandum, it is held that profits derived by the State of Virginia from the operation of liquor stores by the State are not subject to Federal income tax.

Attention is invited to the fact, however, that when a State or political subdivision engages in the operation of liquor stores it is acting in a proprietary capacity. Accordingly, the compensation of employees of the State whose services are rendered in connection with the operation of liquor stores by the State is subject to Federal income tax.

SECTION 116(d). XIV-7-7316
G. C. M. 14407

REVENUE ACT OF 1934.

Profits realized by the State of Montana from the operation of liquor stores by the State are not subject to Federal income tax under the Revenue Act of 1934.

G. C. M. 13745 (C. B. XIII-2, 76) is not to be considered as a ruling on the constitutional issue involved.

The State Liquor Control Act of Montana, approved March 14, 1933 (Laws of Montana, 1933, chapter 105, as amended by chapter 57, Laws of the Extraordinary Session of 1933-34), provides for the creation of the Montana Liquor Control Board, which is given power to buy, possess for sale, and sell liquor; to control its sale and delivery; to determine the location of State liquor stores and to establish such stores; to grant, refuse, or cancel permits for the purchase of liquor; to appoint vendors and officers and employees required for the carrying out of the act; to issue club licenses and special permits for the sale of liquor; and to make regulations for carrying out the provisions of the act. All moneys received from the sale of liquor by the State liquor stores, and from license fees and fees for permits, shall be paid to the board, and no provision is made for segregating the moneys derived from fees from the moneys derived from liquor sales. Out of the profits arising under the act, there is to be created a reserve fund to meet any losses incurred by the State in connection with the administration of the act. When all of the liquor stores which can be established throughout the State have been established and the administration expenses have been paid, the net profits are to be allocated 50 per cent to the emergency relief fund of the State of Montana, and 50 per cent to the general fund of the State until February 1, 1935; thereafter, all such profits are to be allocated 50 per cent to the

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general fund of the State and 50 per cent to the general funds of the counties in the proportion that the population of each county bears to the total population of the State.

The questions raised for consideration are (1) whether the Revenue Act of 1934 imposes a tax upon the income derived by the State of Montana from the operation of its liquor stores, and (2) whether, if the Act be found to impose such a tax, the taxation of such income within the constitutional powers of the Federal Government.

The Revenue Act of 1934 taxes at different rates the income of "individuals" and "corporations," but nowhere in the Act is a tax expressly imposed upon a State. It may be stated with assurance that a State is not an "individual" within the meaning of the Act, if for no other reason than that the credits and exemptions provided for an individual are obviously not applicable to a State. Whether or not a State is a "corporation" depends, to use the language of Mr. Justice Sutherland, "upon the connection in which the word is found." (*Ohio* v. *Helvering* (1934), 292 U. S., 360.)

Clearly, with the possible exception of section 116(d), there is nothing in the Revenue Act of 1934 to indicate that States should be taxed as corporations, and the proper interpretation of that section indicates rather that States should not be so taxed. The first paragraph of section 116(d) of that Act, relating to the "Income of States, municipalities, etc.," provides for the exemption from taxation of the following type of income:

* * * Income derived from any public utility or the exercise of any essential governmental function and accruing to any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, or income accruing to the government of any possession of the United States, or any political subdivision thereof.

It will be observed that the paragraph quoted refers to the income "derived from any public utility or the exercise of any essential governmental function and accruing to any State, Territory or the District of Columbia." Had Congress meant to include within this exemption income derived by the State itself from an activity which it carries on directly, it is suggested that it would have said "income derived from * * * by any State, Territory, etc.," since the words "accruing to" connote the receipt of income from a contract or investment rather than from an act of the recipient. The use of these words serves, if not to make clear that the income referred to must have been derived by an entity other than a State, Territory, or the District of Columbia, at least to raise an ambiguity which justifies resort to extrinsic evidence for its resolution.

In determining the meaning of a provision which is ambiguous the practical interpretation given that provision by the officer charged with its administration must be given great weight, especially when the practice has been long-continuing and the provision has been frequently reenacted by Congress. (*Brewster* v. *Gage*, 280 U. S., 327; *Massachusetts Mutual Life Insurance Co.* v. *United States*, 288 U. S., 269.) This rule does not appear to be limited to affirmative and express construction. It would seem that "the neglect of lawfully constituted authorities to assess taxes [illegible]

Koehn v. *St. Louis Y. M. C. A.*, 259 Mo., 233, 168 S. W., 589; *Westerman* v. *Supreme Lodge K. P.*, 196 Mo., 670, 94 S. W., 470.) (See also *Mintz et al.* v. *Baldwin*, 289 U. S., 346; *United States* v. *Farrar*, 281 U. S., 624.) The practice of the Bureau of Internal Revenue over a course of years, in the light of the ambiguity of the legislation under consideration coupled with the frequent reenactment of that legislation without substantial change, supports the inference just suggested that the first paragraph of section 116(d) was intended to refer, not to the income of a State or municipality resulting from its own direct participation in industry, but rather to that part of the income of a corporation engaged in the operation of a public utility or in the performance of some governmental function which accrues to a State or municipality by virtue of its ownership of such corporation. Parenthetically it should be noted that this construction is entirely consistent with the undoubted effect of the second paragraph of that section in exempting from tax that part of the proceeds from the operation of a public utility which accrues to a State or municipality under a contract entered into with "any person."

In the entire period since the enactment of the Tariff Act of 1913, the Bureau has regularly considered section 116(d) and the corresponding provisions of prior Revenue Acts from the standpoint of the taxability of corporations owned by, or operating under contract with, States or municipalities. (See, for example, I. T. 2436, C. B. VII-2, 147; S. M. 2941, C. B. IV-1, 210; O. D. 250, C. B. 1, 92.) (See also *Jamestown & Newport Ferry Co.* v. *Commissioner*, 41 Fed. (2d), 920.) Not only has the Bureau failed to tax the direct income of any State or municipality but it has throughout this period of 22 years made no effort to obtain income returns from States or municipalities, or to determine by any other means whether any State or municipality has had income of this nature. This persistent nonenforcement of the tax against States may be reasonably explained only as indicating a tacit construction by the Bureau in accordance with the interpretation which has just been suggested.

To assume that this inaction on the part of the Bureau was due to an oversight is highly unreasonable. Eight years prior to the passage of the 1913 Act, the Supreme Court had declared in *South Carolina* v. *United States* (1905) (199 U. S., 437) that agents of a State operating a liquor dispensary system were subject to the special excise tax on retail liquor dealers, and, for at least three years following 1913, the Bureau was actively engaged in collecting this special excise tax from State liquor dispensaries in South Carolina. This in itself is clear evidence that the Bureau was aware of the participation by States in this class of activities, but even stronger evidence is found in the fact that, during the existence of the income tax laws, questions involving the taxability of the income of employees of a city or State engaged directly in carrying on a nonessential governmental function have frequently been determined by the Bureau. In determining such questions, the Bureau has recognized that the States and municipalities were acting in a proprietary capacity, and that their employees were not exempt from the payment of the Federal income tax; yet no attempt has ever been made to tax the income derived by States and municipalities from these activities. (See, for

example, S. M. 2232, C. B. III-2, 83 (cafeterias in public schools); I. T. 2357, C. B. VI-1, 52 (county hospitals); S. M. 5490, C. B. V-1, 37 (Rural Credit Board).) (See also I. T. 2782, C. B. XIII-1, 83; I. T. 2376, C. B. VI-2, 55; *D. G. Wood et ux.* v. *Commissioner*, 29 B. T. A., 919; *Shelby Wiggins* v. *Commissioner*, 27 B. T. A., 576; *T. P. Wittschen* v. *Commissioner*, 25 B. T. A., 46.)

During the time that the Bureau may be said to have been asserting this construction, the first paragraph of section 116(d) has been reenacted eight times with but a single change and that an inconsequential one. On any of these occasions, Congress could, had it disagreed with the interpretation given the paragraph by the Bureau, have so amended the Act as to make it entirely clear that States and municipalities were to be included within the scope of the Act; yet there is no evidence that such action was ever considered.

Additional support for the conclusion that Congress did not intend to tax the income derived directly by States as such is found in the committee reports and the debates on the floor of Congress preceding the passage of the Tariff Act of 1913 (see Senate Report No. 80 on H. R. 3321, Sixty-third Congress, first session, 50 Congressional Record (part 6), pages 5320-5321). They make it clear that what Congress was concerned with, in considering the enactment of the first paragraph of section II G(a) of the Tariff Act of 1913 (section 116(d) of the Revenue Act of 1934), was that part of the income derived by a corporation from the public utility business or from the performance of a governmental function which would accrue to a State or a municipality by virtue of its possession of a "beneficial interest" in the corporation. The type situations cited were all of such corporations. Nowhere in the report or debates is there consideration of the taxation of the income of States or municipalities which would result to them directly without the intervention of the corporate form and it appears to have been taken for granted that such income would not be subject to tax.

It is suggested that Congress, in not taxing the income of States, may well have been motivated by a desire not to limit the activities in which States might otherwise engage. The line between those revenue-producing activities of a State which are "governmental" and those which are "proprietary" is one which is in its nature difficult to draw and which has as yet been only faintly traced by decisions of the courts. For example, while the conduct or operation of prisons is strictly within the sovereign functions of the State, the revenue derived from the manufacture and sale of prison-made merchandise may or may not be the essential result of a governmental activity. Similarly, such activities as the loaning of State funds or the sale of surplus properties are of a character which makes it difficult to predict in which category they would be placed. It may be assumed that Congress did not desire in any way to restrict a State's participation in enterprises which might be useful in carrying out those projects desirable from the standpoint of the State Government which, on a broad consideration of the question, may be the function of the sovereign to conduct; and it may reasonably be considered that it was the possibility of such restriction which persuaded Congress not to includ[illegible]

State income within the subjects taxed by the various Revenue Acts since 1913. While such speculation has, of course, no conclusive effect, it may be proper as an aid in determining the intention of Congress in order to construe legislation patently ambiguous.

It follows from what has been said that the State of Montana is not a "corporation" within the meaning of the Revenue Act of 1934. This conclusion is reached in the belief that, in interpreting a statute, administrative agencies of the Government should not take the position against their better judgment that a tax is payable. While it is true that the possibilities of a judicial review of such an interpretation are meager, the effect of this position is merely to shift the burden of consideration from the courts to the legislature.

Since the question has been determined on the point of construction, the constitutional question need not be considered.

In G. C. M. 13745, supra, the opinion was expressed that profits derived by the State of Oregon from its liquor stores are not subject to Federal income tax. This opinion was prepared as a reversal of I. T. 2797 (C. B. XIII-2, 74), in which it was held to be within the power of the Federal Government to tax the profits from the Oregon liquor stores; and, in withdrawing I. T. 2797, it was pointed out that the decisions in *South Carolina* v. *United States*, supra, and *Ohio* v. *Helvering*, supra, were not controlling on the question discussed in that opinion. In order to clear up any doubt as to the meaning of G. C. M. 13745, it should be pointed out that that opinion is not to be considered as authority for any ruling other than that the income under consideration is not taxable by the Federal Government under existing legislation. It may not be taken as a determination of the constitutional question involved.

The conclusion is, therefore, that the income derived from the operation of liquor stores by the State of Montana is not subject to Federal income tax under the Revenue Act of 1934.

HERMAN OLIPHANT,
General Counsel for the Department of the Treasury.

SECTION 117.—CAPITAL GAINS AND LOSSES.

ARTICLE 117-1: Meaning of capital assets. XIV-3-7261
T. D. 4511

Income tax—Capital gains and losses.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C.

To Collectors of Internal Revenue and Others Concerned:

PARAGRAPH A. Section 117 (Title I—Income Tax) of the Revenue Act of 1934 provides:

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

AGO 530929

municipal bond interest, for Federal income tax purposes, upon its realization by them. If the investors hold the bonds until redemption thereof by the municipality, they will then realize recognized gain of the entire excess of the (par) redemption price received over the purchase price which they paid. If, instead, the investors sell the bonds, they will then realize recognized gain of the entire sale price received or accrued over such purchase price, or sustain recognized loss of the excess of such purchase price over the sale price received or accrued. Such gains or losses to the investors will be taxable or allowable as capital gains or losses, *i. e.*, in accordance with and subject to the capital gain and loss provisions of the 1954 Code.

(Also Section 115.) Rev. Rul. 57-151

The income earned by the Oklahoma County Utility Services Authority, a trust created under State law for the furtherance of public functions, is not subject to Federal income tax. Mortgage bonds and debenture notes issued by such Authority for the purpose of financing facilities for certain utility services to a county are considered to be issued in behalf of a political subdivision and the interest paid thereon is also exempt from Federal income tax.

Advice has been requested whether the income realized by the Oklahoma County Utility Services Authority, a trust created under State laws for the furtherance of public functions, and the interest paid on obligations issued by it are exempt from Federal income tax.

Under the terms of an Oklahoma statute entitled "Trusts for the Furtherance of Public Functions," Title 60 Oklahoma Statutes 1951, sections 176-180, as amended by Laws 1953, express trusts may be created with the State or any political subdivision thereof as the beneficiary for the purpose of furthering any authorized function of the beneficiary. Title 60, section 176, Oklahoma Statutes. Before the trusts can become effective, the beneficial interest therein must be formally accepted by the Governor of the State or by the governing body of the political subdivision which is named as the beneficiary in the trust instrument. Title 60, section 177. The statute designates the trustees under such an instrument as an agency of the State and provides that the trust may be terminated only by agreement of the trustees and the governing body of the beneficiary, with the approval of the Governor of the State. Title 60, sections 178 and 180.

The Oklahoma County Utility Services Authority is a trust created pursuant to the provisions of the statute referred to above, for the purpose of providing municipal utility services, such as water supply, fire protection and sewage disposal, for the residents in the outlying areas of Oklahoma County. The Board of County Commissioners of Oklahoma County has formally accepted the beneficial interest in the trust and has thereby rendered the trust effective. Under the terms of the trust instrument, the Authority is empowered to issue first mortgage revenue bonds, secured on trust properties and unsecured debenture notes. The revenues of the Authority primarily available for meeting its obligations are derived from the sale of water produced and distributed, although the Authority may have other revenues from other operations in which it may engage in the performance of trust purposes. No obligation of the trust, however, sh

[illegible] become a liability of the beneficiary. No funds of the Authority [illegible] be diverted to any private use and, upon termination of the trust [illegible] payment of all debts and obligations, the remainder of the [illegible] assets shall be distributed to the beneficiary. The Supreme [illegible] of the State of Oklahoma sustained the validity of the trust [illegible] the acceptance of the beneficial interest by the Board of County [illegible] of Oklahoma County, and held that the trustees under [illegible] instrument are an agency of the State of Oklahoma and its [illegible] constituted authority for the performance of the functions [illegible] which the trust was created. *Board of County Commissioners* [illegible], Okl., 285 P. 2d 1034 (1955).

On the basis of the facts present in this case, it is held that the [illegible] to be earned by the Oklahoma County Utility Services Au[illegible] from the furnishing of municipal utility services such as [illegible] supply, fire protection and sewage disposal, and which income [illegible] accrue to the benefit of any person, firm, or corporation [illegible] the county which is the beneficiary of the trust, will not be [illegible] to Federal income tax. It is further held that the mortgage [illegible] and debenture notes to be issued by the Authority for the pur[illegible] financing the facilities to be used in providing municipal util[illegible] services will be considered as issued in behalf of the County, a [illegible] subdivision, and the interest paid thereon will be exempt [illegible] Federal income tax under section 103(a)(1) of the Internal [illegible] Code of 1954. Cf. Rev. Rul. 54-296, C. B. 1954-2, 59.

Rev. Rul. 57-187

Bonds issued by an Industrial Development Board formed under [illegible] 37, Chapter 17 of the Code of Alabama, are considered issued [illegible] behalf of a municipality, a political subdivision of the State. [illegible] received on such bonds is exempt from Federal income tax under section 103(a)(1) of the 1954 Code.

[illegible] has been requested whether interest received on bonds is[illegible] by an Industrial Development Board formed under Title 37, [illegible] 17 of the Code of Alabama, is exempt from Federal income [illegible]

[illegible] Title 37, Chapter 17 of the Alabama Code 1940, sections [illegible], as amended, the legislature has authorized the incorpora[illegible] the several municipalities of public corporations designated [illegible] Development Boards to acquire, own, lease and dispose [illegible] to the end that such corporations may be able to pro[illegible] and develop trade by inducing manufacturing, indus[illegible] commercial enterprises to locate in the State. Title 37, [illegible]

[illegible] the statute an Industrial Development Board may be formed [illegible] the governing body of the municipality concerned has [illegible] formal approval to the creation of the Board and to the [illegible] of incorporation. Title 37, Section 817. The [illegible] of each Industrial Development Board is elected [illegible] body of the municipality concerned and serves [illegible]. Title 37, Section 821. The corporate powers [illegible] power to acquire, improve, maintain, equip and furnish [illegible] such projects and collect rent; to sell and convey

[illegible] Public Works [illegible] he sees [illegible] Milton Pikarsky said [illegible] the money by [illegible] hope of raising [illegible] He said: "We have just [illegible] told by County officials that Chicago can't expect any more help this year from its motor fuel tax funds. Last year, we got $1.5 million from the County and with $2 million of city money we qualified for $7 million in State funds for the CTA."

This formula of matching $2 from the State for each $1 in local contributions is the general rule in applying for the $200 million for mass [illegible] will be placed in the general pool for capital improvements.

Michael Cafferty, CTA chairman, was counting on the entire subsidy when he said there would be no increase in the basic fare, which now is 45 cents, plus 10 cents for a transfer.

The CTA went $18,650,774 further into the red in 1971 and passed a deficit budget for calendar 1972 which exceeds revenues by $43,870,000, exclusive of cost-of-living wage increases.

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VOLUME OF STATE AND MUNICIPAL BORROWING 1896 - 1971

The following table, compiled by "The Daily Bond Buyer" of New York, presents a 76-year record of long-term and short-term State and municipal financing:

Year	Par Amount			No. of
	Long-Term Issues $	Short-Term Issues $	All Issues $	All Issues
1971	24,369,536,105	26,281,467,539	50,651,003,644	8,811
1970	17,761,645,833	17,879,952,793	35,641,598,626	7,604
1969	11,460,251,103	11,783,127,124	23,243,378,227	6,395
1968	16,374,332,960	8,658,556,650	25,032,889,610	7,887
1967	14,287,949,346	8,025,331,071	22,313,280,417	7,964
1966	11,088,938,349	6,523,534,545	17,612,472,894	7,430
1965	11,084,188,715	6,537,396,751	17,621,585,466	7,977
1964	10,544,127,114	5,423,258,660	15,967,385,774	8,138
1963	10,106,665,364	5,480,807,517	15,587,472,881	8,574
1962	8,558,200,662	4,763,474,695	13,321,675,357	8,689
1961	8,359,512,134	4,514,171,800	12,873,683,934	8,490
1960	7,229,500,359	4,006,185,985	11,235,686,344	8,397
1959	7,681,053,623	4,178,641,998	11,859,695,621	8,568
1958	7,448,803,189	3,910,463,987	11,359,267,176	8,523
1957	6,958,152,145	3,273,508,182	10,231,660,327	8,242
1956	5,446,419,571	2,706,324,575	8,152,744,146	7,689
1955	5,976,503,820	2,592,945,267	8,569,449,087	7,732
1954	6,968,641,896	3,350,234,995	10,318,876,891	7,747
1953	5,557,887,369	2,756,631,122	8,314,518,491	7,263
1952	4,401,317,467	2,049,150,972	6,450,468,439	6,410
1951	3,278,153,053	1,636,758,897	4,914,911,950	5,885
1950	3,693,604,165	1,611,133,561	5,304,737,726	6,533
1949	2,995,425,049	1,332,836,205	4,328,261,254	5,794
1948	2,989,731,949	1,004,728,795	3,994,460,744	5,178
1947	2,353,771,562	957,537,229	3,311,308,791	4,338
1946	1,203,557,909	740,844,100	1,944,402,009	3,886
1945	818,781,728	665,118,894	1,483,900,622	2,397
1944	712,305,515	568,897,659	1,281,203,174	1,798
1943	507,566,466	711,162,906	1,218,729,372	1,637
1942	575,588,229	1,113,241,228	1,688,829,457	3,341
1941	1,229,493,072	1,407,782,154	2,637,275,226	6,483
1940	1,497,683,294	1,626,271,523	3,123,954,817	6,055
1939	1,098,604,265	1,208,386,966	2,306,991,231	6,486
1938	1,229,105,539	1,167,926,831	2,397,032,370	7,165
1937	984,094,835	712,255,997	1,696,350,832	5,574
1936	1,156,254,317	733,137,912	1,889,392,229	6,032
1935	1,195,717,486	987,568,002	2,183,285,438	5,208
1934	1,175,333,698	933,072,871	2,108,406,569	5,432
1933	1,127,576,381	988,014,011	2,115,590,392	3,250
1932	936,855,060	1,092,066,907	2,028,921,967	4,108
1931	1,251,771,394	1,086,765,138	2,338,536,532	5,346
1930	1,382,870,539	952,121,721	2,334,992,260	6,661
1929	1,442,381,438	920,982,191	2,363,363,629	6,781
1928	1,389,818,717	716,792,625	2,106,611,342	7,856
1927	1,477,769,824	624,872,483	2,102,642,307	8,312
1926	1,362,037,801	661,210,870	2,023,248,671	7,625
1925	1,404,702,240	866,061,013	2,270,763,253	8,356
1924	1,446,688,993	979,030,752	2,425,769,745	7,736
1923	1,135,167,134	514,156,200	1,649,323,334	8,000
1922	1,279,553,134	395,578,427	1,675,131,561	9,434
1921	1,383,368,900	762,037,232	2,145,406,132	7,227
1920	773,663,986	664,087,293	1,437,751,279	5,499
1919	770,195,248	450,093,607	1,220,288,855	6,752
1918	262,818,844	473,134,727	735,953,571	3,871
1917	444,932,848	392,443,858	837,376,706	5,712
1916	497,403,751	292,407,269	789,811,020	6,560
1915	492,590,441	154,728,247	647,318,688	5,231
1914	445,968,510	286,054,624	732,023,134	4,605
1913	408,477,702	483,217,696	891,695,098	4,191
1912	399,046,083	192,450,139	591,496,222	4,605
1911	452,113,716	190,683,131	642,796,847	4,891
1910	324,360,955	197,166,473	521,527,428	4,512
1909	363,630,786	118,340,309	481,971,095	4,702
1908	355,384,466	174,647,263	530,031,729	4,330
1907	301,048,503	167,841,555	468,890,058	3,641
1906	301,168,061	125,232,239	426,400,300	3,775
1905	197,719,077	150,401,683	348,120,760	3,712
1904	286,708,289	130,797,555	417,505,844	3,531
1903	....	....	224,728,526	3,085
1902	....	....	210,473,052	3,064
1901	....	....	168,168,773	2,594
1900	....	....	174,578,040	2,312
1899	....	....	144,403,454	2,684
1898	....	....	128,015,728	2,199
1897	....	....	163,352,254	2,024
1896	....	....	119,538,424	1,294

AGO 530932

STATE
of ALASKA

MEMORANDUM

TO: The Honorable William A. Egan
Governor
State of Alaska

DATE: November 1, 1971

FROM: Eric E. Wohlforth
Commissioner of Revenue

SUBJECT: Relative Standing of Investment Banking Houses - 1970; All Municipal Issues

Number of Issues Underwritten

1.	Halsey, Stuart	243
2.	Merrill, Lynch	238
3.	John Nuveen	229
4.	Blyth & Co.	149
5.	First of Michigan	113
6.	First Boston	112
7.	Smith, Barney	109
8.	Lehman Brothers	102
9.	Kidder Peabody	91
10.	Salomon Brothers	80
11.	Underwood, Neuhaus	75
12.	White, Weld	67
13.	Phelps, Fenn	66
14.	W.H. Morton	62
15.	Dupont Glore Forgan	59

Par Value of Issues Underwritten (1,000's omitted)

1.	Halsey, Stuart	1,007,619
2.	Merrill, Lynch	705,187
3.	Lehman Bros.	610,910
4.	Blyth & Co.	554,999
5.	First Boston	544,210
6.	Salomon Brothers	543,494
7.	John Nuveen	503,393
8.	Smith Barney	490,691
9.	Kidder Peabody	371,558
10.	Dupont Glore Forgan	324,114

REVENUE ISSUES ONLY

Number of Issues

✓1.	Merrill, Lynch	110
✓2.	John Nuveen	101
✓3.	Halsey, Stuart	89
4.	Blyth & Co.	61
5.	Smith, Barney	61
6.	Kidder, Peabody	56
7.	Lehman	45
8.	First Boston	45
9.	White, Weld	41
10.	Eastman Dillon	31
✓11.	Salomon Brothers	29
12.	Dupont Glore Forgan	28
13.	Boettcher & Sharrod	28
14.	WH Morton	27
15.	Rothschild	27

Par Value

✓1.	Halsey, Stuart	548,000
✓2.	Merrill, Lynch	395,000
3.	Blyth & Co.	379,000
4.	Smith Barney	340,000
5.	Kidder, Peabody	295,000
✓6.	John Nuveen	271,000
7.	First Boston	229,000
8.	White, Weld	204,000
✓9.	Dupont Glore Forgan	188,000
✓10.	Salomon Brothers	179,000

AGO 530933

REMARKS OF THOMAS BROUSSARD
TO THE JOINT HEARING OF THE SENATE COMMERCE COMMITTEE
AND THE HOUSE STATE AFFAIRS COMMITTEE
ON PROPOSED ALASKAN LEGISLATION CONCERNING
PIPELINE REGULATION, RIGHT-OF-WAY AND
STATE OWNERSHIP -- MARCH 6, 7, & 8, 1972

MR. CHAIRMAN: MY NAME IS THOMAS BROUSSARD, AND I AM A TAX ATTORNEY IN THE LEGAL DEPARTMENT OF ATLANTIC-RICHFIELD COMPANY.

TOGETHER WITH COUNSEL REPRESENTING SEVERAL OTHER OIL COMPANIES, INCLUDING COUNSEL FROM SEVERAL LAW FIRMS, I HAVE STUDIED THE QUESTIONS OF FEDERAL TAXATION OF THE STATE OF ALASKA ON POTENTIAL PROFITS TO BE DERIVED FROM OWNERSHIP OF A TRANS-ALASKA PIPELINE AND THE SEPARATE QUESTION OF THE TAXATION OF INTEREST RECEIVED BY BONDHOLDERS FROM ANY BONDS THAT MIGHT BE ISSUED BY THE STATE OR A PUBLIC AUTHORITY FOR THE PURPOSE OF BUILDING THE PIPELINE. IT IS MY OPINION AND THAT OF MY COLLEAGUES THAT IT IS VERY DOUBTFUL THAT EITHER THE STATE OR ITS BONDHOLDERS, UNDER THE BILLS INTRODUCED BY THE ADMINISTRATION, WILL BE EXEMPT FROM FEDERAL INCOME TAX.

THE PROPOSAL FOR PIPELINE OWNERSHIP AS DESCRIBED TO THE COMMITTEES SEEKS TWO TAX ADVANTAGES TO INCREASE STATE REVENUES AT THE EXPENSE OF THE FEDERAL TREASURY. THE FIRST ASSUMED ADVANTAGE IS FOR THE STATE ITSELF TO RECEIVE AS PIPELINE PROFIT AN AMOUNT EQUAL TO THE FEDERAL INCOME TAX WHICH WOULD BE PAID BY THE OIL COMPANIES ON ANY INCOME EARNED FROM THE PIPELINE. THE SECOND

AGO 530934

HOPED FOR ADVANTAGE IS TO REDUCE THE INTEREST COST ON DEBT FINANCING OF THE LINE BY AN AMOUNT EQUAL TO THE FEDERAL INCOME TAX WHICH WOULD BE PAID BY HOLDERS OF PRIVATE COMPANIES' BONDS.

CONSIDERING THE LIKELIHOOD OF THE STATE'S EXEMPTION FROM FEDERAL INCOME TAX ON PROFIT FROM THE PIPELINE, THERE IS NO QUESTION THAT CONGRESS HAS THE CONSTITUTIONAL POWER TO TAX THE STATE ON ITS INCOME FROM BUSINESS OPERATIONS. THE PAST POSITION OF THE IRS HAS BEEN THAT CONGRESS HAS NOT IMPOSED THE FEDERAL INCOME TAX ON A STATE DIRECTLY ENGAGED IN A BUSINESS ACTIVITY FOR THE PURPOSE OF PROVIDING A PUBLIC NECESSITY OR IN THE EXERCISE OF ITS POLICE POWER. HOWEVER, IT IS DOUBTFUL THAT THE IRS WILL MAINTAIN THAT POSITION IF ASKED TO RULE ON THE QUESTION OF THE STATE OF ALASKA OPERATING A 3.5 BILLION DOLLAR PIPELINE TO CARRY OIL FOR A LIMITED NUMBER OF PRIVATE OIL COMPANIES.

IF THE IRS DID GRANT A FAVORABLE RULING, WHERE, AS STATED BEFORE THIS COMMITTEE, THE INTENTION OF THE STATE IS TO SUBSTITUTE ITSELF FOR PRIVATE BUSINESSES WHICH ARE READY, ABLE AND WILLING TO ENGAGE IN A COMMERCIAL ACTIVITY FOR THE BENEFIT OF RELATIVELY FEW PRIVATE USERS, AND PASS ON TO THOSE COMPANIES ALL OR A MAJOR PORTION OF THE SAVINGS FROM ITS PRIVILEGE OF TAX EXEMPTION, CONGRESS IS ALMOST CERTAIN TO EXAMINE WHETHER THE PRIVILEGE OF TAX IMMUNITY SHOULD BE CONTINUED. THE RESULT, I AM SURE, WOULD BE AN AMENDMENT TO THE STATUTE TO MAKE CLEAR THE INTENTION OF CONGRESS THAT SUCH INCOME SHOULD NOT ESCAPE FEDERAL TAXATION. IN FACT, IT IS DOUBTFUL THAT CONGRESSIONAL REACTION WOULD BE LIMITED TO THIS STATE ACTIVITY.

WITH RESPECT TO THE POSSIBILITY OF THE EXEMPTION FROM FEDERAL INCOME TAX OF INTEREST RECEIVED BY THE HOLDERS OF BONDS ISSUED BY A

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STATE AUTHORITY TO FINANCE THE PIPELINE, THE ANSWER IS CLEAR. INTEREST ON STATE BONDS IS EXEMPT FROM FEDERAL TAX SOLELY BY VIRTUE OF SECTION 103(A) OF THE INTERNAL REVENUE CODE.

IN THE WORDS EARLIER THIS YEAR OF AN ATTORNEY-ADVISOR IN THE OFFICE OF TAX LEGISLATIVE COUNSEL OF THE U.S. TREASURY DEPARTMENT "THE INCREASING USE OF TAX-EXEMPT FINANCING FOR PURPOSES BEYOND THOSE ORIGINALLY CONTEMPLATED BY SECTION 103(A) HAS LED TO A SERIES OF ACTIONS BY THE TREASURY AND THE CONGRESS TO RESTRICT SUCH FINANCING TO THE PURPOSES FOR WHICH THE EXEMPTION WAS ORIGINALLY GRANTED."

THE ABUSE WHICH PROMPTED CONGRESS IN 1968 TO AMEND SECTION 103 WAS PRIMARILY THE USE BY STATES OF THE TAX EXEMPTION TO FINANCE INDUSTRIAL PROJECTS FOR PRIVATE COMPANIES. TO MY KNOWLEDGE, THE LARGEST SUCH PROJECT INVOLVED STATE BONDS OF LESS THAN 100 MILLION DOLLARS. THE PROPOSED LEGISLATION WOULD UTILIZE THIS PRIVILEGE FOR A PROJECT ESTIMATED AT 35 TIMES THAT AMOUNT. THE PREVIOUS CONCERNS EXPRESSED BY CONGRESS AND THE TREASURY THAT EARLIER ISSUES WERE CREATING UNINTENDED BENEFITS FOR PRIVATE BUSINESS AND REDUCING THE MARKET FOR MUNICIPAL BONDS FOR NEEDED GOVERNMENTAL SERVICES ARE DWARFED BY THE MAGNITUDE OF THIS PROPOSAL.

THE ACTION BY CONGRESS TO RESTRICT THE TAX EXEMPTION OF INTEREST ON MUNICIPAL BONDS ARE CONTAINED IN SECTION 103(C) OF THE INTERNAL REVENUE CODE WHICH DENIES TAX EXEMPTION FOR INTEREST ON INDUSTRIAL DEVELOPMENT BONDS. FOR OUR PURPOSES AN INDUSTRIAL DEVELOPMENT BOND MAY BE DEFINED TO MEAN ANY OBLIGATION ISSUED AS A PART OF AN ISSUE, ALL OR A MAJOR PORTION

OF THE PROCEEDS OF WHICH ARE TO BE USED DIRECTLY OR INDIRECTLY IN ANY TRADE OR BUSINESS CARRIED ON BY ANY NON-TAX-EXEMPT PERSON AND THE PRINCIPAL OR INTEREST OF WHICH IS SECURED OR TO BE DERIVED FROM ANY INTEREST IN PROPERTY USED IN A TRADE OR BUSINESS OR FROM PAYMENTS IN RESPECT OF SUCH PROPERTY.

THIS LATTER TEST, CALLED THE SECURITY INTEREST TEST, IS CLEARLY SATISFIED WHEN THE BOND SERVICE IS TO BE PAID FROM THE REVENUES OF THE PIPELINE AS PROPOSED, PROVIDED THE PIPELINE IS USED IN THE TRADE OR BUSINESS OF THE OIL COMPANIES.

THE FIRST TEST, CALLED THE TRADE OR BUSINESS TEST, IS THE CRITICAL ONE. THE PROPOSED REGULATIONS INTERPRETING THIS LANGUAGE ARE SUBJECT TO CHANGE, BUT AT PRESENT PROVIDE THAT THE TRADE OR BUSINESS TEST IS MET "IN THE CASE OF A FACILITY CONSTRUCTED. . .OR ACQUIRED WITH THE PROCEEDS OF AN ISSUE WHICH IS OSTENSIBLY OWNED AND OPERATED BY AN EXEMPT PERSON (SUCH AS THE PROPOSED TRANS ALASKA AUTHORITY) BUT WHERE ONE OR MORE NON-EXEMPT PERSONS (SUCH AS THE OIL COMPANIES) AGREE, PURSUANT TO ONE OR MORE LONG-TERM CONTRACTS, TO TAKE, OR TO TAKE OR PAY FOR, A MAJOR PORTION (MORE THAN 25%) OF THE OUTPUT OF SUCH FACILITY (WHETHER OR NOT CONDITIONED UPON THE PRODUCTION OF SUCH OUTPUT) FOR PERIODS OF TIME WHICH ARE SUBSTANTIAL IN RELATION TO THE TERMS OF THE BONDS."

ALTHOUGH THE REGULATION SPEAKS OF OUTPUT OR PRODUCTION FROM A FACILITY, THE SAME RULE WOULD APPLY TO GUARANTEEING INPUT TO A FACILITY SUCH AS A PIPELINE ~~IN WHICH~~ Where THE REVENUE IS EARNED FROM CARRYING CRUDE OIL.

FROM DISCUSSIONS WITH PERSONS EXPERIENCED IN PUBLIC FINANCING OF PIPELINES, WE HAVE BEEN CONSISTENTLY ADVISED THAT LONG-TERM

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COMMITMENTS TO SUPPLY CRUDE TO THE LINE UNDER A TAKE OR PAY THROUGHPUT AGREEMENT WILL BE NECESSARY TO SELL THE BONDS.

INDEED THE MINIMUM SHIPPING AGREEMENTS DESCRIBED BY MR. GUILDEHOUS (WHILE NOT SUFFICIENT TO SATISFY INVESTORS IN THE VIEW OF MR. GARY) IS IN MY OPINION SUFFICIENT TO SATISFY THE TRADE OR BUSINESS TEST OF SECTION 103(c) AND, THUS, TO MAKE THE PROPOSED BONDS INDUSTRIAL DEVELOPMENT BONDS NOT ENTITLED TO TAX EXEMPTION. UNDER SUCH A PLAN (WHICH THE TEMPLE REPRESENTATIVES SAID HAS NOT BEEN ACCEPTED BY THE STATE OR ITS FINANCIAL ADVISORS), THE COMPANIES WOULD BE ASKED TO MAKE A LONG-TERM CONTRACT TO GUARANTEE TO PROVIDE MORE THAN 25% OF THE CRUDE TO BE TRANSPORTED THROUGH THE LINE WHICH IS THE EQUIVALENT OF GUARANTEEING TO TAKE OR PAY FOR MORE THAN 25% OF THE TRANSPORTATION SERVICE.

MR. CADES STATED THAT THE VOLUME OF THE LINE AVAILABLE FOR THE OWNER COMPANIES IS SUBJECT TO REDUCTION FOR OTHER USERS, WHICH CHANGES THE TAKE OR PAY NATURE OF THE CONTRACT. BUT, SINCE ANY ADDITIONAL USERS ARE UNLIKELY TO REDUCE THE ORIGINAL COMPANIES' COMMITMENT BELOW 25% AND SUCH USERS ARE THEMSELVES NON-EXEMPT PERSONS, I FAIL TO SEE HOW THIS WOULD ESCAPE THE DEFINITION OF INDUSTRIAL REVENUE BONDS SET FORTH IN THE REGULATIONS.

THERE IS AN EXCEPTION THAT "FACILITIES WILL NOT BE TREATED AS INDIRECTLY USED IN THE TRADES OR BUSINESSES OF NON-EXEMPT PERSONS WHERE SUCH PERSONS PURCHASE THE OUTPUT OF THE FACILITIES ON TERMS WHICH ARE CUSTOMARY IN THE INDUSTRY FOR SALE OF SUCH OUTPUT AND WHICH DO NOT HAVE THE EFFECT OF TRANSFERRING TO THEM THE BENEFITS AND BURDENS OF OWNERSHIP OF SUCH FACILITIES."

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

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

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

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

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

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

WHERE AN OBLIGATION MEETS THE TESTS OF AN INDUSTRIAL DEVELOPMENT BOND, THE INTEREST MAY STILL BE EXEMPT FROM TAX IF THE PROCEEDS ARE USED FOR CERTAIN FACILITIES LISTED IN SECTION 103(c)(4). THOSE FACILITIES ARE:

"(A) RESIDENTIAL REAL PROPERTY FOR FAMILY UNITS;

(B) SPORT FACILITIES;

(C) CONVENTION OR TRADE SHOW FACILITIES;

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(D) AIRPORTS, DOCKS, WHARVES,
MASS COMMUTING FACILITIES,
PARKING FACILITIES, OR STORAGE
OR TRAINING FACILITIES DIRECTLY
RELATED TO ANY OF THE FOREGOING;

(E) SEWAGE OR SOLID WASTE DISPOSAL
FACILITIES OR FACILITIES FOR
THE LOCAL FURNISHING OF ELECTRIC
ENERGY OR GAS;

(F) AIR OR WATER POLLUTION CONTROL
FACILITIES, OR

(G) FACILITIES FOR THE FURNISHING OF
WATER, IF AVAILABLE ON REASONABLE
DEMAND TO MEMBERS OF THE GENERAL
PUBLIC."

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

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

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THIS RULE DOES NOT APPLY TO POLLUTION CONTROL FACILITIES.

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

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SENATE BILLS NOS. 294 AND 313

RIGHT-OF-WAY LEASING

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

IV. OTHER PROVISIONS OF THESE BILLS ARE UNCONSTITUTIONAL.

A. Court Jurisdiction.

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

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

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

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

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

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

B. Penalty Provision.

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

C. Regulatory Jurisdiction.

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

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

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

D. Forfeiture.

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

E. The Option To Purchase.

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

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

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

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

F. The Savings Clause.

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

V. CONCLUSION.

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

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