SCOMM

#12:4

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

kept separately.

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

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

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

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

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

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

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

Markham: It would be the old rate.

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

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

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

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

available procedure and I doubt that the commission would intervene.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

the amount of oil that [redacted] going through it.

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

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

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

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

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

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

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

Croft: What figure is/the current Sohio estimate of the total cost of the project at a given capacity.

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

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

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

Croft: Who does no know the answer.

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

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

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

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

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

Donaldson: No sir, that is not the point.

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

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

McVay: it would be initially in the interest of the operating companies to have as high a tariff as possible, is that correct? In other words going back to Mr. Holm's question, most carriers the advantage is always because of competition, that sort of thing to have the lowest tariff. But in this case, I think can see where if you have the patience to have a high tariff, because that again reflects against the wellhead price.

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

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

Croft: Let me go back...this is ~~probably not...~~ a fundamental. the wellhead price determined by backing up from the refinery, the expenses involved in the finished product, is that correct? o.k. Now if you put a high tariff on the transportation from Prudhoe to Valdez , say, lets just use...

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

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

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

DONALDSON: Sure.

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

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

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

is no question about it, as Harry Jones said yesterday, _____ STATE DEPARTMENT _____ DEPARTMENT regulations.

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

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

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

MCVEIGH: Mr. Huber, then Mr. Young.

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

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

HUBER: ITS YOUR AREA OF EXPERTISE I have a small question on a -- a small question on fairness of rates. ~~I WANT TO EXPLORE~~ Now (coughing) I want to explore another area that we haven't been exploring that appears to be in your expertise, and that is I wonder if you would reiterate to us the relationship with pipelines, gas and oil pipelines, which ones are required under what conditions to be common purchasing AS WELL AS common carriers. I WANT TO TRY TO GET THAT GROUND WORK LAID AT THIS TIME.

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

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

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

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

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

HUBER: ALL RIGHT One other question that's having to do with rates. And we're still trying to determine here whether the State should be owner and operator of the line. Then I understand ~~some of~~ FROM your testimony so far today, "Should the State Be the ~~Owner~~ OPERATOR of the Line?" A rate of 7%, on the total value of the line , or about 210 million dollars a year wouldn't be anything unfair FOR THE STATE REAPING THAT AMOUNT OF HARVEST OFF THE LINE IT WOULD BE ~~even~~ a fair system.

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

of the 8% return, which the commission fixed some years ago will reopen, as I suggested yesterday that the commission would go either up or down on it, you can make the assumption for purposes of going ?. I don't think that you can predict or I can predict or anybody else can predict, what rate of return THE COMMISSION would decide was the maximum allowable return for the state if it were TO OCCUR,

Huber: I understand that then we could be legally right at 7% if the state were running the line, but in order to be morally right we may have to drop down to something like 200 million dollars a year or about 5.6%, where you indicated was the average for the conservitives that now make up Aleyeska. A MORE REASONABLE FIGURE.

Markham: I'm afraid I didn't make myself clear, I'm not even sure that the 8% would be legally right, as you suggest, if the question were open . The ultimate decision as to weather a 7% return was reasonable for the state as prepared, would have to be made by the ICC, and I simply am not in a position to PREDICT WHETHER that they wouldsay 7% is the maximum reasonable return for the state under the circumstances. I DON'T KNOW. So I don't think that you can assume that it is even leagally permissable rate regardless of any moral questions that might be involved.

McVay: In other words there may be a difference, whether it is a privately owned pipeling or a state owned pipeline.

Markham: There could well be, There could well be. Particularily if the state relies on the fact that its exempt from income tax.

McVay: Mr. Donaldson would like to comment on that.

Donaldson: Mr. Huber, your suggesting that perhaps THE 5.6 % IS SORT OF A BENCH MARK TO FOLLOW leaves me to make 2 comments for information of this committee. 1) first is, and I'm not sure if its any question of morality. IT'S simply a reflection of what probability they've actually been able to earn in a situation where there was some risks. Obviously if there hadn't

had been a whole lot of risks it might have been closer to YOUR T/R.
Second point is, these are pipelines running through terrain where there
is a lot of experiance and its not to difficult to lay pipe. The risk terrain
here that we have is essentially more, and, ah, as investor or as A FAMILIAR
whether its the state or loner companies , there isn't a reasonable argument
higher risk ought to be rewarded to whoever steps up and does the job AND
those comments be serious discussion. and I think they add to the picture, I'M NOT SURE.

McVEIGH (SENATOR): Mr. Retting do you have any question. Neither Mr. Donaldson nor

[illegible]

Rettig: Neither Mr. Donaldson nor Mr. Markham, when this is ONCE FUNCTIONING
were going to have 7 different tariffs is that correct? Ah,

Markham: Yes, IF IT that operates as non-divided INTEREST LINE.

Rettig: Now, In responding to the request for an estimate of the tariffs
at this time, this would involve again the 7 different tariffs, would it not?
If it were possible, in attempting to do this at this time do you RUN AFOUL OF
Dept. of Justice problems in discussing these matters which may in the end,
combine themselves into a particuliar rate.

Donaldson: Let me, DON'T answer that question. I'm not sure I can either, EXCEPT TO SAY THIS,
AT STANDARD OIL OF OHIO AND BRITISH PETROLEUM,
We don't, discuss tariffs with any other mambers of our project
for just that reason. When we get down to the rate procedures, tariff questions
and this sort, we will make our independant FILINGS with the ICC. At that time
it will all be out on the table and we'll see how our work compares with any
body else's but this is a subject that we just don't do. and I'm not sure that
any such thing as a ANTI-TRUST expert, but most of the time I TAKE PART OF IT BY
I'VE BEEN PRACTICING IN CLEVELAND, ITS BEEN IN THIS FIELD AND WE STAY AWAY FROM IT
EXTRADITE. The ? defender cross questions for compatable numbers,
HIS AN INDIVIDUAL COMPANY AND, EXAMPLE
you would almost have to respond what are own ideas would be. And, ah, it is an
interesting exercise, BECAUSE given the case a set of assumptions instructions, the computer will run
and give you a number. The question is, not whether it works, but what the assumptions

and, ah, I think for (Cook) Inlet with some discussion of the company to Enstar or representative (Cook), you should be clear that you will not do it.

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

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

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

Markham: That is correct.

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

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

Rettig: Thank you

McVay: Senator young,

Young: I'm not sure whether I want to ask any questions or not. For they've been asked while I've been waiting to be recognized. Mr. Chairman, it's early in the morning Yesterday it was established that the intra-state are your feeders or witnesses use the grounds of the cold, etc. Now I've been trying to find an example of a pipeline similar too (or ~~27~~) thats proposed in AK, I think AKN's have a unique psychological hang-up, that they're the first ones involved in something of this magnitude. And if I remember correctly, the little 36'' pipeline from West TX to CA, thats owned and operated by the Pacific Gas and Elec. Co., as a separate owner and operator. When they established they, there must be a consorting with a, or is a climate, which either one it is. Consorting with companies that utilize this line in shipping gas and I know that you said that you didn't know anything about gas lines, and if there is a consorting group do they through with establishing new tariffs, or how does this work? Is there any corolation between the two is what I'm trying to find out?

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

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

Young: There is no coralation between gaslines and the oil lines?

Donaldson: Not to my knowledge, not at this particuliar point.

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

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

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

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

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

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

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

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

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

Markham: The 1940 case was certainly such a case.

Rose: I thought that was a determination of how much was the maximum profits. And was there a finding that excessive profits had been assessed?

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

Rose: And that was 42 years ago.

Markham: That was 42 years ago but its been mighty effective in controlling the earnings

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

Markham: There has never been a reperations case brought envolving pipelines as for as I know

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

Markham: I'm afraid I'm not.

Rose: And the group

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

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

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

Rose: But amyway, I'm not familiar with it ~~XXXXXX~~ frankly. HA HA HA I have been furnished and I discussed it yesterday with Mr. Collins. With the statement I have got from Mr. W. ~~G~~ C. Moore Jr. I testified before the sub committee of priorities Economy ~~Gove~~ Government Authority ~~X~~ economic committee. Jan. 11, 1972 And at that ~~X~~ Time he indicated on page 3 of that statement that ICC applications also makes it possible for pipeling ~~g~~ owners to install this regulatory rate, Etc... I assume that this individual knows ~~more~~ alot about it than I do are you familiar with that testimony sir?

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

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

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

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

Rose: Thank you Mr. Chairman

McVeigh: Mr. Donald, did you have some thing.. I noticed (pause) You don't have to respond if you don't want to.

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

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

McVeigh: Are there other questions? Thats fine Mr.

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

McVeigh: Mr Barber,

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

pointwhere it isn't financially feasible to bring the north slope oil to market? By that I mean the current market prices on the west coast and the rapaidly esclating construction costs of the pipeline where it has gone from 1.5 billion to 3.5 billion in 5 months.

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

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

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

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

Barber: Well, I can't see the point is there.

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

Donaldson: He can give you that number.

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

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

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

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

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

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

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

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

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

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

Pge 2: ~~Last page~~ PARAGRAPH 5 PAGE 2 insertion: B Again we are using a Cook Inlet Form P as an example. And, if this Form were used to report on TAPS by any of the owner companies, there would be, or could very well be additional pages completed, many more probably. Continue--- Continuation after Page 3: As to revenue the schedule could set out TAPS revenue separately and if further detail would be desired by the State, as schedule that summarized such data could be prepared. Any necessary additional operating information desired by the State could also be provided on this or a similar page. The State would also be interested in the valuation of TAPS carrier property. As you know, the Interstate Commerce Commission determines the company's original valuation and traditionally brings it down to date each year. A copy of a company's valuation report which set out valuation of property located in each State is sent to each state by the ICC. In addition, because of the magnitude of investment in TAPS we expect that the ICC will determine the valuation of tax facilities separate from the valuation of owner ~~xxxx~~ companies other carrier facilities. This information would also be provided to the State of Alaska by the

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

McVey: Do you have questions for the witness?

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

Seymour: Yes, that is correct

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

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

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

Seymour: Yes, Sir. That is correct.

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

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

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

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

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

LAST PART OF E.L PATTON'S TESTIMONY, ON TAPE # 31

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

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

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

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

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

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

ELP/nl
3/3/72

E. L. PATTON

* Attachment

LARGE PIPELINE RIGHT-OF-WAY LEASE RATES

STATE OWNED LANDS

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

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

ELP/nl
3/6/72

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

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

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

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

Mr. McVeigh: Any further questions? Mike Miller.

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

present time, the prudent reserves don't indicate a real need for that. Could you give us an estimate/in dollars or percentage how much more Alyeska is willing to invest in the two million capacity, forty-eight inch pipeline as compared to what would have invested if they had taken into consideration only the proven reserves?

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

Mr. Miller: Thank you very much.

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

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

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

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

Mr. McVeigh: Thank you. Any further questions?

Mr. Merdes: I have one.

Mr. McVeight: Senator Merdes.

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

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

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

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

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

Mr. McVeigh: Thank you.

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

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

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

Mr. Patton: Well, I think...

Mr. Barber: In the realm of millions

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

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

Mr. Patton: That is correct.

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

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

Mr. McVeigh: If you care to, yes. We'll be with you when you're through.

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

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

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

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

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

Mr. McVeigh: Any further questions.

Mr. Rader: Mr. Chairman.

Mr. McVeigh: Yes, Senator Rader.

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

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

Mr. McVeigh: Any further questions?

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

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

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

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

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

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

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

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

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

than other

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

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

Mr. Culetta: As the owner

Mr. Patton: The owners plural

Mr. Culetta: agent

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

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

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

Mr. McVeigh: Any futher questions. Thank you, Mr. Patton.
items requested that statements be passed out in advance as to the oral testimony of your witness.

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

: We're going to get the statements now

: We're going to go through until 11:30. There will be, I understand, a (which is planned) roll call in the House at 11:00 o'clock, but there will be no counts. Members wishing to make roll call, I will have a brief pause at ten minutes to eleven so that they can leave.

: Thank you.

: Is the mike on now?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The point here is that the value of this land to be determined for purposes of reasonable rental, which is the limit of what can be charged without inhibiting or burdening interstate commerce is the value of the land to any normal person or any general user who might want to use it, and not the special, peculiar value of this particular user. I should further emphasis that in all the discussion about having the rent gauged to the profitability of the land, it is not profitability of the land that has been really talked about, what they are talking about under these bills is profitability of the pipeline. Under ~~these~~ A conditions ~~I would~~ WHERE IT IS assumed private capital will build that pipeline. The defect of the real formula of Senate bills294 and 313 is that they bear no relationship to the value of the particular land involved. And are not ~~limiting~~ limiting to the land itself, but seek to use some measure of gross revenues for the profitability of the pipeline built with private capital. This clearly goes beyond what the Supreme Court has said could be reasonably charged and would constitute a prohibitive burden on interstate commerce. Furthermore, since these unusual charges are wholly out of keeping with general practice in other states, as Mr. Patton has indicated, and in the state of Alaska as well and are largely addressed to this pipeline project they might

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

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

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

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

C. Is an important regulatory Jurisdiction, both of these bills which seek to require the condition of the lease, that the lesee consent to regulatory jurisdiction of some regulatory body of the State of Alaska. I would point out that as has already been testified by previous witnesses that quite obviously the regulatory area pretaining to interstate commerce is preempted by the Federal Government, whether excersized or not, and that an attempt by the State, by indirect, such as in the Western Union Case, that ~~was~~ A cited earlier Where the State of Massachusetts sought to acquire the telegraph company to render stock quotation service to whomever the State of Massachusetts said. That determination was to be made by the telegraph company was considered to be ~~Violate~~ violative to the Federal Constitution and paramount of interstate Commerce even though the state sought to exercise sought to impose that . . . . .

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

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

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

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

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

Cortese: Yes sir.

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

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

Rose: ^Even It is investigated that president state ownership/assuming their financial capability.

Cortese: Are there legal impedements?

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

Cortese: Yes, I ~~would~~ will get to that ~~effect.~~ this afternoon. If time permits

McVay: Mr. Harris.

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

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

McVay: Mr. Barber.

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

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

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

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

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

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

Barber: Even when it goes over a foreign country?

Cortese: Oh yes.

McVay: It is interstate and foreign commerce.

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

McVay: Mr. Groth . . Mr. Holm.

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

Cortese: Even jurisdiction over the .....

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

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

Groth: Lets assume its even two hundrend.

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

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

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

Groth: Thank you.

McVay: Mr. Holm.

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

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

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

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

Whereupon there are spaces

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

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

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

BREAK

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Mr. McVeigh: Senator Rettig has some questions.

Mr. Rettig: Mr. Gary. . . . .

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

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

Gary: How many years are we talking about?

Rettig: Well, we're talking about 25 years I suppect. The operation has continued smoothly for 10 years or 15 years.

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

dollar pipeline, and often several owners each own a moderate percentage of ~~dollars~~ these. I have known pipelines that has 17 owners in it, the leading owner owning only 9%. Well let me use an example to help. The pipe line that has 17 owners in it, and the whole financing is $35,000,000 and the largest interest in it, I believe is held by a subsidiary of Gulf around 9%, I don't think investors worry much about the Gulfs through-put commitment on that pipeline. This pipeline, it is so large that ~~knowone~~ anyone is going to regard the throughput agreement as any other than a guarantee of debt. They are going to think its a percentage interest of the pipeline multiplied by the 3-1/2 billion or what ever amount of debts outstanding, that would added onto the balance sheet, rating agencies will do it, certainly investors will do it, its not going to be overlooked. There is a lot of talk about off balance sheet financing if you will not being charged up. Thats not true any more. Investors know about it, they understand it rating agencies do. I've talked to both of the major rating agencies on throughput agreements and what they mean and I'm charged they represent our oil companies credit. And I've talked to both sides, and they claimed in one hand, everything is working fine, it is not really charged in that because it is an operating expense. On the other hand if it is not working so well, it is a true liability. And interestingly enough throughput agreements in a sense is stronger than a ~~guarantee~~ guarantee in that it retains its working capital commitment assured against usually they may plus the modern insures the pipeline as having enough money to meet all of the its obligations in the past.

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

So against each of these companies.'

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

even tho it doesn"t appear in dollars and cents on the balance sheet?

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

Thank You.

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

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

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

: I don't think there is any disagreement

: You seem to indicate that (if I understand your testimony) that in order for the State to build this pipeline, they would have to have the full financial credit of the oil companies. I thought Mr. GUILDERHOUSE indicated that that wouldn't be necessary.

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

I'm sure these oil companies would certainly have that expectation. They don't know where, how much, or with what degree of certantly or assurance that that could be done. But I'm talking ~~about~~ from standpoint of financing FROM THE STANDPOINT OF FINANCING. The oil companies ~~are~~ perfectly capable of taking that risk that they wont find those additional reserves. But a lender isn't going to take that risk. He's going to want to be backstopped ~~stopped~~ against that event not happening. That's not his business. That's putting the lender in the oil business if you make him assume that risk. Now, if the satisfaction of that first assumption or that ~~certain~~ first condition just isn't here, at the time the financing needs to be done so it has to be backstopped ~~stopped~~. Now thats true of all the ~~beautiful~~ USUAL things that you have to ~~set up for~~ SATISFY a ~~lenders~~ lenders ON,

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

I understood that his fifth point was

1. Was operation pipeline sound business
2. The cost fees are various assumptions - it will cost three and
3. ~~It will~~ one-half billion It will be built and utilized.
4. That the State's credit is not adequate to sell the G.O. bonds.
5. ~~And~~ Perhaps I misunderstood that the oil companies will not be obligated to lend their full faith for credit

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

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

to get it up to the two million barrels a day level. When the oil company takes ~~this~~ those risks it does it because its opotomistic and hopeful, and just to round out this point, thats why they have to have the expectation of the profit.

GARY: Mr. Holms.

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

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

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

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

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

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

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

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

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

Entire Corporate

and it got these in other pieces

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

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

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

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

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

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

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

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: _____ state ownership.

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

: I think that answers my question.

Rose : Mr. Gary, what Indicative is the oil companies individualy can here, interest, ownership concept ~~in~~ raise the necessary money - you said the money for that particular site)??) is available in the market. Th en you indicate under the corporate arrangement, to form a single entity ~~I would~~ That would change The Picture ~~say do better~~ . One thing that I don't understand is, why couldn't the And wish you could clarify for me

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

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

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

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

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

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

Rose : I have one other question:

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

seven oil companies, but the name on the bond is Trans Alaska Pipeline System. Its only one name. joint Humble
If they do it in undivided/interest form the/pipeline comes to market, the
~~Robot~~ mobil? comes to market, Amerada comes to market, Union comes to market,

GARY: They
Rose : You see that they may do it along all the lines of the
ROSE!
rest of their financing too. I don't think theres any difference in the
availability of_____.

Gary : Yes.

Rose : Alright, The next question that I have sir

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

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

Gary: ~~Oh~~, 35 hundred million dollar issue, spaced right,
Rose: RIGHT
5 MONTHS WHAT
Rose: WITH A TOTALITY OF : 3-1/2 billion - what is the total cost to the State for of the, of course, best approximation possible
underwriting these counsel fees and other fees ~~adhering~~ RELATING to it?

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

Rose : Well, either way....it makes no difference.....
GARY: Is it tax exempt?
Rose: Let's Assume not.

Gary Assume not: The State issues, guaranteed by ~~law~~, The oil companies contradiction of terms,

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

Gary : ~~The State may as well (??) the tax limit for taxable bonds~~
AS A TAX EXEMPT OR TAXABLE BOND
Rose: Right
.....let me first talk about ~~taxes~~.....I don't get the picture of the State
TAX EXEMPT BONDS
selling a taxable bond....

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

Gary : Now, let me try to answer your question. There is confusion here somewhere. Tax exempt bonds, for new purp oses, where investors have to be educated, and large size..all right, lets assume this is 100 million dollars, a large issue, for a new purpose, where you have to do very substantial education of investors, I would guess that the underwriting spread would have to be in the neighborhood of 2-1/2%, on the first issue. Now included in that underwriter's selling commission out of that, I would say, Ach, you might have to pay a selling commission of about half of the total spread, a little more than half maybe.

Rose : Is that included in the 2½?

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

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

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

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

Chairman : Lets take a ten minute break.

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

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

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

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

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

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

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

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

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

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

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

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

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

Wohlforth : I see, so thats ....

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

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

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

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

Gary : I will discuss this point with clients. (??)
I think I might point out that these companies already have a fair amount of money invested in that pipe thats sitting on the ground., and those are expenditures that ~~xhax~~ ought to be funded on long term. The cost of What I'm saying is that with this cloud hanging over , its not propitious, it simply wouldn't be propitious for them to attempt to go to market and face the kind of doubts and clouds that this event is causing.

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

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

Wohlforth : Thats all I have, Mr. Chairman. Thank you very much.

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

Wohlforth : Surely.

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

Wohlforth : This is correct and the trust ~~debentures~~ indentures usually provide that its maturity when ~~a~~ is no longer than 12 months, 18 months or 24 months, in governments or instrumentalities of the United States.

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

Wohlforth : It certainly would not, in a given year. That is cor rect.

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

Rettig : Thank you very much, Mr. Wohlforth.

Wohlforth : Thank you mr Chairman

Chairman : Are there any questions? Senator Croft?

Croft : Could I ask Mr. Gary - has there been through the chair problem with ~~less on the~~ financing of pipelines across either Federal land or across State of Texas, either State or University Texas lands in /..where there is at least some question as to the duration of the land interest in the pipeline company?

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

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

CROFT : What about the crossing of Federal land where the interest of the carrier has been described as either ~~trifilerable (??)~~ terminable or cancellable or ~~pre~~revokable? ~~Can~~ Does that cause a problem?

Gary : I'm not aware of any problems that have ever occurred on those grounds. This is one way of tending to demisish ~~I tend to be committed to~~ my earlier testimony, ~~not~~ about this situation - ~~this~~ which is quite different from those.

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

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

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

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

GARY : Let me state it correctly, so it is understood. ~~The~~ WHERE THE problem LIES HERE. THE PROBLEM LIES IN THE ~~was~~, which the State has stated, that they want the limitation, namely to renegotiate terms after five years.

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

GARY : I'm not up on these numbers.

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

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

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

Gary : Nobody can give you an answer to that question, but I'll tell you the areas of concern - ~~the company~~ HERE AND THAT NOBODY can tell you its 1% or 5%. Areas

of concern are first delay and ~~it is only for~~ resulting from delay ~~that~~ you get escalation in cost. Also resulting from delay you may find yourself, by the time you're going to market, in a condition of market where interest rates generally are higher - they might be lower, too. The third factor is that we've created uncertainty here and/certainly in the minds of investors about the viability of this system, over a long time, simply because the general impression that's left by all this is that there are going to be troubles, perhaps,/realizing profits from this operation. Now, that is the worst. The worst kind of instrumental (??) effect because that is the thing that discourages investors, long term investors from p utting their money into it./ So, if the market shrinks, you end up paying a higher cost because you're not tapping as broad a market. In an operation of this kind you've got to get as b road a market as you can, so anything you do to penalize this finnncing is going to have an effect both on the State and on the oil companies. Its disadvantageous. With the result of higher interest cost and _____ and higher interest cost, have to be reflected in the tariff and that works its way back as you've heard many times in the last few days to the wellhead price. So I can't qualify it, but its something of serious concern.

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

Gary : Whats yours?

: I believe Senator_____has a question.

: We all

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

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

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

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

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

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

Rettig: Are there any other question for Mr. Gary? If not we'll . . . Mr. Donaldson, apparently that concludes the . . . Senator Thomas, did you have a queation?

Thomas: No, Mr. Chairman, thank you.

Donaldson: Can Mr. Gary be excused?

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

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

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

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

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

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

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

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

facility constructed . . . or acquired with the proceeds of an issue which is ostensibly owned and operated by an exempt person (such as the proposed Trans Alaska Authority) but where one or more non-exempt persons (such as the oil companies) agree, pursuant to one or more long-term contracts, to take, or to take or pay for, a major portion (which is defined as more than 25%) of the output of such facility (whether or not conditioned upon the production of such output) for periods of time which are substantial in relation to the terms of the bonds." However, the regulation speaks in terms of output or production from a facility, the same rule would apply to guaranteeing input to a facility such as a pipeline where the revenue is based earned by servicing or carrying crude oil. From the discussions previously given by Mr. Gary, it appears clear that the state could not finance such an ownership commitment without commitments from the oil companies to guarantee a source of supply to the pipeline far in excess of 25% thats upon. Indeed the minimum shipping agreements which have been described by Mr. Guilderhouse (while not sufficient to satisfy investors in the view of Mr. Gary) is in my opinion sufficient to satisfy the trade or business test of Section 103C and, thus, to make the proposed bonds industrial development bonds which would not be entitled to tax exemption on their interest because, under such a plan, the companies would be asked to make a long-term contract to guarantee to provide more than 25% of the crude to be transported through the line which to me is the equivalent of guaranteeing to take or pay for more than 25% of the transportation service. Mr. Cades stated earlier that the volume of the line available to the owner companies, 7 owner companies, is subject to reduction for other users and that because of this it is different from the normal take or pay contract. However, since that commitment of the original owners is unlikely to drop below 25% of the input and since the other users are themselves going to be limited to a very few number of private oil companies, I fail to see how this ~~would~~ is going escape the definition of the industrial revenue bonds which is previously set forth in the regulations. Thus, it is our conclusion that it is extremely unlikely that a favorable ruling could be

obtained from the Internal Revenue Service that interest on these proposed bonds would be tax exempt. Although rulings, once obtained and acted upon by the recipient, are seldom, if ever, retroactively reversed by the Treasury, ~~and~~ it seems unlikely that Congress, in this instance, in view of the strong position it took in 1968 to attempt to close exactly this type of activity would not act to nullify such a ruling before any commitment had been made in reliance on the ruling. In fact, in our own experience in obtaining a ruling from the IRS, some three months after the ruling was granted, we received a call from the Treasury asking whether we had taken any adverse action as a result of this, the ruling. In that case we had concluded the transaction involved, service foreclosed in the action, but from that point on their ruling requests, similar requests, were denied by the Treasury. So, it is possible that during a period of time that even if the ruling were obtained prior to your going to market and making commitments this ruling could be reversed. Perhaps one additional matter should be mentioned. It has been suggested that if the state could obtain the tax benefits upon which the administration's projections are based, that these benefits would be passed on to the oil companies either in total, as a result of an ICC ruling, that because they were tax exempt they were not entitled to the right of a normal tax payer or in part. The magnitude of any differential in interest rates, because of any possible tax exemption has already been discussed, but assume for the moment that some tax savings could, in fact, be accomplished and could be passed on to the oil companies. The benefit which the companies would perceive would not be equal to the amount of the savings derived from tax exemption because the companies would , as a result of the reduced cost of transportation, have increased their profit in other factors, in other areas of the movement of the oil openly to market, which would result in higher income taxes as a result of the increase in income. So the net benefit to the oil companies is not in the magnitude of any tax savings which the state is seeking to obtain. In conclusion, the requirements

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

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

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

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

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

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

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

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

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

Broussard: Well I'm not/ A controlling economist but to the extent that you reduce your tariff in order to put your oil in a better position on the market, I assume you not mean priced your oil at less than you could ~~possibly~~ optimately price at. So I don't see that

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

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

Holm: . . . .

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

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

Wohlforth: Yes it is.

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

Barber: Mr. Broussard, I understand you to say that it is unlikely that the Internal Revenue Service or the Treasury Department would hold such operations as the state operated oil line tax free. Now I emphasize your word unlikely. We will never know until we put before them that question. Is that right?

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

Rettig: Are there any other questions? Senator Rader.

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

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

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

Broussard: No it would not.

Rader: Thank you Mr. Chairman.

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

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

Seymour: (prepared statement)

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

INTRODUCTION

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

RATIONALE OF TESTIMONY

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

Cook Inlet Pipeline

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

DESCRIPTION OF COOK INLET PIPE LINE COMPANY FACILITIES

COOK INLET PIPE LINE COMPANY WAS INCORPORATED IN MARCH, 1966. ITS STOCK IS OWNED BY ATLANTIC RICHFIELD COMPANY, 20% MARATHON OIL COMPANY, 30% MOBIL PIPE LINE COMPANY 20% AND UNION OIL COMPANY OF CALIFORNIA. 30%

THE COOK INLET PIPE LINE FACILITIES WERE COMPLETED IN THE FALL OF 1967 TO OPERATE AS A CRUDE OIL PIPELINE SYSTEM ON THE WEST SIDE OF COOK INLET, KENAI BOROUGH, ALASKA. (414 A map of the pipeline system is attached as exhibit 1) THE MAIN LINE OF THIS PIPELINE SYSTEM CONSISTS OF FORTY-TWO MILES OF TWENTY-INCH PIPE FROM GRANITE POINT TO DRIFT RIVER. A TERMINAL COMPLEX LOCATED AT DRIFT RIVER ~~CONSISTS~~ includes OF SEVEN 270,000 BARREL CRUDE OIL STORAGE TANKS, DEBALLASTING AND BALLAST WATER TREATMENT FACILITIES, LIVING QUARTERS, OFFICES AND MAINTENANCE SHOP, AND AN AIRSTRIP AND HANGAR. OIL TRANSPORTED TO THE DRIFT RIVER TERMINAL BY THE PIPELINE IS

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

CONSTRUCTION OF FACILITIES

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

PIPELINE PROJECT JUSTIFICATION

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

PIPELINE THROUGHPUT

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

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

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

#38 Lee Hall

TARIFF AND FINANCIAL POLICY

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

ADL which is redacted

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

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

OIL PRODUCTION AND PIPELINE THROUGHPUT

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

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

CRUDE OIL PIPELINES VERSUS PUBLIC UTILITIES

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

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

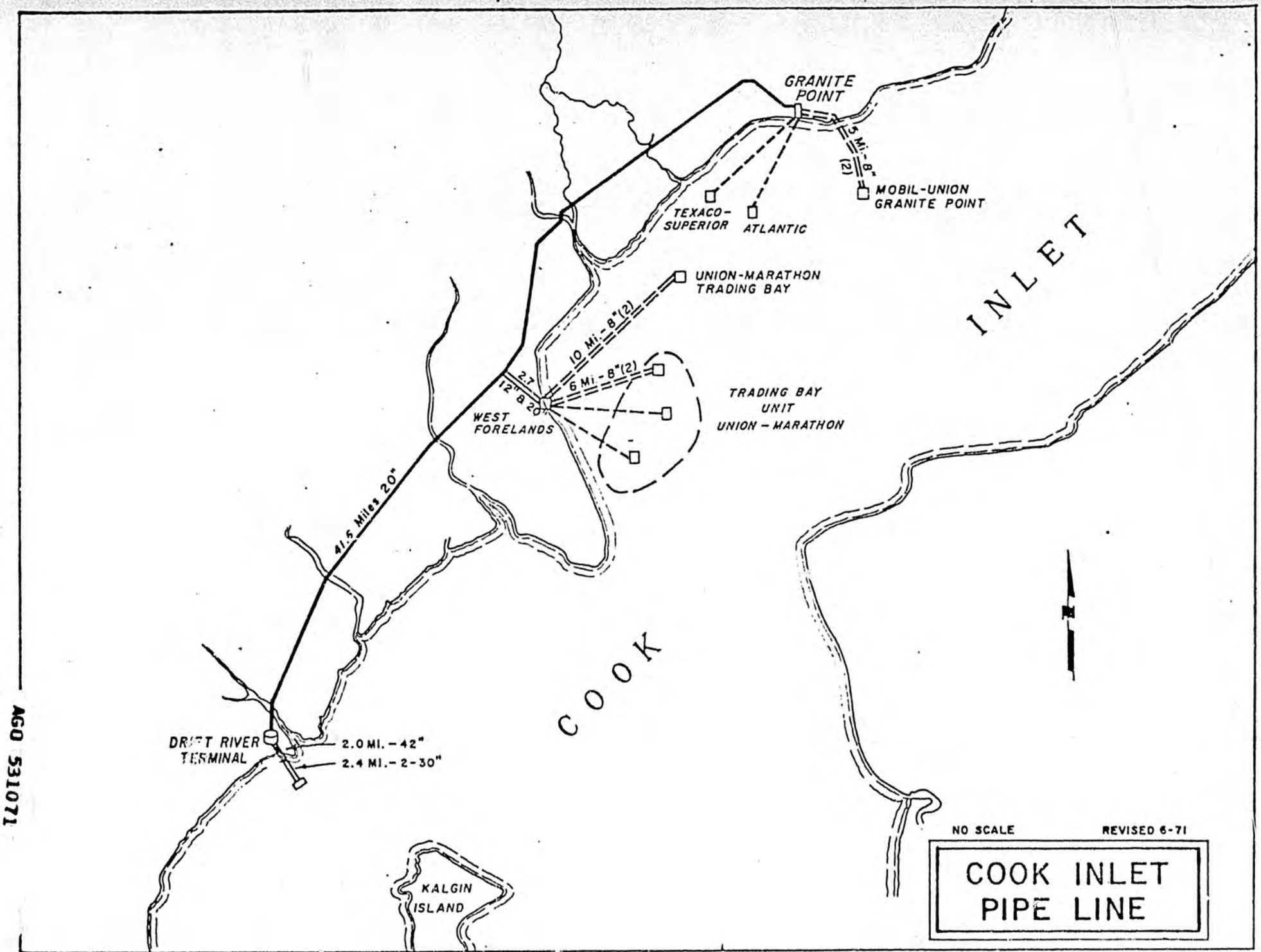
EVEN THAT THE ANTICIPATED PROSPECTIVE CRUDE OIL RESERVES WILL ULTIMATELY BE PRODUCED AND TRANSPORTED IN THE PIPELINE. THE ABANDONMENT OF THE PIPELINE FACILITY WHEN OIL RESERVES ARE DEPLETED IS A CONCRETE PROBABILITY FROM THE VERY INCEPTION OF THE PIPELINE PROJECT. THESE UNUSUAL CRUDE OIL PIPELINE RISK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

RECOGNITION OF RISK

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

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

JRK-GAS/JV
MARCH 3, 1972



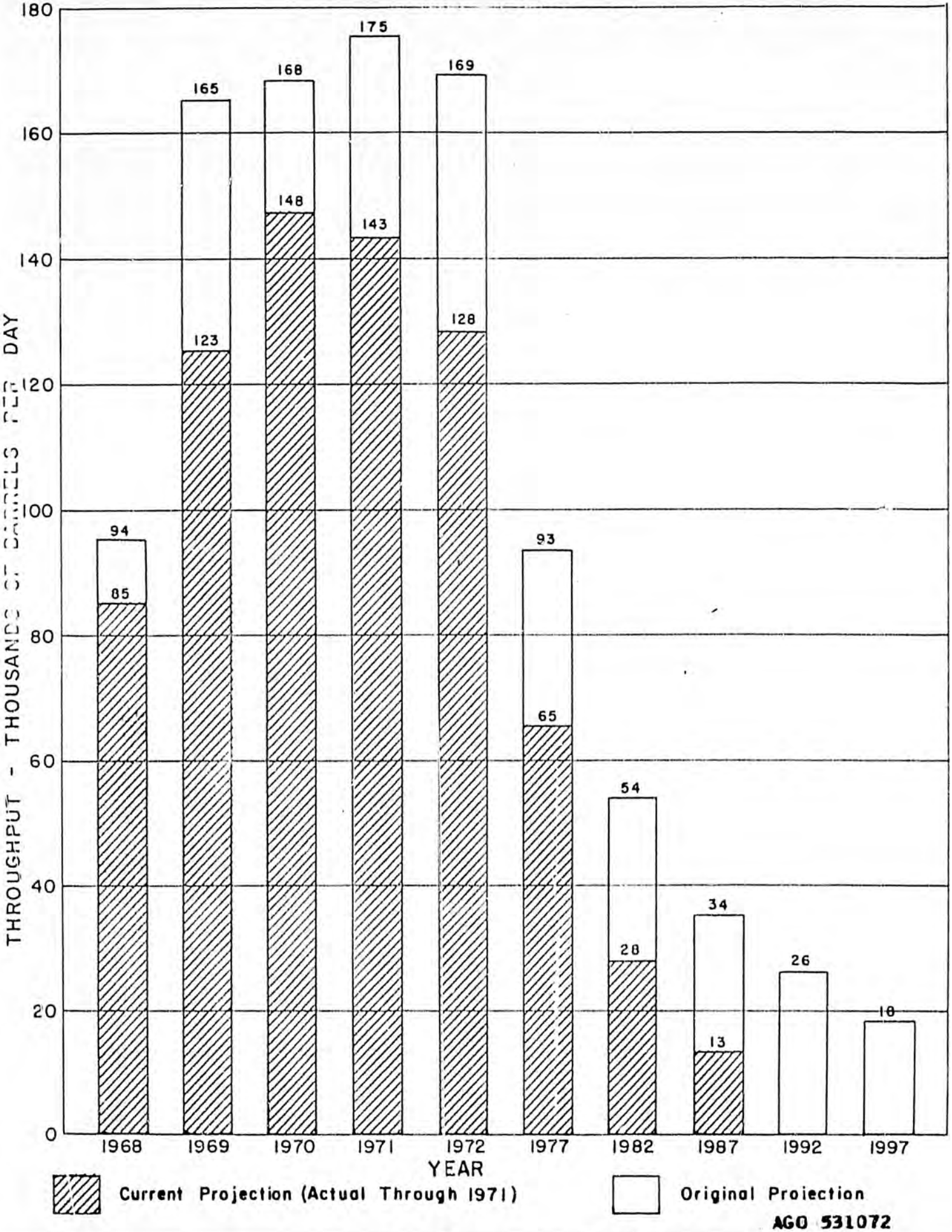
AGO 531071

EXHIBIT I

A-2291-5

COOK INLET PIPE LINE COMPANY
ANNUAL THROUGHPUT VOLUMES

EXHIBIT II



AGO 531072

Seymour: (statement was pre-typed)

Rettig: Are there any questions? Mr. Barber.

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

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

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

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

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

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

Barber: Through the transportation cost and their prospective increases.

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

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

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

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

Seymour: Yes sir.

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

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

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

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

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

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

Seymour: Well, now I did't say that. When and if we complete the Trans-Alaska project the ~~terminial~~ TERMINAL operation, from a stand point of complexity and operation will be a much more ~~complacated~~ COMPLICATED than the pipeline operation will be.

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

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

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

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

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

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

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

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

Rettig: Mr. Rose.

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

Seymour: Repeat that I didn't understand . . . . .

Rose: When the production projections vary then the tariff is adjusted accordingly?

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

Rose: At that point you readjusted the tariff

Seymour: Yes sir

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

Seymour: Thats right. Now I would like to point out that the we didn't make just one projection when first decided to look at the evaluation of Cook Inlet. We have annual forecast from the producers as to what the production we be, and they have constantly declined.

Rose: So my conclusion then and I would like you to tell me if I am right or wrong on this. Is that on that basis it can be a reasonable conclusion that a pipeline operation can be expected not to lose money in the long run but to come out even and if the original projections come out correct or nearly so. In other words, the choice would be to come out even at the end or make a profit.

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

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

Rose: I am sorry Mr. Chairman, obvious the thrust of my question was not understood. What I am saying is that you can through revaluation of projections eliminate, for all practical purposes, the loss at the end.

Seymour: Well, yes, of course, unfortunately, if the tariff gets to the point where the cost of transportation so drastically effects the price of the crude oil you cease to transport anything. There is no profit guarantee at all.

Rose: Thank you Mr. Chairman.

Rettig: Senator Radar.

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

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

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

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

established that the ~~equitity~~ EQUITY would be returned. This was done by means of dividends and that there would no future dividends in the operations.

~~Radar:~~ RADER Do you normally, this kind of situation, return your ~~equitity~~ EQUITY before your DEBT IS PAID ?

Seymour: It can be done. This is a matter of choice by the directors of the company. Now we have, also, ~~choosen~~ CHOSEN to increase our debt retirement rate, ~~So~~ so hopefully it can be retired before we run out of something to transport.

Radar: Thank you Mr. Chairman.

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

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

Seymour: That is correct.

Barber: Now we are in agreement. Thank you.

Donaldson: May Mr. Seymour be excused.

Rettig: Yes.

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

Cortese: (Statement is prepared)

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

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

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

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

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

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

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

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

5. That House Bill 569 involves unlawfull delegations of legislative powers to the proposed Trans-Alaska Authority and to other executive and administrative offices.

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

couple of years each.

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

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

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

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

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

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

development loans. In Wright V. City of Palmer, decided by Alska Supreme Court in 1970, the City's issuance of general obligation bonds to construct a plant to be leased to a manufacturer was approved upon evidence that the object and effect would be to encourage industrial development which was urgently needed because the City's , because the City's economic growth was nil, high year-round unemployment existed, jobs had been lost by the closing of mining and lumbering enterprises, there was no manufacturing in the City, and businesses were moving out of the City. The need for the City itself to take an active role in the financing was apparent. It has been held that industrial development financing serves no public purpose where the facts make it plain that private funds will provide for the project without the injection of public financing. The case where Manning v. Fiscal Court of Jefferson County decided by the highest court in Kentucky in 1966, where the Court said that " That no public purpose is served by substituting public credit for private funds. That result appears to be consistent with the approaches taken by the Alaska Supreme Court in the cases mentioned above. From an examination of the proposed statement of legislative findings and policies contained in House Bill 569, it is difficult to perceive any necessity whatever for State financing in order to achieve the objects stated, incidently the objects stated are such as, constructing the pipeline, getting it built, the consequent job development, the decrease in unemployment, economic development in general and environmental protection, all of which have been testified upon by Mr. Patton as being achieved by private financing by Alyeska and the pipeline companies. It is difficult to percieve any necissity whatever for the State financing in order to achieve the object stated especially when it is apparent that the planning, development, and expertise represented in Alyeska Pipeline Service Co. are essential to the early achevement of the pipeline project consistent with those ojectives, and in view of the substantial question s as to the practical ability of the State to finance the project. It should be borne in mind that private capital has already spent or encumbered a half billion dollars

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

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

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

The Illinois Supreme Court had previously approved lease type 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 propased lease commitment of the State of Alaska in connection with the pipeline project; for if at any time the pipeline was not earning enough to cover the debt, there would be no practical way to avoid a burden on the State general fund for there would be no takers for a losing facility which has no other practical use. Thus with the vast cost, and consequent heavy debt service burden, of this single purpose facility, the type of financing involving a lease commitment by the State poses a substantial constitutional question as a contracting of State debt without complying with constitutional requirements for vote of the people. I would like to summarize the balance of this memorandum without taking an undue amount of your time. The next point is that there is a substantial question as to whether the Bill 569 constitutes a local or special law violating the constitution or prohibition against passing local or special act , acts if a general act can be made applicable. And I refer to the fact that the project that may be financed is limited to this single pipeline from the North Slope to the Prudhoe Bay area, excuse me the Valdez area. And that in similar circumstances in litigation in which my firm was involved in , in Ohio we provided for the financing of state underground parking facility. Only under the State House grounds our Supreme Court under similar constitutional provisions held that since there was a general purpose in providing parking, the general purpose might be in need of satisfaction elsewhere in the State to restrict this to a single facility was a special act in violation of the constitution. Incidently that litigation took a five year period of

time. Also, I point out that there are substantial questions of unlawful delegation of legislative powers provided for under this bill. In particular reference is made to the granting of authority of exclusive jurisdiction control and management of all pipeline facilities in the state which would be amended by amendments submitted to this committee on Monday I believe or Tuesday which change that provision giving the authority exclusive management control over those pipeline serving the source as defined by the Authority as conveying the oil or gas over a route as defined by the Authority so that the Authority is given ----------choose as it will, which in my judgement also raises substantial question of unlawful delegation of legislative powers. Also I have that the leasing provision would create an unlimited rental obligation of the State for an unlimited period of time without any particular guidelines indicating an uncontitutional delegation of legislative authority to the Governor, I also refered to the guarantee [illegible] as being so wide open and as being mandated really by the bond documents, the bond agreements made by the authority such that the Governor presumably would have to put his signature on any guarantee on any bonds that the authority or two members thereof had agreed should be guaranteed as being without any proper standards or distraints so as to constitute an unconstitutional delegation. The administration proposes striking that section from the bill, however, I suggest to you that it was not ------- as was indicated is to you that the proposed constitutional amendment would still need implimentation and that this type of provision can be looked upon as the type of implimentation that would be involved ultimately there would be certainly in that respect the serious question of unconstitutional delegation of legislative powers to the Governor. In conclusion it appears that HOuse Bills 560 and 570 raise many substantial legal problems that could keep a large number of lawyers busy for many years; and there are justifiable concerns that they would do precisely that if enacted. In view of the delays of the project already experienced, and the ecomonic 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 this legislature. Again if should be emphasized that, as previously testified to, even in the complete absence of any legal question, the patent inability of the State or a public cooperation of the State to successfully market such a huge volumeof bonds in the short time required, presents a direct practical and critical problem which strongly indicates that House Bills 569 and 570 are practical approaches for achievement of the objectives of the State.

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

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

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

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

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

Croft: Yes, I think even Prf. Weathersponn acknowledges there is that limitation

that you have to obtain fair value.

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

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

Rettig: Go right ahead.

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

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

Croft: You're not suggesting that either the Impact Committee Bill or the Administration bill distinguish between intra and inter state commerce.

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

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

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

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

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

Cortese: From the use of the land?

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

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

Croft: You are saying thats not constitutionaly permissible to take

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

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

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

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

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

Croft: What if instead of one application to could cross state land instead of this joint venture arra ngement each of the companies were going to construct an independant line, would they have authority to say that all lines had to be constructed within one part as adjutant of its propietary power?

Cortese: I doubt as an adjutant of its propietary power, I should thing more commonly that that consideration would fit into its adjutant as a sovereign that it has some interest where development takes place particular facility in that that is a fair consideration of a matter of state local concern, however, you bear in mind the supremacy of the federal constitution and of the commerce clause, so that to the extent that that local interest of the state would so conflict as to impede, interfere with excessively burden interstate commerce, the state concern would have to give way to that degree

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

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

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

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

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

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

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

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

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

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

Rettig: If you could _____ this legislation CHANGE / we'll pursue it.

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

Rettig: You're referring to right away leases.

Croft: Yes I'm curious WHAT DISCRETION

Cortese: You're ~~guaying~~ CLAIMING the reserves with the right of way.

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

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

Croft: That wouldn't be...

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

Croft: And that wouldn't be a burden on interstate commerce, the fact that we withheld our part, even if .!? WAS

Cortese: If you with-held the oil

Croft: Yes

Cortese: I should think not.

Croft: ~~They're holding~~ But withholding the lease ~~here~~ is.

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

Croft: But we don't know that it's the only way , that may be the best way to the company, ah, but I mean one of the companies have spent over forty million dollars exploring another route and has even said that it is ~~pleasable~~ FEASIBLE under certain circumstances , it's not the only route, does that have any EFFECT

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

Croft: This may be the best alternative but not the only alternative.

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

Croft: Yes, but in that case Oklahoma had given ah, the right to cross to domestic corporations that were engaged in ~~inprospect~~ INTERSTATE commerce, but with-held it from foreign corporations engaged in interstate commerce. That's a distinction that neither the administration or the committee's BILL ~~might~~ MADE.

Rettig: We're going to have to conclude this ah, debate, ah, that's what it's becoming ah, we're going to ah continue tomorrow ah, at 8:00 ah, we are coming close to ah, at least the end is forseeable. We could ah, come back this evening or perhaps ah, hold a marathon session that we do not choose to ~~but~~, and I don;t mean to imply that because Mr. Sandooske from Marathon is going to speak tomorrow, we do have ah, at least three more speakers and we'll conclude ~~it~~ AT this time and ah, have Mr. Donaldson conclude the testimony for the industry tomorrow, following which we will have the other two speakers, ON THESE SPEAKERS there may be three and following that ah, I understand the administration wants to have some supplemental testimonies and hopefully we can conclude by noon tomorrow. 8:00 in the morning.