

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672

933 SCOMM32: AK GENERAL STOCK OWNERSHIP CORP. 1979-80 933

Section 5.09. The Treasurer. The Treasurer shall (a) have charge and custody of, and be responsible for, all funds and securities of the Corporation and deposit all such funds in such banks, trust companies or other depositories as shall be selected in accordance with the provisions of these By-Laws; (b) receive, and give receipts for, monies due and payable to the Corporation from any source whatsoever; (c) sign such documents as shall require the signature of the Treasurer; and (d) perform such other duties as from time to time may be assigned to him by the Board of Directors. The Treasurer shall give a bond for the faithful discharge of his duties in such sum and with such sureties as the Board of Directors shall determine.

Section 5.10. Comptroller. The Comptroller shall keep, or cause to be kept at such office of the Corporation as the Board of Directors shall from time to time by resolution designate, and shall be responsible for the keeping of, correct records of the business and transactions of the Corporation and at all reasonable times shall exhibit such records to any of the directors of the Corporation upon application at the office of the Corporation where such records are kept. The Comptroller shall perform such other duties as from time to time may be assigned to him by the Board of Directors.

Section 5.11. Duties of Officers May Be Delegated. Subject to the approval of the Board of Directors, which approval may be of a general or specific nature, any officer of the Corporation may delegate to any employee of the Corporation, for the period set forth in such delegation, but not to exceed the term of office of the person making such delegation, any authority or duty of his office; provided, however, that any such delegation shall not be effective until such delegation and the approval relating thereto are evidenced in writing and filed in the Office of the Secretary of the Corporation.

Section 5.12. Compensation. The compensation of the officers shall be fixed from time to time by the Board of Directors. No officer of the Corporation shall, without prior full disclosure in writing to the Board of Directors and express approval thereof by the Board of Directors, receive any salary from any source other than the Corporation during his period of employment by the Corporation.

Section 5.13. Outside Interests of Officers and Employees. The Board of Directors from time to time may adopt rules and regulations governing the conduct of officers or key employees with respect to matters in which they have a financial interest adverse to the interests of the Corporation. Such rules and regulations may forbid officers or key employees from participating personally and substantially in corporate action with respect to any contract, transaction or other matter in which, to the knowledge of any such officer or employee, he or any member of his immediate family has a financial interest, unless (a) such officer or employee makes full disclosure of the cir-

cumstances to the Board or its delegate and the Board or its delegate determines that the interest is not adverse, or is not so substantial as to affect the integrity of the services of such officer or employee, or (b) on the basis of standards to be established in such rules or regulations, the financial interest is too remote or too inconsequential to affect the integrity of such services. Such rules and regulations may also prohibit, or establish appropriate limits upon, the ownership by such officer or employee, or member of his immediate family, of securities of any firm or corporation doing a substantial volume of business with the Corporation.

ARTICLE VI

SHARES AND THEIR ISSUANCE AND TRANSFER

Section 6.01. Certificates for Shares.

(a) Shares of stock of the Corporation shall be represented by certificates for shares in such form, including the form of electronically-stored data, as the Board of Directors may from time to time prescribe. No certificate representing any share shall be issued initially to anyone except a qualified individual as defined by the Alaska GSOC Act. Each certificate representing shares of common stock shall state that the transfer of the shares represented thereby is subject to the provisions of the Alaska GSOC Act, the Articles of Incorporation, and the By-Laws of this Corporation. Shares of common stock shall be held in trust (escrow) for the account of each eligible individual for a period of five (5) years from initial issuance pursuant to the Alaska GSOC Act and for such additional period or periods of time as the Articles of Incorporation, By-Laws, or escrow and stock transfer regulations adopted pursuant to the By-Laws of the Corporation may provide. Certificates for shares of stock of the Corporation shall be numbered and registered in the order in which they shall be issued.

(b) A record shall be kept of the name of the person in which each certificate for shares of stock of the Corporation shall be issued, the number of shares represented thereby, the date thereof, and, in case of cancellation, the date of the cancellation thereof. A record shall also be kept of the declarations made as provided in Section 6.02 of these By-Laws by each person, in whose name a certificate for shares of common stock is issued.

(c) No certificate for shares of stock of the Corporation shall be valid unless it shall have been signed by the President or a Vice President and by the Secretary or an Assistant Secretary and shall have been impressed with the corporate seal; provided, however, that to the extent permitted by law, the signatures of such officers or any of them and such corporate seal may be facsimile, and such certificates may be in the form of stored electronic data.

Section 6.02. Declarations Required. No issue or transfer of shares of common stock shall be registered on the books of the Corporation, and no certificate for shares shall be issued, except after execution and delivery to the Corporation, by or on behalf of the person in whose name such shares are to be registered and in whose name the certificate for such shares is to be issued, of an application containing declarations, in such form as may be prescribed by rules or regulations of the Board of Directors, with reference to the limitations on ownership of shares set forth in Section 5.01 of the Articles of Incorporation and to the qualifications of persons to whom shares may be issued set forth in the Alaska GSOC Law, the Articles of Incorporation, or in the By-Laws or in the stock transfer regulations adopted pursuant thereto.

Section 6.03. Transfer of Stock. Except as otherwise provided by law, transfer of shares of stock of the Corporation shall be made on the books of the Corporation only by the holder thereof, or by his attorney thereunto authorized by a power of attorney duly executed and filed with the Secretary, and on surrender of the certificate or certificates, if issued, for such shares properly endorsed and the payment of all taxes on the transfer thereof. The Corporation shall have the right to treat the person whose name is registered upon its books as the holder of any shares of its stock as the absolute owner of such shares, and, except as otherwise provided in the By-Laws or in regulations duly adopted pursuant thereto, such person shall have the exclusive right to vote and to receive dividends thereon.

Section 6.04. Right of First Refusal by Corporation. As provided in Section 5.01 of the Articles of Incorporation, before any initial shareholder can sell or transfer his initial share(s) of common stock, during the first five (5) years after issuance, such initial shareholder shall first offer said share(s) to the Corporation and the Corporation may exercise its right of first refusal in the following manner: (a) The initial shareholder shall deliver a notice in writing by mail or otherwise to the Secretary of the Corporation stating his intention to sell or transfer such share(s). (b) Within thirty (30) days thereafter, the President or his delegate shall, subject to any limitations imposed by the Articles of Incorporation or by law, have the prior right to purchase such share(s) on the following terms and conditions: (i) Purchase will be at book value as determined by the Corporation's Independent Public Accountants as of the end of the quarter immediately preceding offer to sell or transfer either for cash or in installments over a period not to exceed five (5) years. (ii) Should the Corporation fail to purchase such share(s) at the expiration of the thirty (30) day period, or prior thereto decline to purchase such share(s), the shareholder may dispose of his share(s) to any person qualified as a resident as of the date of transfer to hold shares of the Corporation.

Section 6.05. Lost, Destroyed and Mutilated Certificates. The holder of any shares of stock of the Corporation shall immediately notify the Corporation of any loss, destruction or mutilation of the certificate therefor, and the Board of Directors may, in its discretion, cause a new certificate or certificates to be issued to him, upon the surrender of the mutilated certificate, or in the case of loss or destruction of the certificate, upon satisfactory proof of such loss or destruction, and the deposit of a bond, in such form and amount and with such sureties as the Board of Directors may require.

Section 6.06. Regulations. The Board of Directors may make such rules and regulations as it may deem expedient concerning the issue, escrow, transfer and registration of certificates for shares of stock of the Corporation. It may appoint one or more transfer agents and one or more registrars of transfers, and may require all certificates of stock to bear the signature of either a transfer agent or a registrar or both. The Corporation may act as its own transfer agent, and, through the internally established trust and escrow department or division, as the escrow holder or trustee for its own shares. It may not, however, act both as transfer agent and as registrar for its own shares.

Section 6.07. Closing Transfer Books - Fixing Record Date, Etc. Insofar as permitted by law, the Board of Directors shall have power to close the stock transfer books of the Corporation for a period not exceeding fifty (50) days preceding the date of any meeting of the shareholders, or the date fixed for the payment of any dividend or distribution, or the date for the allotment of rights, or the date when any change or conversion or exchange of shares will be made or go into effect. If the stock transfer books are so closed for the purpose of determining shareholders entitled to notice of or vote at a meeting of shareholders, such books shall be closed for at least ten (10) days immediately preceding the date of such meeting. If the stock transfer books are so closed for any purpose, written or printed notice of the closing shall be mailed at least ten (10) days before the closing to each shareholder of record of the Corporation at his address appearing on the records of the Corporation, or supplied by him to the Corporation for the purpose of notice. While the stock transfer books of the Corporation are closed, no transfer of shares shall be made thereon. In lieu of closing the stock transfer books as aforesaid, the Board of Directors may, in its discretion, fix a time, not more than fifty (50) days prior to the date of any meeting of shareholders or the date fixed for the payment of any dividend or distribution, or the date for the allotment of rights, or the date when any change or conversion or exchange of shares will be made or go into effect, and, in the case of a meeting of shareholders, not less than ten (10) days before the date of the meeting, as a record date for the determination of shareholders entitled to notice of, or to vote at any such meeting, or entitled to receive payment of any such dividend or distribu-

tion, or to receive any such allotment of rights, or to exercise the rights in respect of any such change, conversion or exchange of shares. If a record date shall be fixed as aforesaid, such persons as shall be shareholders of record on the date so fixed, and only such persons, shall be entitled to notice of, or to vote at, such meeting, or to receive payment of such dividend, or to receive such allotment of rights, or to exercise such rights, as the case may be, notwithstanding any transfer of any shares on the books of the Corporation after any record date so fixed as aforesaid. If the stock transfer books of the Corporation shall not be closed as herein provided and if a record date for the determination of shareholders entitled to receive notice of, or to vote at, any shareholders' meeting shall not be fixed as herein provided, the date on which notice of the meeting is given shall be in accordance with Section 2.05 of these By-Laws and shall be the record date for such determination.

Section 6.08. Corporate Records. The Corporation shall keep at its principal place of business (a) the original or a duplicate record of the proceedings of the shareholders and directors, (b) the original or a copy of its By-Laws, including all amendments or alterations thereto to date, certified by the Secretary, and (c) appropriate, correct and complete books and records of account. The Corporation shall keep at its principal place of business or at the registered office of the Corporation in _____, Alaska, the original or a duplicate share register of shares.

ARTICLE VII

SEAL

The Corporation shall have a corporate seal, which shall be in the form of a circle and shall bear the full name of the Corporation and the words and figures "Incorporated _____, Alaska", or words and figures of similar import.

ARTICLE VIII

INDEMNIFICATION

Section 8.01.

(a) The Corporation may indemnify each and every person against any and all expenses and liabilities incurred by him or imposed on him in connection with any claim, action, suit or proceeding (whether actual or threatened, brought by or in the right of the Corporation or otherwise, civil, criminal, administrative or investigative, including appeals) to which he may be or is made a party by reason of his being or having been a director, officer or employee of the Corporation, or at its request of any other corporation in which it owns shares of stock or of which it is a creditor; provided, however, that there shall be no indemnification (i) as to amounts paid in settlement or

other disposition of any threatened or pending action, or in satisfaction of a judgment rendered in an action, by or in the right of the Corporation or such other corporation, or (ii) as to matters in respect of which it shall be adjudged in such action, suit or proceeding that such person was liable for negligence or misconduct in the performance of his duty to the Corporation or such other corporation and, in the case of any criminal action or proceeding, that he had reasonable cause to believe that his conduct was unlawful.

(b) Any such person shall be entitled to indemnification as of right (i) if he has been wholly successful, on the merits or otherwise, with respect to any claim, action, suit or proceeding, or (ii) except as hereinabove provided, in respect of matters as to which the Board of Directors, acting by a quorum consisting of directors not parties to such claim, action, suit or proceeding, or a court or independent legal counsel shall have determined that he acted in good faith for a purpose which he reasonably believed to be in the best interests of the Corporation or such other corporation and, in addition, in the case of any criminal action or proceeding, had no reasonable cause to believe that his conduct was unlawful. The Board of Directors or such court or independent counsel shall have the power to determine that such person is entitled to indemnification as to some matters even though he is not so entitled as to others. The termination of any claim, action, suit or proceeding by judgment, settlement, conviction or upon a plea of nolo contendere or its equivalent, shall not in itself create a presumption that any such person did not act in good faith for a purpose which he reasonably believed to be in the best interests of the Corporation and, in the case of any criminal action or proceeding, that he had reasonable cause to believe that his conduct was unlawful.

(c) Amounts paid in indemnification of expenses and liabilities may include, but shall not be limited to, counsel fees and other fees, costs and disbursements, and judgments, fines or penalties against and amounts paid in settlement by such person. The Corporation may advance expenses to, or where appropriate may itself at its expense undertake the defense of, any such person; provided, however, that he shall have undertaken to repay or to reimburse such expenses if it should be ultimately determined that he is not entitled to indemnification under this Article.

(d) Payments of indemnification made pursuant to this Article shall be reported to the stockholders in the next proxy statement or otherwise, except that no such payments need be reported if such person has been wholly successful on the merits or otherwise.

(e) The provisions of this Article shall be applicable to claims, actions, suits or proceedings made or commenced after the adoption hereof, whether arising from acts or omissions to act occurring before or after the adoption hereof.

(f) The rights of indemnification provided for in this Article shall not be deemed to exclude any rights to which any such person may otherwise be entitled by any provision of law, Articles of Incorporation, By-Law, contract, vote of stockholders or otherwise; and all such rights shall enure to the benefit of the heirs, executors, administrators, or other legal representatives of such persons.

(g) If any part of this Article shall be found, in any action, suit or proceeding, to be invalid or ineffective, the validity and the effectiveness of the remaining parts shall not be affected.

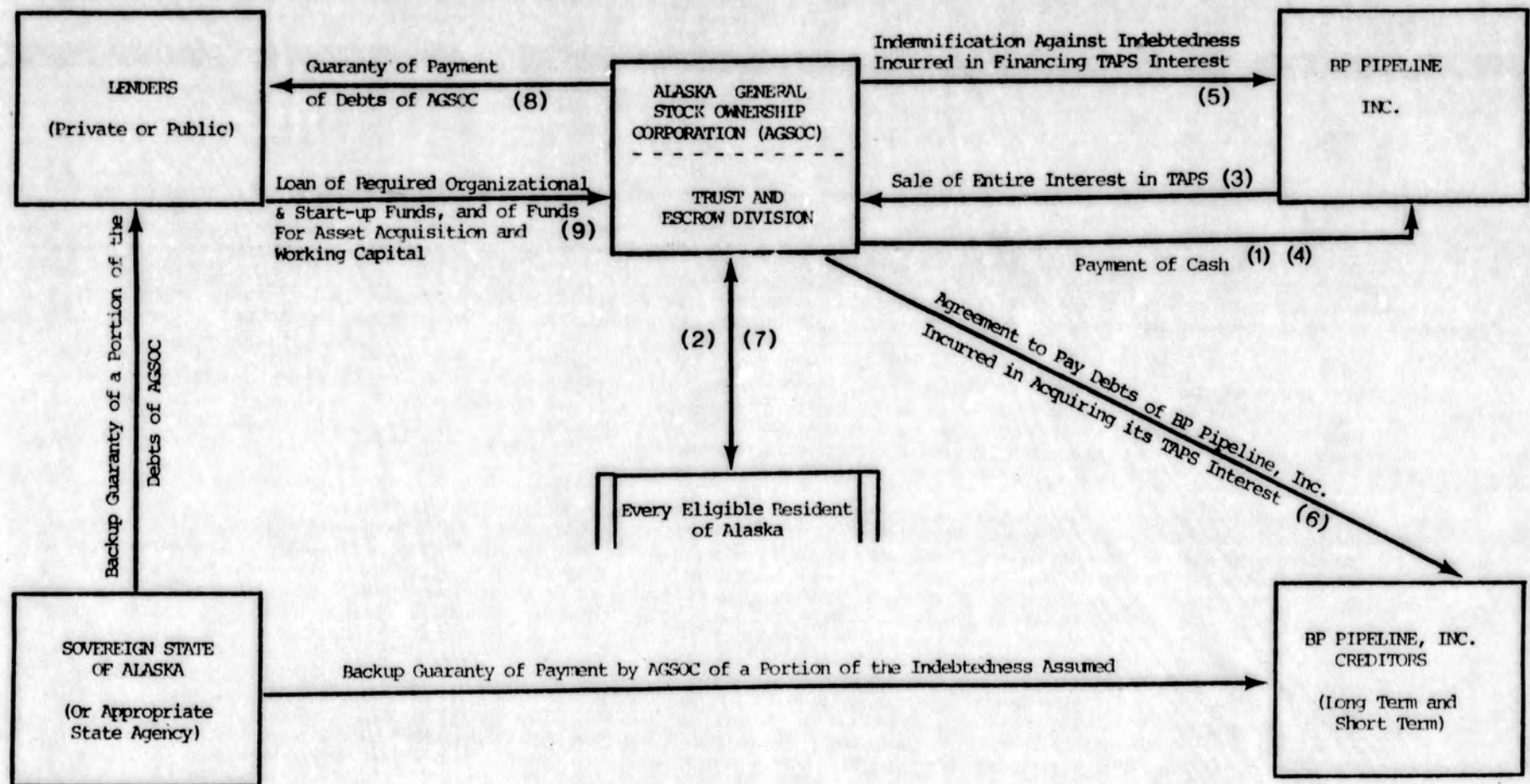
ARTICLE IX

AMENDMENTS

Any of these By-Laws may be altered, amended or repealed, and new By-Laws may be adopted, by the affirmative vote of a majority of the whole Board; provided that (a) such action may be taken only at a meeting of the Board called for such purpose; (b) the notice of such meeting shall state the substance of the By-Law to be made or repealed, or of the alteration or amendment; and (c) the notice of such meeting shall be mailed, telegraphed or delivered personally to each director, at least five (5) days before the date of which the meeting is to be held.

ILLUSTRATIVE DIAGRAM

ILLUSTRATIVE APPLICATION OF THE PURCHASE BY ALASKA GENERAL STOCK OWNERSHIP CORPORATION (AGSOC) OF A PARTICULAR ASSET, NAMELY THE INTEREST OF BP PIPELINE, INC. IN THE TRANS-ALASKA PIPELINE



(1) Payment by AGSOC of the cash initially required to close the transaction. This would provide AGSOC with the cash necessary to pay BP Pipeline, Inc. its cash requirement for the assets to be acquired by AGSOC and would enable AGSOC to retain necessary working capital.

(2) It is tentatively proposed that one share of the stock of AGSOC would be issued to the AGSOC TRUST AND ESCROW DIVISION for each eligible individual prior to its acquisition of any operating assets or anything of net asset value, so that the initial issuance in escrow would merely be the acquisition of a right of indefinite future value and thus not constitute an income taxable event to the shareholder. A U.S. Treasury ruling to this effect will doubtless be sought prior to the issue of stock. All shares issued by AGSOC would be held in escrows established for each individual resident as of the time of such purchase, as "resident" shall be defined by the State Legislature. As valuable assets are acquired by AGSOC, presumably the shares beneficially or directly owned by stockholders would acquire value. The term of the escrow would presumably be established by By-laws of AGSOC or by rules and regulations adopted pursuant thereto. The escrow of initially issued stock presumably would continue at least until expiration of the non-transferability period of five years established by Title VI of the Internal Revenue Code, and until the age of majority under Alaskan law (presently age 19) for under-age stockholders, and until compliance by the shareholders with reasonable rules and regulations of AGSOC covering release of the stock from escrow. While full details can only be developed by the Board of Directors of AGSOC, we presume that AGSOC could function to facilitate transfers of stock between individuals for stock ultimately released from escrow. It is, of course, a political question as to how qualified residents, for purposes of the plan, will be defined. The character of the Federal GSOC law is such that presumably AGSOC could operate much like a closed-end investment fund.

(3) This diagram is based upon the assumption that the entire interest of BP Pipeline, Inc. in TAPS will be purchased by AGSOC. There is also evidence that the seller would be willing to negotiate a sale of 12.5% interest in TAPS rather than 15.84%. Many considerations will enter into the Board of Director's decision whether to buy 12.5% or a greater amount. Among these considerations would be the relationship of the Alaskan oil interest to the resulting AGSOC carrier capacity, the economics of transporting for others, the resulting marketing problems for AGSOC, etc.

(4) The preliminary financial data suggest that the seller would sell its interest at a price that will make it whole, assuming that preferential rights of other TAPS owners are not exercised. Presumably this figure would be adjusted, depending upon negotiations and upon the closing date.

(5) AGSOC under this financial design, would agree to hold the seller harmless from liability for any of the presently outstanding debt of \$1.212 billion.

(6) AGSOC would assume the obligation to pay the debts outstanding of the seller incurred in connection with the seller's acquisition of its interest in TAPS.

(7) These hatch-marks are intended to represent, in the aggregate, each of the qualified residents of the State of Alaska whose eligibility would be defined by the Alaska General Stock Ownership enabling law. Each resident would have an individual escrow account in the escrow facility built in AGSOC by its enabling legislation and By-laws. It should not be an objection to the plan as a whole that the purchase of a single asset, although a substantial one, or even of several substantial assets for a defined body of qualified residents, does not solve all of the economic problems of everyone (in the State of Alaska) forever.

(8) AGSOC would directly guarantee the repayment to lenders of funds loaned to AGSOC initially and from time to time.

(9) The lenders would initially loan AGSOC the cash required for organization, staffing and start-up of operations, as well as funds for the acquisition of operating assets and initial working capital. This illustration assumes the making of guaranties, within the limitations set forth in the Alaska GSOC law and in other applical law pledging the general credit of the State of Alaska, and thus a minimum interest rate should be available. While the guarantee by the State of Alaska of up to twenty-five percent (25%) of the funding, upon proper vote of the citizen shareholders, is contemplated by this proposal, the general credit of AGSOC would, of course, stand behind the entire debt.

#32:20

SCOMM

INVESTMENT OPPORTUNITIES FOR AN
ALASKAN
GENERAL STOCK OWNERSHIP COMPANY

A REPORT TO THE ALASKA STATE LEGISLATURE.

PRINCIPAL RESEARCHERS:

JOHN A. MISKIMEN
G. STEPHEN JIZMAGIAN
ERIC M. BRAMSTEDT

KELSO & CO., INCORPORATED
SAN FRANCISCO, CALIFORNIA

415-788-7454

FEBRUARY 1, 1980

212-742-5000

"this is crap" 2-20-80/11:45

Sam is also
disappointed with
this report as
is Gary Gauche

212-285-5652

Bob Gerard of Dillon
Read investment Bankers
would do free work on this as would
other invest. Bankers
E.F. Hutton, Smith Barney

Gauche →

Jim Lopp

Sam 3-26 to 4-7
available

change

TABLE OF CONTENTS

<u>Chapter</u>		<u>Page</u>
One	Overview of the Economy.....	1
Two	The Major Sectors.....	5
Three	TransXAlaska Pipeline System.....	8
Four	Alaskan Gas Pipeline.....	32
Five	Transportation.....	34
Six	Fisheries.....	42
Seven	Leasing.....	47
Eight	Sources and Costs of Capital Funds.....	51
Nine	Investment Policy.....	59
Ten	Conclusion.....	63
Appendix A -- A Case Study -- British Columbia Resources Investment Corporation.....		64
Appendix B -- Federal Enabling Law.....		68

CHAPTER ONE

OVERVIEW OF THE ECONOMY

Alaska is a state of nearly 600,000 square miles, having an area of approximately 20% of the continental United States. Some two-thirds of the population of 400,000+ is concentrated in cities of Anchorage, Fairbanks and Juneau. Potentially, the Alaskan economy could develop rapidly in future years. A much greater population can theoretically be supported at high living standards as the State's resources are more fully utilized.

Available land resources are large in relation to the population. Production of large exportable surpluses of primary products has traditionally been a feature of the economy. Exports of crude petroleum, fish and other marine products, and forest products provide the greater part of Alaska's overseas earnings.

Overseas influences can therefore have an important bearing on some aspects of the Alaskan economy. Substantial variation in world prices of primary products, for example, can have a significant effect not only on the level of internal income, but also on Alaska's ability to finance imports.

The expansion of secondary industry in Alaska would reduce the influence of external conditions on the economy. The importance of a better balance in the economy was also demonstrated by the problems that developed with the completion of TransAlaska Pipeline System (TAPS).

Population and Work Force

During the years since statehood, Alaska's population growth has been, on the whole, relatively rapid. The period since 1959 has just about doubled the population. Natural increase above the national average was generally responsible for the growth, except for the heavy in-migration during the pipeline period. The impact of immigration

Mike
Change
TYP0

has been greater than is indicated by the contribution to total numbers. The in-migration of young adults has helped reduce the average age to well below the national average. Less than 3% of Alaska's population is older than 65. This change in the age structure of the population results in a more rapid growth of the total work force and very high participation rates.

The size of the labor force has a seasonal pattern, with summer employment approximately 10% above the annual average, and winter well below the average. A significant number of the additional summer workers are temporaries from the lower 48. Seasonality has been declining steadily in recent years.

Employment and Markets

Even adjusting for the distortion produced by the trans-Alaska pipeline, civilian employment has been growing in Alaska well above the expansion of population. The government sector continues to be the largest employer, but has declined from 40% of non-agricultural wage-and-salary employment in 1960 to an estimated 33% in 1979.

The growth of the population and work force has been associated with an expansion in the market demand for goods and services of almost every kind. Apart from increase in prices, two factors have operated to raise expenditure on goods and services -- the above average growth in population, and an increase in average real incomes. The growth in total expenditure on goods and services has meant that economies of larger scale operation have become more rapidly available to existing businesses, and, in addition, it has made possible the establishment of new businesses for which the market was previously too small.

There is every reason to believe that opportunities for expansion into new industries and new products will continue to offer themselves as the population increases. Furthermore, the increasing diversification of the industrial and service structure inevitably fosters further expansion. Newly established industries create demands for

supplies of parts and materials. In other fields, the establishment of one industry may result in raw materials becoming available for the establishment of others. Instances of this are the Alpetco refinery in Valdez and the Pacific Alaska LNG plant in Nikiski.

Similarly the expansion of the economy makes possible the provision of services which would be impractical in a smaller market. Replacement of mail order facilities with full service stores have developed extensively in this way, while the establishment of Alaska offices where previously served from the lower 48 reflects the growth in the financial structure of the economy.

Employment is often cyclical in Alaska. Construction of the oil pipeline increased total employment by perhaps 60,000 over three years. The completion produced a substantial decrease in employment as can be seen in the table below.

Non-Agricultural Wage & Salary Employment

	<u>Annual Average 1976</u>	<u>% of Total</u>	<u>Annual Average 1979 Est.</u>	<u>% of Total</u>
Mining	3,965	2.3	5,519	3.4
Contract Construction	30,233	17.4	10,510	6.4
Manufacturing	10,331	6.0	11,189	6.8
Trans., Communications & Public Utilities	15,704	9.1	16,445	10.0
Wholesale Trade	6,098	3.5	5,678	3.5
Retail Trade	21,466	12.4	23,541	14.3
Finance, Insurance & Real Estate	7,102	4.1	8,039	4.9
Services	27,633	15.9	27,803	16.9
Government	49,670	28.6	54,424	33.2
Miscellaneous	1,297	.7	957	.6
Total	173,499	100.0	164,107	100.0

Source: The Alaska Economic Information and Reporting System, Quarterly Report, October 1979.

Those large projects with a large construction component will probably continue to produce substantial swings in total employment. Because of in-migration of temporary

Change

residents for construction jobs and a larger economic and employment base, future projects should not have as dramatic an impact as TAPS.

Availability of Labor

The availability of labor, both generally and in particular categories, and the terms and conditions that govern employment are of critical interest to businessmen and others contemplating investment.

At the end of 1979 the Alaskan work force numbered about 165,000, or about 40% of the population. Only one out of fifteen workers in Alaska is engaged in manufacturing while three out of every ten work for state, federal or local government. Although comparisons are not altogether reliable, the industrial composition of the Alaskan work force is now broadly comparable with the rest of the United States except for manufacturing where one out of four workers in the lower 48 are engaged in some form of manufacturing activity.

Wages paid are considerably higher than average wages for the United States as a whole, as is the cost of living. Average wages (excluding construction) adjusted for the cost of living difference in terms of consumer buying power, is only moderately above the figures from California, Oregon and Washington.

Prevailing wage rates in Alaska will be an adverse factor to any industry which requires large amounts of labor, unless offset by other advantages. The small employment base is also an inhibiting factor because of the shortage of specialized skills needed for many new businesses.

Change

CHAPTER TWO

THE MAJOR SECTORS

This chapter presents summaries of our views on Alaska's principal economic sectors not covered separately. For some sectors, our conclusions on possible AGSOC participation are preliminary and should be studied in depth by AGSOC's management over a period of time. Also, times do change and what is appropriate or desirable today may be altered in a relatively short period of years.

Forest Products

Although a major industry in Alaska, forest products may not be significant to AGSOC. This is not due so much from a lack of investment potential, but from the effectiveness of private enterprise, and the plans of the village and native corporations. These groups may have preempted the field although some joint ventures could be possible.

Finance, Insurance and Real Estate

The fastest growing major segment of the State's economy seems well served by existing institutions and generally is not capital intensive.

Wholesale and Retail Trade

Traditionally, the second largest employer is the State with growth reflecting population expansion, higher personal incomes and inflation. Potential exists for AGSOC leasing activities, but direct investment is unlikely.

Mining

The mining and processing of minerals has been a declining sector of the Alaskan economy in postwar years since 1946. This is in the face of very substantial mineral resources. Alaska contains large reserves of copper, coal, iron ore, molybdenum,

change

uranium, nickel, mercury, limestone and others. Overall, these resources provide a broad basis for an expanding minerals activity within the State.

Because of the size of the State, many areas have, as yet, received little detailed attention. However, as new discoveries are unlikely to be fortuitous — unlike most of those made in the past — success with probably call for the outlay of considerable sums, both for prospecting and exploration, as well as for development to the production stage. In the past, out-of-state capital has played an important role in mineral development and there is good reason to suppose that this will be true of the future also. Mining costs in Alaska are higher than those in the lower 48, largely because of the remote location of many deposits, high labor and transportation costs.

Higher world prices for many minerals, particularly in the last 18 months, will probably stimulate renewed exploration in Alaska. A doubling of prices relative to expenses obviously does wonders for anticipated profit margins and return on investment calculations.

We anticipate that AGSOC will find a number of investment or leasing opportunities in the minerals area. Some of the more promising appear to be:

Iron ore reduction or pelletizing plants.

Additional mine-mouth electric generating facilities at Nanana coalfield.

Copper smelting.

Transportation facilities, including coal railroad cars for Beluga coalfield.

Electric generating facilities for a number of reduction or smelting plants currently under consideration.

Tourism

Even with a lack of sufficient accommodations and transportation to many areas, the number of tourists to Alaska is growing at an above average rate. Visitor-related activities already employ an estimated 8,000 people within the State. The State

Division of Tourism estimates that the number of tourists per year will expand at a 13% compounded annual rate over the next ten years. Because of higher costs, tourist expenditures could reach \$500 million annually by 1990, compared with \$100 million as recently as 1976.

In order to make Alaska more attractive as a tourist destination, infrastructure facilities will need to be expanded. This should include construction of additional tourist accommodations, construction of access roads and further development of recreation facilities in remote areas. In order to reduce seasonality, additional ski areas would seem desirable.

We are unclear as to AGSOC's exact participation within the industry. Investment opportunities will undoubtedly develop and should be analyzed on a case-by-case basis.

Utilities and Communications

In Alaska, this area is far more heavily government owned and operated than in the lower 48. Employment is about 5,000 state-wide and the various activities consume large amounts of capital. We believe AGSOC participation will probably be centered in the leasing of specialized electric generating equipment covered in other chapters, and not as a prime operator of utility or communication systems.

change

CHAPTER THREE

~~TRANS~~ALASKA PIPELINE SYSTEM

In the last year and a half, there has been much discussion and publicity of an AGSOC purchase of British Petroleum's interest in TAPS. Because of its large size in relation to the Alaskan economy, careful consideration must be given to TAPS as a potential investment opportunity. Various pipeline owners in TAPS have expressed publicly or privately that they would be willing to sell their interests. Although no sales or transfers have been made, some smaller owners have declined to participate in current TAPS expansion programs.

BP's interest in TAPS is valued at \$1.2 to \$1.5 billion depending on certain assumptions used in the valuation. Most of BP's investment is debt financed, since their current debt level is about \$1 billion.

The British Petroleum Company Limited transferred its leases on the North Slope to Standard Oil of Ohio in January of 1970. BP then invested in the Alaska Pipeline because Sohio was under financial pressures and could not handle its full share of the first expansion. Since BP now had substantial ownership of Sohio, BP worked out a partnership basis with Sohio to fund expansion of the pipeline.

BP Company Ltd. established BP Pipelines, Inc. as the vehicle to hold their assets in TAPS. BP Pipelines, Inc. and Sohio Pipelines Company then entered into a partnership for financing of their respective shares in TAPS.

BP Pipelines, Inc. is headquartered in San Francisco and holds the assets of the pipeline as its only operating asset. As a common carrier, the company is subject to FERC regulation. Direct operating expense is over \$6 million per year. About one third of direct expense is fuel to run pump stations, another third are costs associated with rate hearings, and over \$1 million is insurance on the pipeline assets. The remainder of

the operation can operate at a budget of less than \$1 million per year.

AGSOC, were it to replace BP Pipelines, would incur the same expenses with adjustments for its level of participation in rate hearings and shareholder record keeping and reporting expense.

BP Financial Projections

1D, 1B, 2A, 2B, 3A+3B
The analysis summarized in Tables ~~1, 2, and 3~~, show potential projections for BP Pipelines interest in TAPS. *(1C, 1D, 2C, 2D, 3C+3D show similar situation for AGSOC ownership)* A key assumption used in this analysis is a 1.2 million barrels per day capacity for TAPS. Analysis was made at three tariffs. The FERC set tariff of \$4.68 per barrel, the sought tariff at \$6.35, and a mid-range tariff at \$5.50. Depreciation schedules used for tax and reporting purposes are those schedules used by BP Pipelines in its FERC hearings report. The principal payments and amortizations are shown on the schedule in Table 4. *? Table 6 @ 10%* The interest rate used for purposes of this review is the 9.4% interest rate, which is the imbedded interest rate on the total loans outstanding for BP Pipelines. The dismantling, direct expense, and Alyeska expense used are those figures which factor in the 1978 reported figures and 1979 Alyeska's optimistic budget. A tax rate of 50% was applied, ignoring tax loss carry forwards or investment tax credits. *rates set for annual Corporate 650c*

The results of this analysis demonstrates that under a low tariff, (i.e., \$4.68) net before taxes will be approximately \$60 million per year for BP Pipelines. This profit will reduce yearly until a tariff increase or a capacity expansion occurs. Income taxes may take up to half of that \$60 million pre-tax figure, especially after use of loss carry forwards and investment tax credits.

A mid-range tariff of \$5.50 produces higher profits, approximately \$100 to \$120 million, decreasing thereafter.

A \$6.35 tariff will produce revenues of over \$400 million which are currently the revenues used in the 1978 and 1979 BP Pipeline reports. Net before tax income would be in excess of \$150 million and cash flow would be higher, depending upon tax

?

~~consequences.~~ However, cash flow declines after 1979 due to the buildup in principal payments. When, and if, FERC sets a lower tariff, the revenues will also decrease with corresponding decreases in cash flow and pre-tax net.

Added P on NGSOC, Tables 1, 2, 3 - Distribution

Table 1A

HP PIPELINES									
NET INCOME									
(\$000)									
YEAR	DELIVERY VOLUMES (000,000)	TARIFF	REVENUES	OPERATING EXPENSES	INTEREST	DEPRECIATION AND AMORTIZATION	INCOME TAX	NET INCOME	RETURN ON INVESTMENT
1979	64062	5	299810	74000	104735	61580	29748	29747	59405
1980	64062	4.68	299810	79100	104735	61580	27158	27157	54315
1981	64062	4.68	299810	84723	102347	61580	25580	25580	51160
1982	64062	4.68	299810	90654	97647	61580	24965	24964	
1983	64062	4.68	299810	96999	92938	61580	24147	24146	
1984	64062	4.68	299810	103788	80671	61580	26886	26885	
1985	64062	4.68	299810	111053	75961	61580	25608	25608	
1986	64062	4.68	299810	118827	70961	61580	24221	24221	
1987	64062	4.68	299810	127145	65950	61580	22568	22567	
1988	64062	4.68	299810	136045	60950	61580	20618	20617	
1989	64062	4.68	299810	145568	55939	61580	18362	18361	
1990	64062	4.68	299810	155758	50939	61580	15767	15766	
1991	64062	4.68	299810	166661	45928	61580	12821	12820	
1992	64062	4.68	299810	178327	40918	61580	9493	9492	
1993	64062	4.68	299810	190810	35908	61580	5756	5756	
1994	64062	4.68	299810	204167	32289	61580	887	887	
1995	64062	4.68	299810	218458	30080	61580	-5153	-5155	
1996	64062	4.68	299810	233750	27871	61580	-11695	-11696	
1997	64062	4.68	299810	250112	25662	61580	-18771	-18773	
1998	64062	4.68	299810	267620	23453	61580	-26421	-26422	
1999	64062	4.68	299810	286354	21366	61580	-34744	-34746	
2000	64062	4.68	299810	306399	20154	61580	-44161	-44162	
2001	64062	4.68	299810	327847	17616	61580	-53616	-53617	
2002	64062	4.68	299810	350797	16779	61580	-64672	-64674	

INTEREST RATE: 940 TAX RATE: 500 INFLATION RATE: 070

PIPELINE VALUE: 1114200

DEPRECIATION RATE: 000

AMORTIZATION: 1

ALYESIA EXPENSE: 60000

DIRECT EXPENSE: 6500

CASH FLOW

(0005)

YEAR	REVENUES	NET INCOME	DEPRECIATION AND AMORTIZATION	DISMANTLING RESERVE	PRINCIPAL PAYMENTS	NET CASH FLOW	CUMULATIVE CASH FLOW
1979	299810	55955.5	133.86	7500	98027	98027	98027
1980	299810	55955.5	133.86	7500	98027	98027	98027
1981	299810	55955.5	133.86	7500	98027	98027	98027
1982	299810	55955.5	133.86	7500	98027	98027	98027
1983	299810	55955.5	133.86	7500	98027	98027	98027
1984	299810	55955.5	133.86	7500	98027	98027	98027
1985	299810	55955.5	133.86	7500	98027	98027	98027
1986	299810	55955.5	133.86	7500	98027	98027	98027
1987	299810	55955.5	133.86	7500	98027	98027	98027
1988	299810	55955.5	133.86	7500	98027	98027	98027
1989	299810	55955.5	133.86	7500	98027	98027	98027
1990	299810	55955.5	133.86	7500	98027	98027	98027
1991	299810	55955.5	133.86	7500	98027	98027	98027
1992	299810	55955.5	133.86	7500	98027	98027	98027
1993	299810	55955.5	133.86	7500	98027	98027	98027
1994	299810	55955.5	133.86	7500	98027	98027	98027
1995	299810	55955.5	133.86	7500	98027	98027	98027
1996	299810	55955.5	133.86	7500	98027	98027	98027
1997	299810	55955.5	133.86	7500	98027	98027	98027
1998	299810	55955.5	133.86	7500	98027	98027	98027
1999	299810	55955.5	133.86	7500	98027	98027	98027
2000	299810	55955.5	133.86	7500	98027	98027	98027
2001	299810	55955.5	133.86	7500	98027	98027	98027
2002	299810	55955.5	133.86	7500	98027	98027	98027

Table 1B

INTEREST RATE:	940	TAX RATE:	500	INFLATION
~~FDL PENSION RATE: 000~~				
FDL PENSION VALUE:	1114200			
WAGE EXPENSE:	60000	DIRECT EXPENSE:		
		6500		

Table 2A

DP PIPELINES

NET INCOME

(\$000)

YEAR	DELIVERY VOLUME (000 BBL'S)	TARIFF	REVENUES	OPERATING EXPENSES	INTEREST	DEPRECIATION AND AMORTIZATION	INCOME TAX	NET INCOME	~~STANDARD COST INCOME~~
		\$	\$	\$	\$	\$	\$	\$	\$
1979	64062	5.50	352341	74000	104735	61580	56013	56013	
1980	64062	5.50	352341	79180	104735	61580	53423	53423	
1981	64062	5.50	352341	84723	102347	61580	51846	51845	
1982	64062	5.50	352341	90654	97647	61580	51230	51230	
1983	64062	5.50	352341	96999	92938	61580	50412	50412	
1984	64062	5.50	352341	103788	80671	61580	53151	53151	
1985	64062	5.50	352341	111053	75961	61580	51874	51873	
1986	64062	5.50	352341	118827	70961	61580	50487	50486	
1987	64062	5.50	352341	127145	65950	61580	48933	48933	
1988	64062	5.50	352341	136045	60950	61580	46883	46883	
1989	64062	5.50	352341	145568	55939	61580	44627	44627	
1990	64062	5.50	352341	155758	50939	61580	42032	42032	
1991	64062	5.50	352341	166661	45928	61580	39086	39086	
1992	64062	5.50	352341	178327	40918	61580	35758	35758	
1993	64062	5.50	352341	190810	35908	61580	32022	32021	
1994	64062	5.50	352341	204167	32289	61580	27153	27152	
1995	64062	5.50	352341	218458	30080	61580	21112	21111	
1996	64062	5.50	352341	233750	27871	61580	14570	14570	
1997	64062	5.50	352341	250112	25662	61580	7494	7493	
1998	64062	5.50	352341	267620	23453	61580	-155	-157	
1999	64062	5.50	352341	286354	21366	61580	-8479	-8480	
2000	64062	5.50	352341	306399	20154	61580	-17895	-17897	
2001	64062	5.50	352341	327847	17616	61580	-27350	-27352	
2002	64062	5.50	352341	350797	16779	61580	-38407	-38408	

INTEREST RATE: 940 TAX RATE: 500 INFLATION RATE: 070

PIPELINE VALUE: 1114200

~~POPULATION RATE: 000~~ ~~POPULATION:~~

ALYESKA EXPENSE: 60000

DIRECT EXPENSE: 6500

Added
Tabular
AG SEC
1C & 1D

Table 2B

BP PIPELINES

CASH FLOW

(\$000)

YEAR	REVENUES	NET INCOME	~~TOTAL DEPRECIATION AND AMORTIZATION~~	DEPRECIATION AND AMORTIZATION	DISHANTLING RESERVE	PRINCIPAL PAYMENTS	NET CASH FLOW	CUMULATIVE CASH FLOW
	\$	\$	\$	\$	\$	\$	\$	\$
1979	352341	56013	0	61580	7500	0	125093	125093
1980	352341	53423	0	61580	8025	25400	97628	222721
1981	352341	51845	0	61580	8587	50000	72012	294733
1982	352341	51230	0	61580	9188	50100	71890	366631
1983	352341	50412	0	61580	9831	130500	-8677	357954
1984	352341	53151	0	61580	10519	50100	75150	433104
1985	352341	51873	0	61580	11255	53200	71508	504612
1986	352341	50486	0	61580	12043	53300	70809	575421
1987	352341	48833	0	61580	12884	53200	70099	645520
1988	352341	46883	0	61580	13788	53300	68951	714471
1989	352341	44627	0	61580	14753	53200	67760	782231
1990	352341	42032	0	61580	15786	53300	66098	840329
1991	352341	39086	0	61580	16891	53300	64257	912586
1992	352341	35758	0	61580	18073	53300	62111	974697
1993	352341	32021	0	61580	19338	38500	74439	1049136
1994	352341	27152	0	61580	20692	23500	85924	1135060
1995	352341	21111	0	61580	22140	23500	81331	1216391
1996	352341	14570	0	61580	23690	23500	76340	1292731
1997	352341	7493	0	61580	25348	23500	70921	1363652
1998	352341	-157	0	61580	27122	22200	66345	1429997
1999	352341	-8480	0	61580	29021	12900	69221	1499218
2000	352341	-17897	0	61580	31052	27000	47735	1546953
2001	352341	-27352	0	61580	33226	8900	58554	1605507
2002	352341	-38408	0	61580	35552	8900	49824	1655331

INTEREST RATE: 940 TAX RATE: 500 INFLATION RATE: 070

PIPELINE VALUE: 1114200

ALYESKA EXPENSE: 60000

DIRECT EXPENSE: 6500

Added
new Tables
on ACSC
2C + 2D

Table 3A

BP PIPELINES

NET INCOME

(\$000)

YEAR	DELIVERY VOLUMES (000 BBL/S)	TARIFF	REVENUES	OPERATING EXPENSES	INTEREST	DEPRECIATION AND AMORTIZATION	INCOME TAX	NET INCOME	~~STOCKHOLDERS~~
		\$	\$	\$	\$	\$	\$	\$	
1979	64062	6.35	406794	74000	104735	61500	83240	83239	
1980	64062	6.35	406794	79180	104735	61500	80650	80649	
1981	64062	6.35	406794	84723	102347	61500	79072	79072	
1982	64062	6.35	406794	90654	97647	61500	78457	78456	
1983	64062	6.35	406794	96999	92938	61500	77639	77638	
1984	64062	6.35	406794	103788	80671	61500	80378	80377	
1985	64062	6.35	406794	111053	75961	61500	79100	79100	
1986	64062	6.35	406794	118827	70961	61500	77713	77713	
1987	64062	6.35	406794	127145	65950	61500	76060	76059	
1988	64062	6.35	406794	136045	60950	61500	74110	74109	
1989	64062	6.35	406794	145568	55939	61500	71854	71853	
1990	64062	6.35	406794	155758	50939	61500	69259	69258	
1991	64062	6.35	406794	166661	45928	61500	66313	66312	
1992	64062	6.35	406794	178327	40918	61500	62985	62984	
1993	64062	6.35	406794	190810	35908	61500	59248	59248	
1994	64062	6.35	406794	204167	32289	61500	54379	54379	
1995	64062	6.35	406794	218458	30080	61500	48338	48338	
1996	64062	6.35	406794	233750	27071	61500	41797	41796	
1997	64062	6.35	406794	250112	25662	61500	34720	34720	
1998	64062	6.35	406794	267620	23453	61500	27071	27070	
1999	64062	6.35	406794	286354	21366	61500	18747	18747	
2000	64062	6.35	406794	306399	20154	61500	9331	9330	
2001	64062	6.35	406794	327847	17616	61500	-124	-125	
2002	64062	6.35	406794	350797	16779	61500	-11180	-11182	

INTEREST RATE: 940 TAX RATE: 500 INFLATION RATE: 070

PIPELINE VALUE: 1114200 ~~POPULATION RATE: 300~~ ~~POPULATION: 1~~

ALYESKA EXPENSE: 60000 DIRECT EXPENSE: 6500

Table 3B

HP PIPELINES

CASH FLOW

(\$000)

YEAR	REVENUES	NET INCOME	DEPRECIATION AND AMORTIZATION	DISMANTLING RESERVE	PRINCIPAL PAYMENTS	NET CASH FLOW	CUMULATIVE CASH FLOW
1979	\$ 406,794	\$ 83,239	\$ 61,580	\$ 75,000	\$ 0	\$ 152,319	\$ 152,319
1980	406,794	80,649	61,580	80,225	25,400	124,854	277,173
1981	406,794	79,972	61,580	85,887	50,000	99,239	376,412
1982	406,794	78,456	61,580	91,888	50,100	99,124	475,536
1983	406,794	77,638	61,580	98,311	130,500	18,549	494,085
1984	406,794	80,377	61,580	105,119	50,100	102,376	596,461
1985	406,794	79,100	61,580	112,555	53,200	98,735	695,196
1986	406,794	77,713	61,580	120,433	53,200	98,036	793,232
1987	406,794	76,059	61,580	128,865	53,200	97,325	890,557
1988	406,794	74,109	61,580	137,888	53,300	96,177	986,734
1989	406,794	71,853	61,580	147,533	53,200	94,965	1,081,720
1990	406,794	69,258	61,580	157,864	53,300	93,324	1,175,044
1991	406,794	66,312	61,580	168,921	53,300	91,483	1,266,527
1992	406,794	62,904	61,580	180,733	53,300	89,337	1,355,864
1993	406,794	59,248	61,580	193,368	38,500	101,666	1,457,530
1994	406,794	54,379	61,580	206,922	23,500	113,151	1,570,681
1995	406,794	48,338	61,580	221,400	23,500	108,568	1,679,239
1996	406,794	41,796	61,580	236,900	23,500	103,566	1,782,805
1997	406,794	34,720	61,580	253,468	23,500	98,148	1,880,953
1998	406,794	27,070	61,580	271,222	22,200	93,572	1,974,525
1999	406,794	18,747	61,580	290,211	12,900	96,448	2,070,973
2000	406,794	9,330	61,580	310,522	27,000	74,962	2,145,935
2001	406,794	-125	61,580	332,226	8,900	85,781	2,231,716
2002	406,794	-11,182	61,580	355,552	8,900	77,050	2,308,766

INVESTMENT RATE: 9.40 TAX RATE: 500 INFLATION RATE: 0.70

PIPELINE VALUE: 1114200

ADDITIONAL EXPENSE: 60000 DIRECT EXPENSE: 6500

Add new
Table 1/1650e
3C+3D

TABLE 4
TRANS-ALASKA PIPELINE

FINANCE REPAYMENTS
(BP SHARE)

<u>DATE</u>	<u>\$m</u>
1979	0
1980	25.4
1981	50.0
1982	50.1
1983	130.5
1984	50.1
1985	53.2
1986	53.3
1987	53.2
1988	53.3
1989	53.2
1990	53.3
1991	53.3
1992	53.3
1993	38.5
1994	23.5
1995	23.5
1996	23.5
1997	23.5
1998	22.2
1999	12.9
2000	27.0
2001	8.9
2002	8.9
2003	8.9
2004	8.9
2005	8.9
2006	8.9
2007	134.0

BP Loan Agreements and Guarantees

BP Pipelines has three classes of loans outstanding, as summarized in Table 5. Each loan would be assumable in a transfer of interest in TAPS. However, BP would not be relieved as a guarantor without approval of a majority or all of the note-holders.

In essence, all of the note agreements use as security notes issued by BP Pipelines, Inc., and in turn those notes are secured by a guarantee or a note issued by BP LTD. Thus the security interest in the notes are not an interest in the pipeline per se, but are backed up by guaranteed notes from the pipelines' company and/or British Petroleum. ~~The TAPS owners are not allowed to assign their interest in relation to the TAPS agreement.~~

Public Indentures

Under the terms of both public indentures, the company to whom BP Pipelines sells or assigns its interest in TAPS may assume payments of the loans as of the original schedules on the indentures. However, such payments or assumptions would not eliminate British Petroleum, the obligor of the notes, without a comparable guarantor.

Any repayment schedules on these notes prior to normal redemption dates would have to be in the same proportions for both Standard Oil of Ohio and AGSOC. However, BP may be able to prepay their guarantee to the capital company without the capital company having to redeem any notes prior to the normal redemption schedule. If AGSOC or Standard Oil of Ohio wanted to prepay in different proportions, however, there would be a disproportionate amount due under the terms of the note for future debt outstanding. In all likelihood, the 1983 note with the 8-5/8% interest would not be prepaid prior to redemption date unless the AGSOC were to pay cash for the sale.

The 8-5/8% indenture requires a principal payment in 1983 for BP of \$80.5 million. In any other year the payment schedule for all notes outstanding have total principal payments of \$53 million or less except for the year 1983 and the year 2007.

*how would this effect
AGSOC cash flow?*

Thus, in summary as regards the 1983 Public issue, AGSOC could either pay cash for the system and finance it through debt or assume payments of this indenture with the principal due in 1983.

On a cash sale for TAPS, a section of the Note Agreement states that the net proceeds of the sale (for at least fair value as determined by the Board of BP Pipelines) be applied in an amount in cash equal to the proceeds of such sale, to the retirement of the guaranteed note.

How does all of this relate to its relative significance to the states economy and that of a maximum return to stockholders? also how might AGSOC expect FERC to react to AGSOC's unique tax status in establishing a rate and the impact of such on return to stockholders?

Thus, in summary as regards the 1983 Public issue, AGSOC could either pay cash for the system and finance it through debt or assume payments of this indenture with the principal due in 1983.

On a cash sale for TAPS, a section of the Note Agreement states that the net proceeds of the sale (for at least fair value as determined by the Board of BP Pipelines) be applied in an amount in cash equal to the proceeds of such sale to the retirement of the guaranteed note.

How does all of this relate to its relative significance to the state's economy and that of a maximum return to stockholders? also how might AGSOC expect FERC to react to AGSOC's unique tax status in establishing a rate and the impact of such on return to stockholders?

TABLE 5

BP PIPELINE NOTES

Principal Amounts

		<i>Principal</i> \$MM
PUBLIC ISSUE	9-3/4% DUE 1999	80.5
PUBLIC ISSUE	8-5/8% DUE 1983	80.5
PRIVATE PLACEMENT	10-5/8% DUE 1993	262.6
PRIVATE PLACEMENT	10-5/8% DUE 1998	300.9
PRIVATE PLACEMENT	9-3/4% DUE 1993	116.8
PRIVATE PLACEMENT	9-3/4% DUE 1998	44.1
VALDEZ BONDS	6 % DUE 2007	112.7
VALDEZ BONDS	6.05 % DUE 2007	<u>101.4</u>
	TOTAL	\$1,099.6

Public Issue Debenture Due 1999

Under the terms of this note and the other public issue, in order to separate Sohio and BP in the prepayment schedules and obligations, a 66-2/3% majority of the holders of the notes must have approved such changes. No such changes would extend the maturity or reduce the interest rate. Otherwise, redemptions for Sohio and BP would have to be made in the same proportions and at the same time. The normal redemption schedules on these notes begin in June 1980 and increase by approximately \$3 million in 1985, continuing until 1999. The earlier principal amounts are approximately \$1 million for the BP share. In the BP Pipelines note purchase agreement on this public issue, BP Pipelines would be able to transfer property under a sale, provided that the successor corporation observe all the terms and covenants of the indenture, or BP may receive as of the previous note the net proceeds of the sale at the fair value of the sale and such proceeds be applied to retirements of the note or held for such.

Since these notes are higher interest (9-3/4%) than the previous notes and have due dates ranging from 1980 to 1999, there may be an advantage for the AGSOC to pay this portion in cash directly to BP, rather than assume the obligations of the note. The benefits would be substantial under the terms when AGSOC could borrow at a lower interest rate and possibly a longer payback period.

The major problem with remaining under the terms of the note would be in the event that Sohio or AGSOC wanted a different repayment schedule than that provided for under the note indenture. Such a modification would require a 66-2/3% majority vote of the bond holders. This may not be an impossible task.

Valdez, Series A Bonds

The Valdez Series A bonds are 6% municipal bonds with a total principal amount of \$112.7 million for BP's share. The final due date for these bonds is the year 2007; however, mandatory sinking fund redemptions commence on July 1, 1998 up through 2006

of approximately \$5 million per year. The remainder will be due in the year 2007.

These bonds are based on a lease and sublease basis and are revenue bonds. Leases are from the Lessor BP Pipelines, Inc. to the City of Valdez and a sublease in return from the City of Valdez to BP Pipelines, Inc. Under the terms of the sublease agreement, the Lessor or BP Pipelines may sell its assets providing that the receiving corporation is an Alaskan corporation and unconditionally assumes the due and punctual performance of the obligations under the lease and sublease agreement. At that point the Lessor will have no further obligations under the lease. The subrents under the lease back to BP Pipelines is 32.2% of principal premium or interest on the total revenue bonds and related expenses.

The BP guarantee on the Valdez bonds is an unconditional guarantee for full payment of 32.2% of the principal and premium and interest when due. However, there is no cross guarantee from BP on any default on the Sohio guarantee. Contrary to other bonds and notes, it does not appear that BP has to redeem in the same proportion in prepayments as Sohio in terms of their respective 68/32% ratio. Thus if BP were to prepay or redeem at a quicker rate, they would, in effect, receive credit for their share of the prepayments and not be required to cross pay any of Sohio's notes when due. It also appears that a sale of the assets of the pipeline does not release British Petroleum under the guarantee agreement.

Under the redemption or prepayment clauses, the redemption price has a penalty of 3% in 1987 and 1988 going down to 1/2 of 1% in 1993.

Redemption is at principal amount after 1993. Any proposed change in the guarantee agreement as it would affect the elimination of BP or Sohio would require the consent of 100% of the bond holders.

Valdez Series B Bonds

The Valdez Series B bonds are 6.05% revenue bonds due the year 2007 and are again

governed by a lease/sublease agreement between the City of Valdez and BP Pipelines and the guarantee agreement by British Petroleum Company Limited. The terms are similar to the Series A bonds with no cross guarantee by Sohio or BP for the other share, and prepayments again treated separately and credited to each subleasee's account. If BP Pipelines were to sell its interest in TAPS assets, then BP Pipelines, Inc. would be relieved from obligations under the lease/sublease agreements. However, the BP guarantee, as in the Series A, bonds is not affected by any sale or disposition of assets. Thus BP would always remain as the guarantor. The mandatory sinking fund redemptions of the Series B bonds begin in 1998 and ends in 2006, at an amount approximately \$4 million per year. Prepayment penalties start with a 3% penalty in 1987/1988, going down to 1/2 of 1% in 1992, and at principal amount after 1993. The balance would be due in the year 2007. The amount of these bonds for BP Pipelines is \$101.4 million.

Private Placement Issue

The first private placement issues were 10-5/8% notes due January 1993 and 1998 for a total BP share of \$563.5 million. Mandatory repayments are 1.96% quarterly or approximately 8% yearly of the 1993 notes and 1.41% quarterly or slightly over 5-1/2% annually for the 1998 notes. These repayments begin in 1980. Beginning in 1987, BP and Sohio, if they jointly agree to do so, may double the above percentages. Otherwise, there is a prepayment premium beginning in 1987 ranging from 3-1/2%, reducing annually to zero in 1992 for the 1993 notes, and 3-1/2% reducing annually to zero in 1995 for the 1998 notes.

Under the agreement, BP Pipelines may sell its assets to AGSOC providing that AGSOC assumes all of the BP Pipelines' obligations. However, no sale can be made if the book value of BP Pipelines' share in TAPS becomes less than \$855 million or the through-put capacity becomes less than 142,560 barrels per day. This restriction is equivalent to a through-put capacity of less than 900,000 barrels per day for the total TAPS system.

Any sale must be for cash and must conform to the TAPS amended agreements. The notes at the 10-5/8% interest rate are \$262,591,000 for the 1993 notes and \$300,909,000 for the 1998 notes. The prepayments, therefore, on the 1993 notes are approximately \$17 million per year. The option of doubling these prepayments only upon agreement with Sohio would, in effect, double those above values.

An alternative to the sale for cash is a sale for or to a corporation whose only assets are the interest in TAPS.

That corporation would be bound by the terms and conditions of the private placement note agreement. BP's guarantee is unconditional and would not be affected by sale to AGSOC. According to the note agreement, BP will not permit any sale of stock in BP Pipelines except to BP or a wholly-owned subsidiary of BP.

The guarantees are not cross guarantees and BP is not responsible for Sohio's debt under the terms of these agreements.

The terms and agreements of the 9-3/4% notes are similar to the 10-5/8% notes. The 1993 notes carry a prepayment schedule of approximately \$9 million per year. The total of these notes is \$116,886,000. For the 1998 notes (principal amount \$44,114,000), the prepayments would amount to approximately \$2-1/2 million per year. The option to double these prepayments would require the consent of Sohio to double theirs in an equal and proportionate share. Other than those changes, the note agreements are similar to the 10-5/8% interest notes.

AGSOC Investment in TAPS

? The major issues at stake in the projections of AGSOC interest in TAPS are the rate hearings at FERC and valuating and financing of ownership. One of the major risks in buying part of TAPS is the actual tariff to be set by FERC. A low tariff would make operations marginally profitable.

The expected methodology for setting the tariff is to set a valuation for the

why not
shown in
Tables 1, 2 & 3

Make Change

pipeline and thereby for each owner's share, and to apply a rate of return on that valuation. The tariff calculation would entail adding the rate of return in dollars to the operating costs to arrive at revenue needed. A tariff is then set. The first phase hearings will set a valuation formula, which in all likelihood will be the actual cost of the pipeline. There may be some other factors entering into the cost values, such as interest used during construction. There probably will not be an allowance for return on equity during construction. The actual percentage rate of return can range from 9 to 20%.

One of the assumptions in the financial analysis used in this report is that the tariff does not decrease in the future at constant capacity. This will most likely be the case, since operating expenses will increase with inflationary pressures probably at least at a rate of 7% per year. Although the value of the pipeline may be reduced due to depreciation, the result of a decreased in valuation should not be as large as the increase in inflationary pressures on the operating expenses of the system. Thus, the tariff need not be reduced through a constant formula imposed by FERC. As capacity expands, a lower tariff may produce the same rate of return. However, there may be requirements for an increase in the tariff if through-put drops in the future.

One of the major issues at the FERC hearings is whether or not the actual cost on the books for constructing TAPS is, and should be, included in the valuation of the pipeline. The factor for not including all historic costs would be mismanagement during construction. Phase II of the hearings will address this issue, and might possibly result in a reduction in valuation due to the unwarranted increase in costs.

Although current rates are in effect at the operator's requested levels, there is the possibility that carriers would have to refund revenues if permanent rates are set by FERC at a level lower than the current rates.

 The most critical inputs to the financial projections for AGSOC are valuation of purchase price, tariff rate, and interest rate. Other inputs such as inflation rate,

0

operating expenses, Alyeska or indirect, have a much smaller effect on the overall viability of an AGSOC investment.

The most critical factor in the feasibility of a TAPS investment is the tariff rate selected by the FERC hearings. A 2% change in tariff rate would cause at least a 10% change in dividends to shareholders and a 50% change in available cash flow at the end of a 20-year period.

At this stage AGSOC would have little effect in influencing the tariff to be selected by FERC at the hearings.

There are two possibilities in this regard. One is to become an interested party in the current hearings since (a) AGSOC is identified as a possible investor in TAPS, and (b) AGSOC's tax structure as it regards federal income taxes would be significantly different than the other TAPS owners. An initial reading from FERC would eliminate the uncertainty. The second possibility would be for a full hearing on the valuation of the purchase price between AGSOC and BP to be held after the tariff rate has been decided by the FERC hearings. An estimate on when a tariff might be approved is mid 1980.

The second most critical variable in financial projections for AGSOC is the purchase price of an interest in the pipeline. A 2% reduction in purchase price would amount to a greater than 5% change in dividends to shareholders and approximately a ^{quarter point} ~~200%~~ difference in cash flow at the end of a 20-year period. For comparison purposes, a ^{very easy to get 3% change if re-capitalized fully} 3% change in the interest rate would result in a change in the shareholder dividends and net cash flow approximately equal to a 2% change in purchase price. For example, a \$20 million change in the purchase price would have approximately the same effect as a 1/4 of 1% change in the interest rate on the debt for a 100% debt-financed purchase. Contrary to the influence AGSOC may have on a finally set tariff rate, AGSOC will have a great deal to say on the purchase price and a significant amount of influence on the interest rate for new debt.

? return to stockholders

Other variables which affect the financial projections are a decrease in Alyeska operating expenses. A 1% decrease in expense would produce approximately a 1% change in shareholder dividends and a slightly higher change in cash flow. The real problems with the expense side of the picture is that inflation would seriously affect operating expenses in a 10-to 20-year period, and tariffs or revenues wouldn't increase as rapidly as operating costs in a heavy inflationary period. A change in the form of principal payments and/or depreciation schedules again has some affect on the overall financial projections for AGSOC, but these effects have not proved to be significant in relation to other variables.

A summary of financial project for AGSOC are shown in Table 6. The financial estimates for AGSOC have the following assumptions built into the income and cash flow projections: i) Under a 1.6 billion barrel per day capacity, delivery would be 85,429,000 barrels per year. ii) The operating expenses for AGSOC would be a sum of the Alyeska expenses at a 15.84% rate for the BP share, and direct expenses which were estimated to be equal to the estimated expense currently projected for BP Pipelines. (Note that the direct expenses for AGSOC staffing may be less than the staff expenses of BP Pipelines in terms of management and operations of AGSOC. However, the major expense which will impact AGSOC which is not incurred by BP Pipelines would be the administrative cost in shareholder reporting. Rough estimates of that cost would be approximately \$2.00 per shareholder on an annual basis, with extra cost for setting up the program and probably a more extensive annual reporting procedure. Thus the direct costs of AGSOC would be approximately equal to the present direct costs of BP Pipelines, assuming the TAPS investment is carrying all of the AGSOC's operating expenses.)

Interest is applied to year end balance after that year's principal payments have been deducted. The principal payments are assumed to be deducted at the end of the year. The depreciation and amortization would be on a straight line basis or an

⑦

accelerated basis, depending on the circumstances of the schedule. Income tax is assumed to be zero, presuming that AGSOC elects to be non-taxed and distributes 90% or more of income to the shareholders.

? max. return to stockholders

Added TP re: cash flow and dividend year and
alternatives for continued distributions etc.

TABLE 6

BP rate is
9.4% / page 9
?

<u>\$ Tariff</u>	<u>Pipeline Capacity MM b/d</u>	<u>AGSOC Purchase Price (\$000)</u>	<u>Imbedded Interest Rate</u>	<u>First Year Citizen Distribution Pre-Tax</u>	<u>Number of Years Income Stream</u>	<u>(\$000) Cash Balance 24 Years</u>
4.68	1.6	1,600,000	10%	155	14 yrs	-111,088
5.00	1.6	1,600,000	10%	216	16	158,504
5.00	1.6	1,500,000	10%	238	17	346,226
5.25	1.6	1,450,000	10%	335	21	612,585
5.50	1.6	1,600,000	10%	334	21	668,317
5.50	1.6	1,500,000	10%	366	22	699,443
5.50	1.6	1,600,000	7%	441	22	733,717
6.35	1.6	1,600,000	10%	496	24	898,341

?
what years?
?
total accumulated
negative

0

The citizens income is based upon a 90% distribution. This dividend would be prior to the income tax withholding. Note that a figure above \$133 would result in a net check to the shareholder for over \$100, after a 25% tax withholding rate. The principal payments would be deducted from the cash flow, leaving a yearly net cash flow and a cumulative cash flow for a 24 year period. *Added strategies for AGSOC re: negative cash flow*

? what is this with the neg. balance

Under an expanded capacity system, additional investment would be required in TAPS. Estimates in 1977 dollars indicate an investment of over \$650 million to increase capacity to 1.6 million b/d and over a billion to go to 2 million b/d. Thus, in 1980 dollars, the investment for a 15.84% share may range between \$100 to \$150 million, increasing with any delays. Our assumptions under this capacity show beginning full year flow in 1982. The AGSOC purchase price in Table 6 reflects the additional investment to increase capacity.

Under a \$4.68 tariff for the 1.6 million barrel per day capacity, a 15 year income stream with an individual shareholder distribution of about \$150 would occur with a \$1.6 billion valuation and a 10% imbedded interest cost (see Table 6). (However, at such a capacity, cash flow would cause serious problems if, in fact, capacity were to drop after the first 10 or 15 years.) At a \$5.00 tariff, and a value of 1.5 billion to 1.6 billion, shareholder distribution would range from \$200 to \$300, depending upon the interest rate. At this tariff, a 15 year income stream with steady volume flow in the pipeline would keep a positive cash flow throughout the 25-year period. However, if the flow were to drop below 1.6 billion barrels, there would be problems after a 10- or 15-year period.

At a \$6.35 tariff under the expanded capacity line, AGSOC could distribute between \$400 and \$500 for each shareholder for a number of years.

Current flow capacity has been raised to about 1.4 million barrels per day and shall approach 1.5 million barrels per day by the end of 1980. Most of the higher flow capacity

has been achieved through use of a special chemical additive, without construction of new pump stations, although new pump stations are being completed.

To date, only Arco, Exxon, and BP are participating in the capital expansions, and BP's share should increase to a 16.8% ownership of TAPS by the end of 1980.

We have previously discussed the possible AGSOC investments in the British Petroleum share of TAPS. However, there are alternative investment opportunities in TAPS through acquisition of pipeline interests of other companies. Prior to the 1979 and 1980 expansion programs, Mobil held a 5% interest in TAPS, and Union and Phillips each held a 1.66% interest (or about one-tenth the size of the BP interest). Since Mobil, Union, and Phillips have so far declined to participate in TAPS expansion, their respective shares have dropped to about 4.3% for Mobil, and 1.4% for Union and Phillips.

If AGSOC were to purchase a 1.5% interest in TAPS at an assumed price of \$125 million, the pro-forma would be as follows under current tariffs:

(000)

Net Income	\$17,900
Depreciation & Reserves	7,000
Principal Payments	(2,000)
Net Cash Flow	<u>22,900</u>
Stockholder Distribution	16,100
Cash Surplus	<u>\$ 6,900</u>

*@ 90% / 400,000 shareholders
= \$32.23 dividend/yr.*

Such a pro-forma is for the first few years and will change considerably as principal payments increase or as oil flow changes. With initial cash reserves, AGSOC can invest in other TAPS interests. As oil reserves change, or as pipeline expansion continues, AGSOC can participate in expansion not committed by other owners.

CHAPTER FOUR

ALASKAN GAS PIPELINE

Although there is much discussion about state and federal financing in the Alaskan gas pipeline, an opportunity may exist for AGSOC ownership in the Alaskan section of the proposed gas pipeline. Although current partnership agreements are in existence for ownership of the Alaska Highway gas pipeline, no definitive financing arrangements are set. Thus, flexibility in ownership and financing allows for new concepts in private and public investment in the line.

The Alaska Highway Gas Pipeline venture is still somewhat speculative. Risks arise from the marginal economics in the market for gas which must carry high transportation costs and uncertainties of cost overruns, engineering or regulatory problems, or interruption of gas production. Although there is much discussion in public and private circles about these problems, they are, in essence, not unlike the risks in construction and operation of TAPS.

Because of the high transportation costs of gas through the pipeline to Eastern or Western leg markets, Alaskan gas prices may be double the existing gas prices of present production in those markets. Transportation costs of 2 to 3 dollars per mcf are within current estimates of pipeline system costs. Transportation costs alone are therefore equal to current gas prices in the markets to be served. Once wellhead prices are added, total costs far exceed current prices.

Although analysis of costs appears to be a negative factor in the gas pipeline project, these same concerns faced TAPS in its initial history. Many factors will come into play to drive the end price of gas to levels which can eventually support the Alaskan Highway Pipeline costs. Rapidly escalating oil prices — spurred even more by the so-called windfall profits tax — will create more demand for natural gas at higher price

levels. Furthermore, a gradual decrease in U.S. dependence on foreign oil imports will create more internal demand for natural gas as a substitute for oil in long-term energy planning. Thus, even though there appears to be a glut in gas supplies, and a cost difference between Alaskan gas energy and other currently available sources, these conditions are essentially temporary and should not be a deterrent to consideration of investments in the gas pipeline project.

Although the overall cost for the gas pipeline is around \$14 billion, the 730 mile Alaskan section will cost about \$2 billion in today's dollars. With a debt-to-equity ratio of 75%/25%, and an overall rate of return of 16% based on current debt costs, a proforma operating statement of the Alaskan pipeline would be as follows:

16% Return on Rate Base
(Excluding Interest)

\$320,000,000 @ 16% *in P form*
1/2 Billion investment

Depreciation 125,000,000

Debt Service *75% debt*

(191,000,000) *180 million interest*
11 " principle
19P

Taxes - AGSOC

-0-

Net Cash Flow

254,000,000

Potential Net Profit -
Available For Dividends

321
- interest
\$140,000,000

? Net Retained Cash Flow
After Distribution
(Assume 90% Stockholder
Distribution)

@ 90% = 126,000,000

1400000 =

\$315.7/shareholder

128,000,000

= 10% + depreciation

(Thus, with an AGSOC investment of \$500 million of equity money, the net available retained cash flow would be over \$100 million per year in early years, and over \$100 million could be distributed to the stockholders.) ~~If AGSOC and the Permanent Fund were in a joint venture to raise the \$500 million equity, the Permanent Fund may be reimbursed over a five- to ten-year period and still have an equity interest in the operations.~~

what about 10 share limit
does it not apply to Perm Fund?

Added P on gas conditioning
plant, indicated as possible investment

CHAPTER FIVE

TRANSPORTATION

Overview and Conclusion

The unique importance of public (common carrier) passenger and cargo transportation to the State of Alaska and its citizens provides substantive philosophical rationale for AGSOC to consider transportation investments. Our review at this stage is more conceptual than specific, even though we cite some individual companies as examples and for background informational purposes. We are categorically excluding public sector transportation activities such as Alaska's land and marine highways and general cargo port facilities.

Transportation investments can be accomplished in at least two ways -- acquisition of an operating entity and by leasing long life major capital assets (railroad locomotives and rolling stock, commercial aircraft, ocean barges, freighters, bulk carriers, etc.) to existing transportation companies serving the state. Since equipment leasing is discussed in another chapter, this section will concentrate on opportunities for direct investment in operating companies.

Certain transportation sectors are highly fractured. In Alaska this circumstance is found in intrastate trucking and air taxi services. These type companies tend to be small, have high failure rates, and erratic operating records. For these reasons, we do not generally view intrastate motor carriers and local service airlines as appealing investment candidates.

By definition, transportation is cyclical, leveraged, labor and capital intensive, and regulated. Accordingly, unusual discipline must be exercised in the traditional investment criteria of quality and depth of management, financial strength, operating records, competitive position, return on invested capital, etc. We also generally favor

existing businesses with documented histories and prospects rather than start-up situations, unless these new ventures can achieve near immediate profitability as in the case of a new mine-to-port railroad or slurry pipeline.

Based on our initial survey, the number of Alaskan oriented sufficiently large transportation investments are quite limited in number. Further, their capital intensive, cyclical nature makes transport companies inherently more risky than some of the other target industries that AGSOC is considering.

The AGSOC, when created, may want to direct its initial investment selection process in other areas unless appropriate transportation investments can be identified.

Air Transportation

Scheduled air and cargo passenger carriers within Alaska and between Alaska and the lower 48 are Alaska Airlines, Wien Air Alaska, Northwest, Western Airlines and Flying Tiger Line (cargo only). Alaska and Wien are truly indigenous to the state in their history, service orientation and route structure, and their recent operating records are the most indicative barometers of the growth of Alaskan air services.

Alaska Airlines

Alaska is the larger of the two companies. Its Boeing 727 airplanes serve about 40 points in Alaska, and Seattle, Portland and San Francisco. The company's common stock is traded on the American and Pacific Coast Stock Exchanges.

Alaska Airlines
Operating Highlights
(000's)

Year	Revenues			Operating Income	Net Income
	Passenger	Cargo and Mail	Total		
1978	\$72,392	\$7,241	\$84,246	\$8,671	\$7,231
1977	63,537	6,679	76,518	8,064	3,414
1976	57,359	5,729	69,475	7,448	7,631
1975	52,274	6,482	66,620	6,428	6,111

Source: Moody's Transportation Manual

Wien Air Alaska

Wien has an approximate 11,000 mile route structure serving 150 points within Alaska, Whitehorse, Yukon Territory and Seattle with Boeing 737 and Fairchild turbo-prop aircraft. Following a recent tender offer and treasury stock purchase, about 55% of its common stock is owned by a subsidiary of Household Finance Corp. and 25% by Alaska Northwest Properties, Inc., a spin-off from Alaska Airlines. In November, Alaska Northwest Properties was reportedly holding discussions with Alaska native corporations about buying its interest.

Wien Air Alaska
Operating Highlights
(000's)

Year	Revenues				Operating Income	Net Income
	Passenger	Cargo	Mail	Total		
1978	\$34,134	\$12,505	\$10,770	\$62,495	\$3,538	\$ 482
1977	29,900	10,641	10,469	55,769	195	(742)
1976	37,593	13,462	9,549	62,708	6,092	2,421
1975	31,336	12,835	8,828	55,991	7,191	3,676

Source: Moody's Transportation Manual

Maritime

The principal general cargo common carrier ocean transportation between Alaska and the lower 48 (Seattle-Tacoma) is provided by Sea-Land, Alaska Hydro-Train, and Totem Ocean Trailer Express (TOTE). Sea-Land and TOTE provide at least bi-weekly

sailings between Seattle and Anchorage in medium size cellular container and RO-RO vessels, respectively. Alaska Hydro-Train is a rail car barge service operating between Seattle and Whittier.

There are additional specialized and contract maritime operators between the lower 48 and Alaska, although their number has diminished since the completion of TAPS. The Merchant Marine Act of 1920 (Jones Act) requires that maritime trade between U.S. states be conducted in U.S. built vessels. There is, of course, a great cargo imbalance northbound since only two of Alaska's major export commodities — lumber and fish products — can be carried in liner type services.

There is no ocean passenger service per se to Alaska other than the state ferry system, although the Inside Passage and panhandle ports have become very popular summer destinations for cruise ships. (The investment in and development of Alaskan tourist facilities by the AGSOC is discussed elsewhere in this report.) Most, if not all, of the Alaska cruise ships are foreign owned, built and manned, providing them with a prohibitive economic advantage over a U.S. operation.

In the maritime sector, Kelso & Co. believes that TOTE may warrant further investigation as an AGSOC investment candidate. TOTE, which began service in September, 1975, is a subsidiary of Sun Shipbuilding (Sun Company) and leases its two RO-RO ships from Sun. The original sponsors of TOTE tried unsuccessfully to raise start-up financing in the private capital market during the difficult period of the 1974-75 recession. While TOTE's financial performance reportedly has been marginal, the company has steadily gained market share and now carries over 55% (vis-a-vis Sea-Land) of the Seattle-Anchorage ocean borne general cargo.*

* Because of the participants' ownership structure and the Federal Maritime Commission's non-disclosure policy, Kelso has been unable to expeditiously obtain cargo statistics and financial data on the Alaska-Seattle marine trade route and operators.

Motor Carrier

Without having conducted a specific survey and analysis, we have earlier stated our philosophical aversion to investments in small intrastate truckers even though Alaska's transport infrastructure may be deficient in motor carriage services.

On the other hand, there is an Alaska-lower 48 trucker — Lynden Transport, Inc. — which has a strong market position, solid operating history and sound balance sheet could be a prime AGSOC investment candidate. Kelso & Co. has not had any discussions on this subject with Lynden management and principal stockholders, although Lynden has in recent years been buying into its treasury a sizeable portion of its publicly held shares.

Lynden is a common carrier of freight between Washington state and Alaska by highway and water (TOTE), a milk hauler in Washington, Idaho, Oregon and Alaska, a motor freight operator in western and northwestern Canada, an Alaskan intrastate special and general commodities carrier, and an air freight forwarder to and from Alaska. The company is the largest highway carrier within Alaska and between Alaska and the Pacific Northwest. A subsidiary conducts construction, gravel, and coal operations.

Lynden's 1978 revenue profile was (000's):

U.S. Transportation	\$28,107
Canadian Transportation	2,745
Construction, etc.	<u>1,538</u>
Total Revenues	\$32,390

Change

Lynden Transport, Inc.
Operating Highlights
(000's)

Year	Revenues					Operating Income	Net Income
	Freight	Mail	Milk	Constr- uction	Total		
1978	\$23,880	\$4,385	\$2,587	\$1,538	\$32,390	\$1,741	\$ 648
1977	17,569	4,362	2,302	853	25,086	1,003	419
1976	20,552	4,087	1,978	863	27,481	1,722	1,131
1975	21,384	3,421	1,831	---	26,636	3,646	1,540
1974	11,647	3,010	1,783	---	16,441	1,813	888

Source: 1978 Annual Report to Shareholders and 10-K; Moody's Transportation Manual.

Railroad

Alaska is served by two railroads — the Alaska Railroad (ARR) and the White Pass & Yukon (WP & YR).

We dismiss the WP & YR as an AGSOC investment because it serves only one Alaska city (Skagway), is Canadian owned, and essentially provides a transshipping mode for the Yukon territory's booming mining industries. Neither is WP & YR a logical equipment leasing candidate since it is a narrow gauge line.

From a political and public interest standpoint the federally-owned Alaska Railroad would be a most reasonable AGSOC investment candidate. Kelso & Co. has reviewed the railroad's operating and financial record and the plethora of consultant and government studies that have been prepared on the ARR in recent years. We have concluded that the Alaska Railroad is intrinsically unprofitable under its present route structure, commodity mix and labor agreements, particularly since it does not now have to bear the financial burden of debt service and income taxes. The railroad was quite profitable during TAPS construction and would probably earn money during the gas pipeline construction. However, unusual or abnormal events are heavily discounted in the fundamental investment decision making processes.

Alaska Railroad
Operating Highlights
(000's)

<u>Period</u>	<u>Rev. Tons</u>	<u>Ton* Miles</u>	<u>Total Revenues</u>	<u>Total Expenses</u>	<u>Gain (Loss) After Depreciation</u>
11 Mos. to 8/31/79	N/A	N/A	\$22,875	\$28,933	(\$6,058)
Sept. FY 1978	2,178	330.0	29,091	33,625	(4,534)
Sept. FY 1977	2,305	404.0	35,022	35,982	(960)
TQ 1976	N/A	N/A	10,051	11,164	(1,113)
June FY 1976	2,188	529.9	53,678	49,597	4,081
June FY 1975	1,862	475.9	42,287	37,079	5,807

* In millions

N/A — Not Available

TQ — Transitional Quarter

Source: Alaska Railroad Financial Statements

Beyond the railroad's desultory financial record and outlook, there are several other structural and political problems that are collectively very dissuasive:

- a) The prevalent perception of the railroad as a "public utility." This problem has become manifest in at least two areas — the requirement of the railroad to provide passenger service at a loss and the difficulty in implementing fair market value rental rates on the ARR's commercial and industrial properties.
- b) The non-commercial orientation of management as cited in the 1978 GAO report.
- c) The difficulties of segregating under private ownership data processing, purchasing and other management functions now handled through U.S. government agencies.

- d) The requirement for large capital outlays on the railroad property and for equipment in the event of a sharp traffic pickup. Between 1975 and 1978, \$37 million was expended for much needed roadbed, bridge and tunnel improvements, and purchase of new locomotives and rolling stock which program has upgraded the ARR to an "excellent...light density single track railroad."*
- e) The dispute over certain railroad property ownership rites between the railroad and Federal-State Land Use Planning Commission.

There are long range plans for extending the railroad to the lower 48 via British Columbia. If Alaska's extensive mineral deposits of copper and steam coal are eventually developed, new rail lines may be constructed to serve these mines. The financing requirements for such railroads will be considerable and the AGSOC would be a vehicle for providing some of this imbedded capital on a basis that could be fully compensatory to the trust.

In conclusion, Kelso & Co. believes that direct AGSOC investment in Alaska's existing railroads is not desirable, but long-term (finance) leases of equipment could be considered.

*Railway Age, April 9, 1979, p. 29. Underlining by Kelso.

CHAPTER SIX

FISHERIES

Fishery products represent a major industry for Alaska. In addition to the value of the commercial catch, fish processing represents about half of the state's manufacturing employment. A series of recent studies indicate that the best opportunity for expansion of the Alaskan fishing industry lies in bottomfishing.

Although Alaska's waters are highly productive, Alaska's bottomfish industry is not fully utilized, especially by domestic fishing interests. The extension of U.S. territorial waters to 200 miles will give Alaska fisherman better access to the supply which in the past have been taken by foreign trawlers. An opportunity exists for a major expansion of the Alaska fishing industry with significant economic benefits. It is estimated that full development of Alaska fisheries can add almost 30,000 in employment and impact trade balances of one billion dollars by 1990.

One of the impediments to expansion is the lack of access to private capital for vessels and processing facilities. Programs are now available for government-guaranteed loans for vessel construction or conversion, and tax deferred programs are available for harvesting and processing vessels. However, the major inhibition to development of fisheries is the absence of associated processing facilities.

AGSOC, through its favorable tax treatment, would provide a current effective tax deferral program for a processing plant. Coupled with a processing plant, the AGSOC could provide cold storage facilities and service facilities for fishing fleets. These areas are capital intensive components of establishing fisheries, yet are areas in which direct government involvement is not recommended. In addition, since the capital requirements are much higher than those for vessel purchase (except for catcher processors or floating processor plants), private development of these plants and service facilities is slow.

Many indirect benefits will fall from an AGSOC program in Fisheries. The project will receive wide publicity and promote public sector attention to developing the infrastructure necessary to fisheries, especially in harbor facilities. Additionally, such publicized entrance in fishing could stimulate private and independent fishing vessel construction and conversion to bottomfishing.

A recent publication of the U.S. Department of Commerce indicates investments for Alaskan groundfish development by 1990 as follows:

Harvesting Vessels	\$ 185,000,000
Processing Facilities	\$1,990,000,000
Public Facilities	\$ 527,000,000

AGSOC participation in the vessels could be through leasing operations as discussed further. However, there appears to be some private development efforts for catcher-processors in Alaska by Energy Resources Company of America (ERCA), and through government guaranteed financing, capital investment may not be too restricted.

Major investments are required for the processing facilities. Except for the catcher-processors, United States efforts in major off-shore processing ships are unsuccessful and undeveloped. Thus, in the near term, the fishing industry must develop through shore-based processing plants.

New plant investments would range from \$3,000,000 to \$4,000,000 for processing facilities in Ketchikan, Sitka, Seward, and Homer, \$15,000,000 for Kodiak, and \$40,000,000 for Dutch Harbor. Return on investments based on normal operations and 1979 level of prices would range from 3% to 20% per year with varying assumptions.

An example of processing plant economics is shown in Table 7.

TABLE 7
AGSOC Processing Plant - Small Size

Revenue		
(11,000,000 lbs @ \$.90/lb average all species)		~~(000)~~ <u>\$9,900,000</u>
Cost of Fish	<i>11,261,904.76 lb waste</i>	
<i>22,261,904.00</i> (@ \$.21/lb average all species) X <i>22,261,904.00 lb</i> =		4,675,000
Shipping Costs		1,225,000
Labor		1,270,000
Sales, G & A		1,200,000
Maintenance and Utilities		330,000
Depreciation		250,000
Interest (100% financed at 11% interest) for fixed assets		385,000
Land and Dock Lease		<u>50,000</u>
Total		\$9,385,000
Income Before Taxes		<u>\$ 515,000</u>

The projections in Table 7 assume that AGSOC has 100% financing for all fixed assets in the plant. In addition, it assumes that AGSOC leases land, dock, and access roads from a government entity on fair market value lease rates. It also assumes that AGSOC maintains and operates interim storage units, but not shipping containers. Furthermore, the processing plant site shares facilities with vessel refueling and servicing operations at the dock. Those operations are to be run independently.

Based on a continuous level of operation for five years, AGSOC would have a retained cash flow of \$100,000 per year or \$500,000. It would have retired about 1/3 of

its debt and have a net long-term debt of \$2,250,000. If net earnings before tax were to increase at a rate of 10% per year (based on a semi-successful fishery development) the AGSOC processing plant would have a fair market value of over \$3,500,000 and AGSOC could sell the facility to a private party and have a net cash profit of over \$1,500,000.

An alternative to an AGSOC operating division running the processing plant would be to lease the plant to an existing fish processing business or to have a management company run the plant. The net result would be an eventual sale of the plant to the operator after a five- or ten-year period. For AGSOC to make a fair return, sale should be set at fair market value or pre-set on an option basis, assuming a reasonable profit growth and a price/earnings ratio.

Vessels

The development of Alaskan fisheries requires major investments by the private sector in harvesting and processing vessels for bottomfish. Investments range from approximately \$1,000,000 for an 85-foot trawler to about \$12,000,000 for a 250-foot catcher-processor. On the other hand, conversion of existing shrimpers or crabbers for bottomfish can range from \$50,000 to \$500,000.

Recent financing programs, such as the Fishing Vessel Obligation Guarantee program administered by the National Oceanic and Atmospheric Administration (NOAA), provide a loan guarantee of up to 87-1/2% of vessel construction or reconstruction. In addition, the Capital Construction Fund allows deferral of federal taxation of vessel income when that income is used for investments in new vessels.

Although efforts are underway on the part of some Alaskan businesses to promote harvesting under these programs, other fishing interests and independent fishermen find it difficult to gain access to this capital. It is at this point where an AGSOC leasing operation has a role.

For example, an 85-foot vessel with a capital cost of \$1,000,000 can earn over

\$100,000 in income and maintain \$150,000 per year in payments for the vessel. Based on a 10% annual interest rate and a 15-year amortized loan, the AGSOC would have an annual payment of \$129,000 and could net over \$20,000 per vessel per year on a leasing program. Additionally, as vessels become more expensive and fisheries develop profitable operations, lease revenues may increase and substantial residual values on vessels would contribute to AGSOC capital accumulation.

Since some estimates of new fishing vessel requirements in Alaska over the next 10 years approximate 200, or a value of almost \$200,000,000, an AGSOC leasing operation has a large market potential. If AGSOC were to lease 25% of the requirements over the next 10 years, its net lease revenue would reach a maximum of \$1,000,000 per year profit excluding a buildup of residual value worth.

CHAPTER SEVEN

LEASING

Leveraged leasing could offer some favorable tax advantages for AGSOC. Additionally, an AGSOC leasing program could stimulate many segments of the Alaskan economy which are currently restricted by lack of capital.

Although leasing is an alternative source of financing capital equipment, it offers advantages to both sides of the relationship. Both have some tax advantages, and although the leasing company assumes more risk, the lessee grants compensation for its diminished risk in higher rental payments.

There are many variables in the structure of a lease so that a single financial model would not cover all cases. However, for illustrative purposes, the following example shows the advantages to AGSOC:

Suppose a company were to lease a \$1,000,000 piece of equipment through AGSOC. If this equipment had a 20-year life, possible lease payments (under today's high interest rates) might be as high as \$175,000 per year or higher if a short-term lease were executed. On the other hand, AGSOC's principal and interest payment could be under \$150,000 per year. Thus AGSOC could achieve a cash flow spread of at least 2-1/2% of the equipment value per year, and under certain conditions this could be as much as 5%. However, the significant tax factors which would benefit AGSOC and its stockholders would be the investment tax credit and depreciation. In the first year of the investment, 10% of the value of the equipment could be claimed as a tax credit. Under the Federal legislation, Subchapter U to the Internal Revenue Code, this would be passed through directly to AGSOC's shareholders.) The distribution of profits could be controlled by the

?
do these
benefits not also
apply to all other
potential AGSOC
investments, if so
why wasn't it
stated elsewhere?

depreciation schedule used so that up to the full value of the positive cash flow could be retained by AGSOC without tax penalty. This reserve could be used to offset future cash requirements or for new investment.

A major attractiveness of leasing for AGSOC is that it could borrow nearly 100% of the purchase price of certain investments. Our recent discussions with major banks, indicate that the banks would loan to AGSOC at favorable rates, assuming a reasonable AGSOC capitalization. Additionally, for large investments, most institutions will provide necessary expertise in structuring the lease and managing the asset through the lease term.

If AGSOC were to operate a leasing company serving different industries with different products, the company would need marketing support and other administrative, legal, and clerical services. The level of the support required would approach 5% of the total revenues received by the company.

A sample pro-forma of a leveraged leasing company with \$100,000,000 of equipment on lease is as follows:

Revenues	<u>\$24,000,000</u>
Operating Expenses <i>explain</i>	1,200,000
Interest Expense <i>@ what %</i>	11,000,000
Depreciation <i>@ what rate</i>	<u>8,333,000</u>
Total	\$20,533,000
Net Profit	<u>\$ 3,467,000</u>

*@ 90% = 3,120,300.
by 400,000 = \$7.80 dividend*

The above pro-forma would be applicable to the first few years of operation. After that time, interest expense may decline considerably, or alternatively, more equipment can be placed on lease because of cash flow buildups from depreciation. Thus, income can increase with interest expense decreasing producing larger profit margins. The risk associated with this business would fall in the residual value or marketability of the

Option Sold
equipment leased as the lease term expires or if the lessee defaults. *purchase*

Leasing is a competitive business. Initially, we investigated AGSOC leasing aircraft to Alaska Air Lines, for example. However, Alaska Air Lines has multiple proposals for such leases and at much more favorable rates than could be offered by AGSOC. The reasons for strong competition, especially in aircraft, are the favorable tax advantages (increasing for those in higher than 50% tax brackets) and high resale residual values for aircraft after the initial lease terms. Many lessors will therefore sacrifice short-term cash flow for current tax benefits and long-term profits. The best opportunities for AGSOC would seem to be areas of leasing where lease competition is not so high, e.g., for leasing to start-up business ventures, and in other situations where financing sources are difficult to obtain.

Potentially, leasing may be applicable to many sections of the Alaskan economy. Some of the more promising are summarized below.

Motel and Hotel

Over time there should be opportunities in sale and leasebacks of motel/hotel sites and structures. This industry offers more favorable opportunities for AGSOC leasing since there are more favorable tax credits available in motel/hotel leasing than for other forms of commercial real estate.

Fishing

Currently, there are investment opportunities in Alaska for both processing vessels and on-shore processing plants. The vessels offer good opportunities since interim financing during construction would not be as big a handicap as construction of new plants. Leasing of fishing vessels, or sale and leaseback of converted fishing vessels, also offer opportunities in the fishing industry.

Hard Rock Minerals

There will be potential for leasing mining equipment as mining develops within the State.

Oil and Gas

In gas pipeline construction, leasing opportunities will exist in rolling stock used during construction. There also are opportunities for leasing drilling rigs or LNG storage tanks. The high value of storage tanks is attractive for an AGSOC investment.

Petrochemicals

Gas Conditioning Plant?

The development of a petrochemical industry using Alaskan resources has stimulated much interest in parts of Alaska. Construction financing is not an attractive leasing opportunity, but certain installed equipment may offer possibilities.

Agriculture

Agricultural equipment offers some lease opportunities although AGSOC might not want to compete in the financing for the leasing of relatively low value equipment.

Electric Power

not expanded upon because of time & money

Potential for the leasing of prefabricated plants exists in Alaska. Major users of electric power or new hydroelectric plants may have financing difficulties. AGSOC may be able to lease a full plant to potential operators.

Alaska Railroad

The railroad is covered in the Chapter on Transportation. There is a potential lease opportunity in freight cars, locomotives and other equipment. As in the airline industry, rail car leasing is competitive with many participants.

CHAPTER EIGHT

SOURCES AND COSTS OF CAPITAL FUNDS

SOURCES OF CAPITAL

Problems of raising capital and rationing it among competing investment projects are common to all business corporations. The long-run profitability of the enterprise hinges on the solution of these two problems. Knowledge of sources and costs of capital is needed for both.

Good management of corporate capital views as quite separate these two problems: (1) sourcing (acquisition) of capital funds and (2) rationing (investment) of that capital. Rationing capital among investment proposals should be on merit, independent of source or cost of funds for that particular project. Investable funds of AGSOC should be treated as a common pool, not as separate compartments. Similarly, the problem of acquiring capital should be solved independently of its rationing and also on the basis of merit (the comparative costs and risks of alternative patterns of sourcing).

The first part of this chapter surveys, for decision-making purposes, the various sources of capital for AGSOC; the second part examines ways of estimating the cost of capital obtained from major sources.

The supply of capital for corporate investment comes ultimately from the savings of individuals, corporations, and governments. As to immediate sources, a corporation normally has two choices: use its own savings (internal) or tap the savings of others (external).

Internal Sources

The main internal source of corporate savings is the generation of cash from operations. Corporate savings is the act of not paying out all profits in dividends. Stockholders benefit from saving and internal investment of the corporation's after-tax

cash generation when the rate of return on the investment is higher than the corporation's cost of capital. This is approximately the opportunity cost of capital to its stockholders, because the corporation usually has the option of buying its own stock.

Gross cash earnings generated by operations constitute a common pool of future funds from which dividends will be paid and new investments financed. This pool should have corporate-wide availability for capital expenditures. When each division is restricted to the reinvestment of its depreciation charges regardless of the productivity of its investment proposals, the separability of sourcing and rationing of capital funds is abrogated, and one of the major advantages of the diversified firm is destroyed.

When AGSOC elects to take advantage of the special provisions of Subchapter U, the corporation itself will be exempt from all federal income taxes but must distribute 90% of its earnings to shareholders. Thus, except for the remaining 10%, the use of retained earnings as a source of funds will not be available to AGSOC.

External Sources - Debt Capital

As external sources there are two ways for AGSOC to get savings from outsiders: borrow (debt capital) or partner (equity capital). Debt capital can be arbitrarily classified as either short-term or long-term.

Short-Term Debt

Short-term debt of AGSOC can be of two sorts. The first is inadvertent borrowing which is a cultural by-product of normal operations. Mostly it is caused by lags between the time a service is performed and the time it is customary to pay for it. The second sort of short-term borrowing is quite deliberate. The main source for most companies is the commercial bank. A line of credit is usually established, which sets a maximum amount of borrowing which the company may draw down as its needs dictate.

Long-Term Debt

Drawing the dividing line arbitrarily at one year, we classify intermediate-term debt capital as long-term. The term loan is a typical instrument. Its source may be a commercial bank, an insurance company, or a trust fund. Term loans result from direct negotiations between borrower and lender. Thus, they are privately placed as contrasted with public sale through the money market.

For longest term borrowing, the usual loan contract is a bond. It may be placed privately by direct sale to a large financial institution or sold to the public, usually through an investment banker.

Long-term debt can be subclassified in three ways:

- (1) Nature of security (mortgage versus debenture bonds).
- (2) Directness of the obligation (direct debt versus off-balance sheet financing).
- (3) Degree of participation (pure debt versus contingency debt).

These three bases of classification overlap.

Nature of Security

Borrowings may be secured by pledging specific assets (mortgage bonds) or secured only by the corporation's general credit (debenture bonds). The basic security for the debt of any corporation is, however, its uncommitted cash generating ability. A bank does not want to run a coal mine. Sale of a pledged asset is only a resort of desperation. The relevant economic measure of the debt-carrying ability of a corporation is not the balance sheet, but the future generation of cash from operations, which can be derived from forecasted income statements.

Directness of Debt

In addition to direct debt, a corporation can borrow indirectly by a variety of devices such as long-term leases, sale-and-lease-backs, oil payments and royalty arrangements, and through-put agreements. Regardless of legal status or accounting

treatment, these forms of indirect obligation are the economic equivalent of direct debt. They are contractual obligations to make periodic payments for the use of capital and to repay principal under specified conditions. These forms of off-balance-sheet borrowing have attractions. They can be (1) tailored precisely to the borrower's needs as to amount and timing, (2) negotiated privately, and (3) left off the balance sheet. The price of these conveniences is usually a slightly higher interest cost.

Participation

Some debt has partnership features (for example, convertibles and income bonds). Convertible bonds are a cross between debt and equity financing. The bond holder has an option to convert his debt claim into shares of common stock at a predetermined price, which is equivalent to a long-term call on equity. The requirement in the Federal Enabling Law limiting the transfer of common stock to individuals who own no more than ten shares of stock probably will prohibit the effective use of convertible debt by AGSOC. (Revenue Act of 1978, Section 1391(a)(4)(D)(iii).) It is theoretically possible to design a convertible bond indenture that would require immediate sale of the stock received upon conversion back to AGSOC at fair market value.

Quasi-equity features are less clear, but nevertheless are present in most indirect debt (for example, lease-backs and oil royalties). Most lease-backs and oil-payment and oil-royalty arrangements give the lender options and residual values that have some attributes of equity.

Joint bonds are obligations issued jointly by two or more corporations, and are their joint and several obligations. Thus, the Louisville & Nashville and the Southern Railway collateral trust bonds were secured by the stock of the "Monon" Railroad, owned in equal parts by the two guarantors. These two roads were each liable for one-half of the principal and interest, and fulfillment of all other obligations imposed by the indenture under which the bonds were issued. Should either company have defaulted on any of its

obligations under the indenture, the deposited stock belonging to the defaulting company was to become the property of the other company, which thenceforth was liable in severalty upon all the covenants contained in the bonds.

Joint bonds have been issued also by states and municipalities. The bonds of the Authority of the Port of New York are in effect a joint obligation of the states of New York and New Jersey. Joint bonds offer the potential of cooperative ventures by AGSOC, the Permanent Fund, Native Corporations and others.

External Sources - Equity Capital

Equity capital raised externally is of two types: (1) preferred stock, which is a kind of preferential, but limited partnership, and (2) common stock, which is full partnership.

Preferred Stock

Dividends of preferred stock come ahead of common, but are limited in amount. They are, however, not a contractual obligation and hence are not deductible as an expense for corporate income tax. Since the Federal Enabling Law limits General Stock Ownership Corporations to one class of stock, AGSOC cannot have preferred stock in its capitalization (Section 1391(a)(4)(A)).

Common Stock

Common stock is the economic equivalent of full partnership in the earnings and assets of the corporation. Dividends are discretionary, (although a Subchapter "U" GSOC has a strong incentive to pay out 90% of earnings) and common stockholders get only the residual left after other payments.

THE COST OF CAPITAL

All resources command a price for their use. Capital is no exception. Management's task is to blend the various capital sources available to achieve the lowest long-run cost for the Company's total requirements. This overall combined cost is the weighted average of the market cost of the major kinds of corporate capital: debt, preferred stock, and common equity. Capital from internal and indirect hard-to-measure sources should be assigned the cost of its alternative direct source. The alternative for lease debt is direct borrowing for an equivalent term. The alternative for internal cash generation, whether labeled "earnings plowback" or "depreciation," is flotation of common stock.

The Cost of AGSOC Debt Capital

That debt capital as a cost is undebatable. The use of money borrowed from outsiders has a price. This price is established by market forces and is knowable with considerable precision. This price the company must pay.

The price of debt capital fluctuates with changes in supply and demand. At any time, the price differs depending on (1) the credit-worthiness of the borrower, (2) the duration and other terms of the loan, (3) the type of lending institution, and (4) the section of the country. The debt-cost range is wide, from 36% for trade credit if cash discounts are passed, down to prime rate and below. The underlying causes of this wide disparity in the price of debt money are differences in risks and in costs of administration and collection. These two forces sometimes are opposed. For a short-term loan, the risk is less but the costs of launching and administration are proportionately higher. Other features affect the cost structure of debt capital; for example, privacy has a price. Off-balance-sheet borrowing commands higher prices in the marketplace, and corporate private placements cost somewhat more than equivalent public debt.

Market imperfections distort the structure. Ignorance has a price. The astute borrower will try to borrow at the lowest rung of the debt-cost ladder that his credit worthiness will permit. The competent lender will seek as comfortable a cushion of compensation for his risk differential as knowledge will warrant and competition permit. Because of the newness of the federal legislation (1978), AGSOC will be in somewhat unique position as a new borrower. Alaskan banks will be generally familiar with the situation and able to handle short-term AGSOC debt requirements. There are approximately 100 U.S. commercial banks with a legal lending limit over \$10,000,000. Because of geography or other considerations, we have identified 25 of these banks for possible consideration in term loan borrowings. With a reasonable capital structure, AGSOC should be essentially a prime rate customer for the commercial banks.

what 25

In addition, there are 107 foreign banks with offices in the United States, largely in the Eastern portion of the country. However, 9 foreign banks have offices in San Francisco and 6 in Los Angeles. Many of these banks provide services and loan terms other than those offered by U.S. commercial banks and should be considered a potential source of funds.

11

The true cost of debt capital is often higher than its nominal cost. The disparity is produced by many devices. Discounting (deducting interest in advance) increases true interest rate, as does the requirement of minimum balances, because they pare down the amount really available to the lender. Charges for investigation, servicing, and insurance can also raise the effective cost of debt.

The historical outlay cost of debt capital is easy to measure. It is indicated by the market yield to maturity on the company's debt securities, adjusted for costs of flotation and deflated for corporate income taxes. AGSOC might expect to pay an average of 14% in present money markets for a balanced package of short-term debt, term loans and long-term (15 year) insurance company private placements. The private placement area

is dominated by 50 large insurance companies. Except for the very largest insurance companies, the average participation by these companies in a private placement financing is from \$3,000,000 to \$10,000,000 each.

The Cost of Equity Capital

In a market economy, any resource which is scarce, relative to the demand for it, commands a price — however difficult it may be to measure that price. This is true even though reimbursement for the suppliers of equity capital is a residual; that is, what is left after more tangible costs of operations, including interest on debt, are satisfied. In the long run, equity capital is not a discretionary cost. The fact that the rewards are residual does not, as some think, mean that common stock capital is costless. In the long run, equity capital has a market price which is determined by investors' alternatives. Although owners of equity capital assume the ultimate risk by accepting as their compensation what is left, they have in most companies the option of selling at some price. They will not reinvest or long leave their capital in any corporation which does not offer reasonable prospects of returns as high as those promised by alternative investments.

Looking into the future, the AGSOC investments made today must be capable of earning enough in the future to cover all costs, including the costs of equity capital, as well as providing for recovery of the capital invested during the economic life of the project. Only thus can AGSOC maintain its financial integrity over the long term. For this reason, the policy of investment selection should establish investment standards which are based on the price it may pay for capital — the combined cost of equity and debt capital — to assure that no investment will be taken on today which will knowingly be incapable of earning the cost of capital in the future.

CHAPTER NINE
INVESTMENT POLICY
Corporate Intent

** return to stockholder basis to all 3*

Investment policy is a subject closely related to the AGSOC Board of Directors. The primary function of the Board is to set policy. It may be up to the AGSOC senior investment officer to initiate policy and recommend changes in policy. The final decision, however, is the responsibility of the Board of Directors. There are three types of policy decisions that are basic: (1) determining the philosophy of investment, (2) estimating basic industry and economic trends and determining the best way to take advantage of them, and (3) dove-tailing corporate needs and future plans with investment philosophy.

On the philosophy of investment, it is up to the Board to decide in no uncertain terms whether it wishes staff to pursue a conservative, long-term investment program with emphasis on stability and income, or whether it wishes to place primary emphasis on total income (current income plus appreciation), rapid turnover, venture equity, and opportunistic types of investment.

? *

The second type of policy, an estimate of industry and economic outlooks, provides opportunity for the staff to practice their utmost persuasion, but nevertheless it still should be the function of the Board to have the final word with clearly stated guidelines. Finally, the corporate needs of AGSOC must be injected into the equation. Of immediate consideration is the cash flow, dividend policy, and the nature of reserve adjustments. Of longer term consideration are corporate plans for the future.

Availability of Investment Funds

Except for very large projects which will require separate financing, normal investment policy will be heavily influenced by the AGSOC capital structure. The chapter on Sources and Cost of Capital Funds indicated a ready availability of debt funds

to AGSOC presuming a satisfactory equity base. The experience of British Columbia Resources Investment Corporation suggests that considerable success might be possible in the sale of additional participation from the public. (See Appendix A.)

Below is one potential scenario out of many possibilities for development of the AGSOC equity base.*

A. Distribution of One Initial Common Share

400,000 eligible residents, 348,000 ^{elect to participate} shares distributed (assumption is same 87% as achieved by British Columbia Resources).

B. Sale of Convertible Debenture to Residents

17,400 Alaskans purchase nine \$100 principal amount, 8% Convertible Debentures. Each \$100 debenture is convertible into one share of AGSOC common stock, thus keeping within the 10-share maximum as provided under Federal GSOC legislation. Proceeds to AGSOC would be \$15,600,000. (Assumption is that 5% of the 348,000 Alaskans receiving initial shares will purchase the full offered allocation of debentures.) For comparison purposes, 6.5% of the British Columbians that received five free shares purchased at least 100 or more additional shares for proceeds of \$487,500,000. An additional 2.0% purchased less than 100 additional shares.

?
or a fraction of
one share
fractional
purchases
allows future
purchases up
to 10 full shares

* The sample scenario is in technical conflict, but probably not in legislative intent conflict with the Federal Enabling Law which limits ownership to individuals. It could be argued that the Permanent Fund represents a group of individuals or the law could be changed.

C. Purchase by Permanent Fund

Permanent Fund purchases 200,000 common shares at \$100 per share and 200,000 of the same 8% Convertible Debentures sold to individual Alaskans. Combined proceeds to AGSOC would be \$40,000,000.

After the above steps, an AGSOC pro-forma balance sheet is shown.

<u>Assets</u>		<u>Liabilities and Stockholders' Equity</u>	
Current Assets		Current Liabilities	-0-
Cash and Temporary Investments	\$55,600,000	Long-Term Debt	
Investment and Other Assets	-0-	Convertible 8% Subordinated Debentures	\$35,600,000
Total Assets	\$55,600,000	Stockholders' Equity	
		Common Stock, issued 548,000 shares*	\$20,000,000
		Total Liabilities and Stockholders' Equity	\$55,600,000

Under the above scenario, the 8% Convertible Subordinated Debentures would be junior to all other debt, providing AGSOC considerable borrowing capacity. Presuming a combination of additional debt totaling \$44,400,000 at an average interest rate of 14%, AGSOC would have available funds for investment of some \$100 million. A 20% return on invested funds before taxes (approximately the average in recent years from Textron, Inc., a comparable company in many ways) would produce the following pro forma income

*356,600 shares of additional common stock reserved for conversion of the 8% Convertible Debentures.

statement.

Profit Before Interest and Taxes*	\$20,000,000 ⁰
Less Interest Charges	9,064,000 ⁰
Profit Before Taxes*	<u>\$10,936,000⁰</u>
Dividends at 90%	9,842,400 ⁰
To Retained Earnings at 10%	1,093,600 ⁰
Dividends Per Common Share (548,000 Shares Outstanding)	\$17.96 ⁰

0 = 1 Billion Dollar investment

Since income would be larger in this situation from dividends (\$17.96 versus \$8.00 in interest), residents would tend to convert the convertible debentures into shares of common stock. Based on full conversion of the debentures, the income statement would appear as follows:

Profit Before Interest and Taxes*	\$20,000,000 ⁰
Less Interest Charges	6,216,000 ⁰
Profit Before Taxes*	<u>\$13,784,000⁰</u>
Dividends at 90%	12,405,600 ⁰
To Retained Earnings at 10%	1,378,400 ⁰
Dividends Per Common Share (904,000 Shares Outstanding)	\$13.72 ⁰

This scenario represents a relatively small scale GSOC with assets of about 10% of the total of the Native Corporations. (The \$100 million figure was selected to allow easy multiplication to higher levels of size.)

*No taxes due if Subchapter U GSOC.

CHAPTER TEN

CONCLUSION

Alaska has expanded significantly in recent years. It is a State of youth and vitality, and full of opportunity for the enterprising. The pace of development anticipated in Alaska is such that the need for capital is great, and openings exist for new enterprises. Technological development also continues to create additional opportunities for investment. As a result of our work, we see no difficulty in finding adequate investment opportunities even for a large size AGSOC over a period of time. Except for transfers of ownership situations such as TAPS, nearly all of the anticipated investment opportunities should meet a number of Alaska's principal economic goals. Presumably, AGSOC, owned and managed within Alaska, will be sensitive to the needs of employment, economic diversification, reduction of seasonality and other State goals.

Interviews with insurance companies, banks, and others demonstrate considerable interest in participation in AGSOC debt financing. In the beginning each potential source of funds will carefully analyze the AGSOC capitalization, management and business plan prior to making firm commitments. Such analysis will importantly impact the terms, cost and conditions imposed by the lender. Such factors will significantly influence the investment performance of AGSOC.

Added TP explaining summary table & statement of impact of management

? Risk of Failure in table does

(+) = ~~high probability of failure~~
(-) = ~~or does~~

(+) good results; I guess is not failure
(-) negative; I guess is low probability
of failure

APPENDIX A

A CASE STUDY: BRITISH COLUMBIA RESOURCES INVESTMENT CORPORATION

British Columbia Resources Investment Corporation was initially conceived to be a vehicle to return to the private sector certain investments which were owned by the Province of British Columbia under their socialistic regime. The Government wanted to avoid the conflicts which can arise where it had regulatory authority over the forest products industry, for example, and yet had a direct holding in some pulp, lumber and plywood companies. In addition, the Government felt the process could provide a mechanism to raise some badly needed equity capital and would at the same time enable its citizens, who were watching their savings being eroded by inflation, to participate directly and individually in resource ownership.

BCRIC was patterned after the Canada Development Corporation and the Alberta Energy Company. After enacting legislation, the Government appointed five prominent British Columbians to be the founding incorporators of the company and its initial directors. They had one common and very significant characteristic; they are all chief executive officers of their own highly successful B.C. headquartered public company, and their companies do not compete with any BCRIC investments.

The company then acquired their initial investments from the Province for a promissory note of \$151,000,000. The selection of investments (only from the Province's holdings) and the valuation of these investments was through a process audit by the Canadian investment firms of McCloud Young, A. E. Ames, Pemberton, and Richardson. BCRIC selected only good companies from the many Province holdings.

In order to give the ownership to the people, the Government agreed to exchange

the \$151,000,000 promissory note in full settlement for 15,000,000 common shares. Of those 15,000,000 shares, they offered to give 12,000,000 away, or five each, to each of the eligible residents. At the same time as applications were to be received for free shares, BCRIC would accept subscriptions for further shares at \$6.00 each, to be issued from the treasury, to a maximum of 5,000 shares for eligible person. Book value before dilution was over \$10.00 per share. Bearer shares were to be used in order to save the corporation the expense of registering potentially 2.4 million shareholders. In order to have registered shares and be a voting shareholder, one had to purchase a minimum of 95 shares, to be added to the five free ones in order to qualify. Bearer shares could be traded just as registered shares, and the stock exchanges agreed to reduce the trading block to five shares. In order to cut down on shareholder costs, only registered owners received mailed notices. Annual and interim shareholder reports for bearer shares are distributed by delivery of 250 copies to each branch of a financial institution to be placed on counters for pickup. Shareholder service costs are estimated at \$1.50 per year for registered holders.

The distribution was an awesome and expensive undertaking. Because it involved a potential distribution to 2.4 million people, it required the utilization of all the financial institutions in the Province. Without the full participation of those institutions, involving some 1,300 individual locations, the job could not have been accomplished. Each branch of these institutions agreed to accept applications upon presentation of two forms of identification. The computer operations of BCRIC then sorted to avoid duplications.

The distribution and the sale resulted in 83% of the eligible population, or 2,000,000 people, applying for their free shares and 130,000 individuals applying to buy 100 or more shares, yielding gross proceeds of \$487,500,000. Incidentally, another 40,000 people purchased extra shares, but not in sufficient number to be qualified for registration. In total, BCRIC has now 96,500,000 issued shares; the total cost of distributing all shares

was \$15,000,000 or approximately 3% of proceeds to the company.

The response surprised everybody involved in the process. There were a number of factors that produced such astounding results. First, the Canadian stock market was buoyant and a lot of people were interested in the market generally, with gas and oil interest particularly strong. (The inclusion of the gas and oil leases in BCRIC assets added appeal.) Second, people in British Columbia have pride in their Province, and they responded very positively to the concept of a totally B.C. operated and directed company in the resource field. Third, was the Premier's own personal support of the issue. Fourth, the Board of Directors had great provincial credibility. Fifth, the general momentum that the issue developed as people read about it, talked about it, and listened to the advice of professionals as well as their friends and neighbors. They felt it was attractively priced. And finally, of course, there was an element of straight speculation by people anticipating a fast, profitable turn.

Between late June and August 7th, when trading was to commence, there was deliberation on the question of the appropriateness of the company declaring its intention to provide assistance in the maintenance of an orderly market, should it be required. The issue was not underwritten. However, the Board had the courage of their conviction in the principles of a free market, and elected not to provide support. While that decision did take courage, it was also reinforced by the belief that the large majority of the original purchasers were long-term investors and not short-term speculators. Now that shares are traded on the Vancouver and Toronto Exchange, anybody across Canada can buy shares. (There is no holding period for the free or purchased shares.) In 1979, some 24,000,000 shares were traded (about 20% of the total).

BCRIC has been successful in keeping its image as a private company rather than a quasi-public body. It states its responsibilities only to shareholders and not to the Province. It has freedom to invest in companies outside of the Province.

Selection of new investments will be concentrated in the area of natural resources. BCRIC feels no restraint on its investment objectives through other companies, the government, or any social responsibility other than such responsibility any private company may hold. BCRIC intends to be an operating company rather than just a holding company. Its initial and current holdings are:

81% of Canadian Cellulose, a public company and a major pulp and lumber producer in the Province.

100% of two medium-sized lumber producers, Kootenay Forest Products and Plateau Mills, the former also a producer of sheathing plywood.

10% of the shares of Westcoast Transmission, a natural gas pipeline company controlled by Pacific Gas & Electric Company.

A license to explore for gas and oil on some 2.3 million acres of public land in northeastern British Columbia.

BCRIC has a present equity capitalization of over \$600,000,000 through the offer and the initial holdings. In addition, it can borrow to put its total asset holdings over a billion. It currently generates about \$30,000,000 in earnings on a sales volume of \$300,000,000 through its present holdings. Its interest earnings on the cash proceeds of the issue are yielding over \$1,000,000 a week or over 11%; however, in order to stimulate growth, their policy is not to distribute dividends for three to five years.

BCRIC feels that one of the benefits of wide citizen ownership is that employees of its companies see themselves as working for themselves and other citizens as owners rather than unknown shareholders or the government. BCRIC feels that many labor problems will be averted through this concept.

APPENDIX B

FEDERAL ENABLING LAW

REVENUE ACT OF 1978⁽¹⁾

(H.R. 13511)

ENACTING TITLE VI, INTERNAL REVENUE CODE OF 1954, AS AMENDED

GENERAL STOCK OWNERSHIP CORPORATIONS

NOTE: Numbers in parenthesis above the text refer to the explanatory annotations immediately following the text of the legislation.

Sec. 601. ESTABLISHMENT AND TAXATION OF GENERAL STOCK OWNERSHIP CORPORATIONS AND THEIR SHAREHOLDERS.

(a) IN GENERAL - Chapter 1⁽²⁾ (relating to normal taxes and surtaxes) is amended by adding at the end thereof the following new subchapter:

"Subchapter U⁽³⁾ - General Stock Ownership Corporations

"Sec. 1391. Definitions.

"Sec. 1392. Election by general stock ownership corporation.

"Sec. 1393. Corporation taxable income taxed to shareholders.

"Sec. 1394. Rules applicable to distributions of electing general stock ownership corporations.

"Sec. 1395. Adjustments to basis of stock of shareholders.

"Sec. 1396. Minimum distribution.

"Sec. 1397. Special rules applicable to earnings and profits of an electing general stock ownership plan.

"Sec. 1391. DEFINITIONS.

"(a) GENERAL STOCK OWNERSHIP CORPORATION. - For purposes of this subchapter, the term 'general stock ownership corporation' (hereinafter referred to as a 'GSOC') means a domestic⁽⁴⁾ corporation which -

"(1) is not a member of an affiliated group (as defined in section 1504),⁽⁵⁾ and

"(2) is chartered and organized after December 31, 1978, and before January 1, 1984; ⁽⁶⁾

"(3) is chartered by an act of a State legislature ⁽⁷⁾ or as a result of a State-wide referendum;

"(4) has a charter providing -

"(A) for the issuance of only 1 class of stock,

"(B) for the issuance of shares only to eligible individuals ⁽⁸⁾ (as defined in subsection (c));

"(C) for the issuance of at least one share to each eligible individual, ⁽⁹⁾ unless each eligible individual elects within one year after the date of issuance not to receive such share;

"(D) that no share of stock shall be transferable -

"(i) by a shareholder other than by will or the laws of descent and distribution until after the expiration of 5 years from the date such stock is issued by the GSOC except where the shareholder ceases to be a resident of the State; ⁽¹⁰⁾

"(ii) to any person other than a resident individual of the chartering State; ⁽¹¹⁾

"(iii) to any individual who, after the transfer, would own more than 10 shares of the GSOC; ⁽¹²⁾

"(E) that such corporation shall qualify as a GSOC under the Internal Revenue Code; ⁽¹³⁾

"(5) is empowered to invest in properties (but not in properties acquired by it or for its benefit through the right of eminent domain. ⁽¹⁴⁾

For purposes of this subsection, section 1504

(a) shall be applied by substituting '20 percent' for '80 percent' wherever it appears.

"(b) ELECTING GSOC. - For purposes of this subchapter, the term 'electing GSOC' means a GSOC which files an election under section 1392 which, under section 1392, is in effect for such taxable year. ⁽¹⁵⁾

"(c) ELIGIBLE INDIVIDUALS. - For purposes of subsection (a), the term 'eligible individual' means an individual who is, as of a date specified in the State's enabling legislation for the GSOC, a resident of the chartering State and who remains a resident of such State between that date and the date of issuance. ⁽¹⁶⁾

"(d) TREATED AS PRIVATE CORPORATION. - For purposes of this title, a GSOC shall be treated as a private corporation and not as a governmental unit. ⁽¹⁷⁾