

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672

934 SCOM32: AK GENERAL STOCK OWNERSHIP CORP. 1979-80

"(e) STUDY OF GENERAL STOCK OWNERSHIP CORPORATIONS. - The staff of the Joint Committee on Taxation shall prepare a report on the operation and effects of this subchapter relating to GSOC's. An interim report shall be filed within two years after the first GSOC is formed and a final report shall be filed by September 30, 1983.

"Sec. 1392. ELECTION BY GSOC.

"(a) ELIGIBILITY. - Except as provided in section 1393, any GSOC may elect, in accordance with the provisions of this section, not to be subject to the taxes imposed by this chapter.⁽¹⁸⁾

"(b) EFFECT. - If a GSOC makes an election under subsection (a) then -

"(1) with respect to the taxable years of the GSOC for which such election is in effect, such corporation shall not be subject to the taxes imposed by this chapter and, with respect to such taxable years and all succeeding taxable years, the provisions of section 1396 shall apply to such GSOC,⁽¹⁹⁾ and

"(2) with respect to each such taxable year, the provisions of section 1393, 1394, and 1395 shall apply to the shareholders of such GSOC.⁽²⁰⁾

"(c) WHERE AND HOW MADE. - An election under subsection (a) may be made by a GSOC at such time and in such manner as the Secretary shall prescribe by regulations.

"(d) YEARS FOR WHICH EFFECTIVE. - An election under subsection (a) shall be effective for the taxable year of the GSOC for which it is made and for all succeeding taxable years of the GSOC, unless it is terminated under subsection (f).

"(e) TAXABLE YEAR. - The taxable year of a GSOC shall end on October 31 unless the Secretary consents to a different taxable year."⁽²¹⁾

"(f) TERMINATION. - The election of a GSOC under subsection (a) shall terminate for any taxable year during which it ceases to be a GSOC and for all succeeding taxable years.⁽²²⁾ The election of a GSOC under subsection (a) may be terminated at any other time with the consent of the Secretary, effective for the first taxable year with respect to which the Secretary consents and for all succeeding taxable years.⁽²³⁾

"Sec. 1393. TAXABLE INCOME TAXED TO SHAREHOLDERS.

"(a) GENERAL RULE. - The taxable income of an electing GSOC for any taxable year shall be included in the gross income of the shareholders of such GSOC in the manner and to the extent set forth in this subsection. (24)

"(1) AMOUNT INCLUDED IN GROSS INCOME. - Each shareholder of an electing GSOC on any day of a taxable year of such GSOC shall include in his gross income for the taxable year with or within which the taxable year of the GSOC ends the amount he would have received if, on each day of such taxable year, there had been distributed pro rata to its shareholders by such GSOC an amount equal to the taxable income of the GSOC for its taxable year divided by the number of days in the GSOC's taxable year. (25)

"(2) TAXABLE INCOME DEFINED. - For purposes of this section, the term 'taxable income' of a GSOC shall be determined without regard to the deductions allowed by part VIII of subchapter B (other than deductions allowed by section 248, relating to organizational expenditures). (26)

"(b) SPECIAL RULE FOR INVESTMENT CREDIT. (27) - The investment credit of an electing GSOC for any taxable year shall be allowed as a credit to the shareholders of such corporation in the manner and to the extent set forth in this subsection.

"(1) CREDIT. - There shall be apportioned among the shareholders a credit equal to the amount each shareholder would have received if, on each day of such taxable year, there had been distributed pro rata to the shareholders the electing GSOC's net investment credit divided by the number of days in the GSOC's taxable year.

"(2) NET INVESTMENT CREDIT. - For purposes of this paragraph the term 'net investment credit' means the investment credit of the electing GSOC for its taxable year less any tax from recomputing a prior year's investment credit in accordance with section 47.

"(3) RECAPTURE. - There shall be apportioned among the shareholders of a GSOC, in the manner described in paragraph (1), an additional tax equal to the excess of any tax resulting from recomputing a prior year's investment credit in accordance with section 47 over the investment credit of the GSOC for its taxable year.

"Sec. 1394. RULES APPLICABLE TO DISTRIBUTIONS OF AN ELECTING GSOC'S⁽²⁸⁾

"(a) SHAREHOLDER INCOME ACCOUNT. - An electing GSOC shall establish and maintain a shareholder income account⁽²⁹⁾ which account shall be -

"(1) increased at the close of the GSOC's taxable year by an amount equal to the GSOC's taxable income for such year,⁽³⁰⁾ and

"(2) Decreased, but not below zero, on the first day of the GSOC's taxable year by the amount of any GSOC distribution to the shareholders of such GSOC made or treated as made during the prior taxable year.⁽³¹⁾

"(b) TAXATION OF DISTRIBUTION. - Distributions by an electing GSOC shall be treated as -

"(1) a distribution of previously taxed income to the extent such distribution does not exceed the balance of the shareholder income account as of the close of the taxable year of the GSOC,⁽³²⁾ and

"(2) a distribution to which section 301(a) applies but only to the extent such distribution exceeds the balance of the shareholder income account as of the close of the taxable year of the GSOC.⁽³³⁾

"(c) DISTRIBUTIONS NOT TREATED AS A DIVIDEND. - Any amounts includible in the gross income of any individual by reason of ownership of stock in a GSOC shall not be considered as a dividend for purposes of section 116.⁽³⁴⁾

"(d) REGULATIONS. - The Secretary shall have authority to prescribe by regulation, rules for treatment of distribution in respect of shares of stock of the GSOC that have been transferred during the taxable year."⁽³⁵⁾

"Sec. 1395. ADJUSTMENT TO BASIS OF STOCK OF SHAREHOLDERS.⁽³⁶⁾

"The basis of a shareholder's stock in an electing GSOC shall be increased by the amount includible in the gross income of such shareholder under section 1393, but only to the extent to which such amount is actually included in the gross income of such shareholder.

"Sec. 1396. MINIMUM DISTRIBUTIONS.

"(a) GENERAL RULE. - A GSOC shall distribute at least 90 percent of its taxable income for any taxable year by January 31 following the close of such taxable year.⁽³⁷⁾ Any distribution made on or before

January 31 shall be treated as made as of the close of the preceding taxable year.

"(b) IMPOSITION OF TAX IN CASE OF FAILURE TO MAKE MINIMUM DISTRIBUTION.⁽³⁸⁾ - If a GSOC fails to make the minimum distribution requirements described in subsection (a), there is hereby imposed on the GSOC a tax equal to 20 percent of the excess of the amount required to be distributed over the amount actually distributed.

"Sec. 1397. SPECIAL RULES APPLICABLE TO AN ELECTING GSOC.⁽³⁹⁾

"(a) GENERAL RULE. - The current earnings and profits of an electing GSOC as of the close of its taxable year shall not include the amount of taxable income for such year which is required to be included in the gross income of the shareholders of such GSOC under section 1393(a).⁽⁴⁰⁾

"(b) SPECIAL RULE FOR AUDIT ADJUSTMENTS.⁽⁴¹⁾ -

"(1) TAXABLE INCOME. - Taxable income of an electing GSOC shall, in the year of final determination, be increased or decreased, as the case might be, by any adjustment to taxable income for a prior taxable year.

"(2) INVESTMENT CREDIT. - The investment credit of an electing GSOC shall, in the year of final determination, be increased or decreased, as the case might be, by any adjustment to the net investment credit for a prior taxable year.

"(3) METHOD OF MAKING ADJUSTMENTS. - An electing GSOC shall include in gross income for the year of an adjustment the amount described in paragraph (1) and shall take into account the adjustment described in paragraph (2), and shall be liable for payment of interest in the amount that would have been payable by the GSOC under section 6601 (relating to interest on underpayment, nonpayment or extensions of time for payment, of tax) or receivable by the GSOC under section 6611 (relating to interest on overpayments) if such GSOC had been a corporation other than an electing GSOC.

(b) TECHNICAL AMENDMENTS. -

(1) NET OPERATING LOSS DEDUCTION.⁽⁴²⁾ - Paragraph (1) of section 172(b) (relating to net operating loss carrybacks and carryovers) is amended by adding at the end thereof the following new subparagraph:

"(H) In the case of an electing GSOC which has a net operating loss for any taxable year such loss shall not be a net operating loss carry-

back to any taxable year preceding the year of such loss, but shall be a net operating loss carryover to each of the 10 taxable years following the year of such loss."

(2) INCOME TAX COLLECTED AT SOURCE.⁽⁴³⁾ - Section 3402 (relating to income collected at source) is amended by adding at the end thereof the following new subsection:

"(r) EXTENSION OF WITHHOLDINGS TO GSOC DISTRIBUTIONS. -

"(1) GENERAL RULE. - An electing GSOC making any distribution to its shareholders shall deduct and withhold from such payment a tax in an amount equal to 25 percent of such payment.

"(2) COORDINATION WITH OTHER SECTIONS. - For purposes of sections 3403 and 3404 and for purposes of so much of subtitle F (except section 7205) as relates to this chapter, distributions of an electing GSOC to any shareholder which are subject to withholding shall be treated as if they were wages paid by an employer to an employee."

(3) ADJUSTMENTS TO BASIS.⁽⁴⁴⁾ - Section 1016(a) (relating to adjustments of basis) is amended by redesignating paragraph (23) as (22) and by inserting after paragraph (20) the following new paragraph:

"(21) to the extent provided in section 1395 in the case of stock of shareholders of a general stock ownership corporation (as defined in section 1391) which makes the election provided by section 1392; and".

(4) RETURN OF GENERAL STOCK OWNERSHIP CORPORATION.⁽⁴⁵⁾ - Subpart A of part III of subchapter A of Chapter 61 (relating to information returns) is amended by adding at the end thereof the following new section:

"Sec. 6039B. RETURN OF GENERAL STOCK OWNERSHIP CORPORATION.

"Every general stock ownership corporation (as defined in section 1391) which makes the election provided by section 1392 shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowable by subtitle A, the amount of investment credit or additional tax, as the case may be, the names and addresses of all persons owning stock in the corporation at any time during the taxable year, the number of shares of stock owned by each shareholder at all times during the taxable year, the amount of money and other property distributed by the corporation during the taxable year to each shareholder, the date of each such distribution, and such other information, for the purpose of carrying out the provisions of subchapter U of chapter 1, as the Secretary may by regulation

prescribe. Any return filed pursuant to this section shall, for purposes of chapter 66 (relating to limitations), be treated as a return filed by the corporation under section 6012.⁽⁴⁶⁾ Every GSOC shall file an annual report with the Secretary summarizing its operations for such year."⁽⁴⁷⁾

(c) CLERICAL AMENDMENTS.⁽⁴⁸⁾ -

(1) The table of subchapters for chapter 1 is amended by adding at the end thereof the following:

"SUBCHAPTER U. - General stock ownership plans."

(2) The table of sections for subpart A of part III of subchapter A of chapter 61 is amended by adding at the end thereof the following:

"Sec. 6039B. Return of general stock ownership corporation."

(d) EFFECTIVE DATE.⁽⁴⁹⁾ - The amendments made by this section shall apply with respect to corporations chartered after December 31, 1978, and before January 1, 1984.

1. The Revenue Bill of 1978 was passed by the Congress of the United States on October 14, 1978, and signed into law by President Carter on November 6, 1978. The General Stock Ownership Corporation provisions were included as a Senate amendment to that Bill (H.R. 13511) and appear in the legislation as Title VI.

2. The Internal Revenue Code is organized into chapters, subchapters, sections, and subsections. Chapter 1 of the Internal Revenue Code deals generally with the income tax provisions of the Federal law covering both personal and corporate taxes.

3. The Revenue Act of 1978 amends Chapter 1 of the Internal Revenue Code to add a new subchapter designated as Subchapter U. This subchapter, containing seven sections (Sections 1391-1397), sets forth the Federal tax law regarding General Stock Ownership Corporations.

4. A domestic corporation is a corporation which is organized under the laws of the United States or a state thereof.

5. The Internal Revenue Code, Section 1504, defines an affiliated group for purposes of determining which corporations are eligible to file consolidated returns. Generally, an affiliated group is formed when one corporation acquires 80% or more of the voting stock of one or more other corporations. The 80% or more definition in Section 1504 is to be read as 20% or more for purposes of the GSOC legislation.

Since GSOC stock may not be owned by a corporation or other non-individual, the limitation on membership in affiliated groups applies only to ownership by the GSOC of stock in other corporations. The GSOC, in order to avoid being a member of an affiliated group, may not own 20% or more of the stock in another corporation. Failure to comply with this requirement would appear to jeopardize the special tax treatment available to the GSOC under Federal law.

This limitation was included in the GSOC provisions in order to prevent the GSOC from becoming a holding company for other corporations' stock. Because of the special nature of the GSOC tax advantages this limitation is not particularly significant. The elimination of corporate income taxes for the GSOC may not be extended to corporations owned by the GSOC. Therefore, any subsidiary corporation would be fully subject to the Federal income tax, and dividends paid by such a corporation to the GSOC would be net of Federal taxes. The special tax advantage of the GSOC in eliminating the Federal corporate income tax would therefore be defeated by significant ownership of subsidiary corporations.

6. In keeping with the experimental nature of the General Stock Ownership Corporation legislation, a five year period was provided during which such corporations may be formed. Any corporation not formed within the dates set forth in the Act

will not be eligible for treatment under Federal tax law as a General Stock Ownership Corporation. However, any corporation formed and qualifying under these provisions during the five year period will continue to receive the special tax treatment provided GSOCs indefinitely. There is no limitation on the tax advantages once a corporation is established within the designated time frame.

7. The term charter is used in its broadest sense and means that the corporation must have a special grant of powers from either the State Legislature or a statewide referendum. It would not appear to be acceptable for a state to generally authorize the creation of GSOCs. But, it also does not appear necessary for a state to adopt into the law the actual Articles of Incorporation for the GSOC. Indeed, it may be unacceptable for a Legislature to enact the Articles of Incorporation into law and subsequently allow the stockholders of the corporation to amend the Articles. Amendment of the Articles of Incorporation in such a case would appear to effectively amend the statutes of the authorizing state and this would seem to be an unconstitutional delegation of the power of a State Legislature. Conversely, if the Articles of Incorporation could not be amended by its stockholders, it would not appear to be a private business corporation as Congress contemplates by this law.

8. Eligible individual is defined in Section 1391(c) and will be further discussed in Footnote 16 below.

9. At least one share of stock in the General Stock Ownership Corporation must be issued to each eligible individual unless that individual elects within the first year of ownership not to receive the stock. This language does not appear to preclude charging a purchase price for the stock, but in such an event would seem to require that some accommodation be made for those eligible individuals who are not in a position or who are unwilling to pay for the stock. Generally, the drafters of the legislation contemplated the simple distribution of the stock without charge to eligible individuals, with corporate operations and purchases thereafter financed initially through debt instruments only. This would enable the stockholders to build an equity in the stock through amortization of debt with the earnings of corporate investments.

10. In order to qualify as a General Stock Ownership Corporation, the transfer of corporate stock must be restricted during the first five years following its issuance. Since it was contemplated that stockholders in a General Stock Ownership Corporation would be limited to the residents of the authorizing state, an exception is provided so that if an individual ceases to be a resident or dies during the first five years, his stock may be sold or transferred.

The five year transfer restriction was included in order to give shareholders a period of time during which to become familiar with the benefits of stock ownership. It is hoped that

during the first five years of corporate operations the GSOC would be in a position to distribute dividends, giving its shareholders some experience with the income generating capabilities of capital and giving those interested in the formation of these particular corporations an opportunity to study the reactions of shareholders to this new type of investment.

In order to discourage shareholders from emigrating in order to sell their stock prior to the end of the five year period, it may be necessary to provide for some controlled purchase price. This could be done in the form of an option on the part of the corporation to repurchase stock from an individual emigrating from the authorizing state at a value below either the fair market value or income stream valuation approach. Such a repurchase would be consistent with the private capital nature of the GSOC stock and could return to the shareholder his book equity. Book equity valuation for purposes of a mandatory repurchase during the five year nontransferability period might be appropriate in that this represents the shareholder's share of cash invested in acquiring the asset. This is the case because the distribution of stock was cost free to the shareholder and his only investment at the time of sale will be in the form of what would otherwise be cash distributions applied to the repayment of the debt incurred to buy the underlying assets. Thus the shareholder is paying for his capital out of the income it produces.

In the event that a shareholder whose shares are repurchased at book value has incurred tax liability in excess of his distributions of cash from the corporation, his basis in the stock will be increased accordingly and he will receive a capital loss deduction for the difference between the book value purchase price and his adjusted basis. This loss deduction will offset his future additional income from the GSOC, insuring that he remains whole once the transaction is concluded if the assets purchased by the GSOC have thrown off in income their purchase costs and necessary interest.

11. Transfers of GSOC stock may not be made to individuals who are not "residents" of the authorizing state. This limitation is designed to assure that the GSOC, which must begin life as a corporation owned by the residents of a single state, either continues to be owned by those residents or, if they are permitted to take it out of state and cease to be residents, they must at or before their death transfer their GSOC stock to a qualified resident. Thus, while a holder of GSOC stock may sell or otherwise dispose of his stock, he may not do so to a corporation, trust, partnership, or other artificial person nor to any individual who is not a resident of the authorizing state.

12. This limitation on transfers was included in order to assure that great concentrations of GSOC stock do not develop. The GSOC was conceived as a means of broadening capital ownership and thereby spreading more widely the income benefits from capital. This transfer limitation implements these goals.

13. The requirements of Section 1391(4)(A)-(E) are limitations which must be included in both the GSOC authorizing legislation adopted by the State Legislature and the Articles of Incorporation for the GSOC. The limitation set forth in (E) simply makes it clear that both the authorizing Legislature and the incorporators of the General Stock Ownership Corporation intend to qualify under the provisions of Subchapter U of the Internal Revenue Code.

14. There are generally no limitations on the types of investments which GSOCs may undertake. However, because of the unique relationship between GSOCs and the authorizing State Legislatures, certain members of Congress felt it necessary to clarify that GSOCs may not be used as vehicles through which ownership of existing capital assets can be transferred from one group to another through the exercise of the state's powers of eminent domain. Therefore, this limitation was added to prevent the power of state condemnation from being used to transfer unwillingly ownership of an existing business to a General Stock Ownership Corporation. This language does not preclude the condemnation of a pipeline right of way or the purchase by a General Stock Ownership Corporation of an asset a component of which is acquired by the sellers through condemnation. It is designed only to preclude the direct condemnation of existing business assets and a resale thereof to the GSOC.

15. The General Stock Ownership Corporation, in order to avail itself of the special tax treatment provided under Subchapter U, must file an election with the Secretary of the Treasury under the terms of Section 1392, discussed below at Footnote 18.

16. Eligible individuals are those individuals to whom stock must be issued under the provisions of Section 1391(a)(4)(B). Stock must be issued to individuals who are, as of a specific date set forth in the state's GSOC enabling legislation, residents of the state and who remain residents of the state until the date the stock is actually issued. The statutory language with respect to a specific date was included to allow a State Legislature to select a date certain upon which residency could be determined. It was contemplated that such a date might be one prior to the date of the enabling legislation in order to assure that a flood of immigrants to the state would not be encouraged.

The term resident may be defined by the State Legislature for purposes of the GSOC legislation in any constitutional and acceptable manner. The term resident itself is a legal term of uncertain meaning, the definition of which varies with the use. For purposes of general stock ownership legislation it may be appropriate to use a definition of resident which equates that term with the legal term of "domiciliary". This would give a definition of resident dependent not only upon present mailing address or physical location within the state, but intent, however evidenced, to establish and maintain primary geographical living situs within the State of Alaska.

17. The GSOC is to be treated as a private corporation and therefore is not eligible to issue securities or levy taxes as a governmental unit or municipal corporation.

18. To take advantage of the special provisions of Subchapter U, the General Stock Ownership Corporation must file an election under the provisions of Section 1392. The election is to be made at the time and in the manner described by the Secretary of the Treasury. Section 1392(b) is effective for the taxable year of the GSOC for which it is filed and for all later taxable years unless the election is terminated.

19. If the GSOC makes an election under Section 1392, the GSOC corporation itself is exempt from all the income taxes imposed by Chapter 1 of the Internal Revenue Code for the year in which the election is made and all following years until the election is terminated. The GSOC is, however, subject to the limitations of Section 1396 which requires minimum distributions of GSOC income and imposes a penalty tax in the event of a failure to distribute income in accordance with Section 1396 requirements.

20. While the electing GSOC is exempt from Federal income tax, the income of the corporation is taxed to the shareholders under Sections 1393, 1394 and 1395. These sections set out the rules under which the shareholders are attributed the income of the General Stock Ownership Corporation, provide for tax treatment of GSOC distributions, and establish rules for determining the basis of a shareholder's stock.

21. In order to assure that significant deferral of income does not occur, the General Stock Ownership Corporation is required to operate on a taxable year ending on October 31st. This allows the corporation sufficient time to determine its taxable income for the year and to provide that information to the shareholders prior to the April 15th regular filing deadline for shareholders' returns.

22. It appears that under the Federal legislation there is at least one event which could involuntarily terminate the special tax status of the General Stock Ownership Corporation, and that event would be membership in an affiliated group which is prohibited under the terms of Section 1391(a)(1). Depending on interpretations of the general law, other events might involuntarily terminate the special status of the GSOC, such as a revocation by the State Legislature of a corporation's charter or amendments to the Articles of Incorporation which remove the conditions required by Section 1391(4) and (5).

23. The election of the General Stock Ownership Corporation to qualify under Subchapter U may be terminated at any time with the consent of the Secretary of the Treasury. Voluntary termination of GSOC status under Subchapter U might be sought in the event that a General Stock Ownership Corporation were to incur taxable income, perhaps from recapture on the sale of an asset, substantially in excess of cash available for distribution. At

this point the Board of Directors might elect to terminate GSOC status so that the taxable income of the corporation did not flow through to the shareholders, but remained, under the normal rules of corporate taxation, with the corporation. While it is not expected that such an event is likely to occur, it was felt that an option should be provided to allow voluntary termination of elections.

24. This provision makes it clear that the income of the General Stock Ownership Corporation is to be taxed directly to the shareholders.

25. If an individual is a shareholder of a General Stock Ownership Corporation at any point during the GSOC's taxable year, that individual will be attributed a share of the corporation's income for that taxable year. The income must be included in the return of the shareholder for the shareholder's tax year during which the GSOC year ends. Thus, if an individual is a shareholder of a GSOC at any time during the corporation's fiscal year beginning on November 1, 1980, and ending on October 31, 1981, the shareholder would be required to include his share of GSOC income on his personal return for calendar year 1981.

If an individual is a shareholder of a General Stock Ownership Corporation throughout the entire taxable year of the corporation, his share of GSOC income is determined by dividing the total amount of GSOC income for the year by the number of shares of stock outstanding and then multiplying this per share earnings figure by the number of shares owned by the shareholder. If, however, the shareholder should dispose of his stock during the corporation's taxable year, he will be attributed income from the corporation on the basis of the number of days during the corporation's taxable year during which he was a shareholder. The per share income of the corporation for the entire year would be divided by 365 to determine the per share daily earnings of the corporation and this amount would be multiplied by the number of days during the year which the shareholder owned his stock. The product of this formula would give the earnings attributable to shareholder's part year ownership interest and this amount would be included in the shareholder's taxable year during which the GSOC year ends.

26. The term taxable income is a clearly defined term for the purposes of the Internal Revenue Code. The taxable income of the General Stock Ownership Corporation is to be determined under the normal rules for corporations, although the General Stock Ownership Corporation is not required to pay tax on this income. The General Stock Ownership Corporation is not allowed to deduct those items normally allowed to corporations under Part 8 of Subchapter B. These deductions include the dividend received deduction, the foreign corporation dividend received deduction, public utilities dividends deduction, and other minor tax deductions. The General Stock Ownership Corporation is allowed to deduct the organizational expenses allowed by Section 248 under

Part 8 of Subchapter B of the Internal Revenue Code. Section 248 provides an option to corporations to deduct organizational expenses over a period of not less than sixty months.

27. The Internal Revenue Code allows a tax credit equal to 10% of the purchase price of certain types of new and used property. This 10% credit is a dollar for dollar offset against taxes due rather than a deduction from gross income in arriving at taxable income. The property eligible for the investment tax credit is generally depreciable tangible personal property, excluding buildings and structural components, used by an individual or corporation engaged in a trade or business and having a useful life of at least three years. The investment tax credit may be taken on the taxpayer's return during the year in which the taxpayer places such an asset into use in his trade or business. In the event that the taxpayer disposes of an asset on which he has taken an investment tax credit prior to the required seven year holding period, he is subject to recapture by the Federal Government of all or a portion of the investment tax credit in the form of additional tax liability. The sections of the Internal Revenue Code applicable to investment tax credits and investment tax credit recapture include Sections 38, 46, 47, and 48.

The 10% investment tax credit is not allowed to a General Stock Ownership Corporation. This is unimportant, however, since the General Stock Ownership Corporation has no tax liability and therefore could not avail itself of the tax credit in any event. Section 1393(b) provides that the investment tax credit to which a General Stock Ownership Corporation would be entitled if it were taxable shall flow through to the shareholders in much the same manner as income. The investment tax credit and any recapture of investment tax credit generated by the sale of corporate assets will be netted at the corporate level. If there is a net investment tax credit, that amount will be prorated to the shareholders in the same manner as income. If there is a net investment tax credit recapture, this amount will be prorated as well, but will be characterized as additional tax liability to the shareholders. It is not expected that the corporation will operate in such a way as to generate any significant amount of net investment credit recapture.

28. Distributions of corporate income are normally taxed as ordinary income to the extent that they constitute dividends paid out of the earnings of the corporation. Distributions in excess of the accumulated earnings of the corporation are treated as a reduction in the shareholder's basis in his stock and to the extent they exceed the shareholder's basis are taxed at capital gains rates. Additional rules are necessary for distributions from General Stock Ownership Corporations since the distributions do not bear direct relationship to the amount of tax which the shareholders may pay. The rules of Section 1394 are designed to indicate whether a distribution of cash from a General Stock Ownership Corporation is a distribution of

income which has already been taxed to the shareholders, a distribution of capital reducing the shareholder's basis in his shares, or a capital gain.

29. The shareholder income account is simply a bookkeeping entry of the corporation designed to keep track of the relationship between taxable income of the GSOC attributed to the shareholders and cash distributions by the GSOC to its shareholders.

30. The shareholder income account is increased at the close of each GSOC taxable year by an amount equal to the GSOC's taxable income in order to indicate the total amount of taxable income which has been attributed to the shareholders and is taxable to them.

31. The shareholder income account is decreased to a minimum balance of zero at the beginning of each GSOC taxable year by the amount of distributions made to the shareholders from the GSOC during the prior year. Thus the account which has been increased by the amount of GSOC taxable income for the prior year is immediately decreased by the amount of distributions made from the GSOC during the same year. Any balance remaining in the GSOC income account after these entries have been made will show the amount of GSOC income in excess of cash distributions on which the GSOC shareholders have paid tax. A General Stock Ownership Corporation is required by Section 1396 to distribute at least 90% of its taxable income for any taxable year ending October 31st by January 31st of the following year. Any distribution made on or before January 31st is to be treated as if it were made as of the close of the preceding taxable year ending October 31st. This means that distributions made within three months of the close of the GSOC's taxable year will be treated as made during the preceding taxable year for purposes of the shareholder income account.

32. To the extent that distributions of the General Stock Ownership Corporation do not exceed the amount in the shareholder income account as of the close of the taxable year (the taxable income of the GSOC for the current year and any taxable income in excess of the distributions from prior years), the distribution will be treated as a distribution of income which has already been taxed to the shareholders and therefore will come to the shareholders tax free.

33. If the distribution should exceed the balance of the shareholder income account, the account would be netted out at zero and distributions in excess of the account would be dealt with under Section 301(a) of the Internal Revenue Code. Section 301 provides that distributions which are not a dividend within the meaning of Code Section 316 (which such GSOC distributions would not be) are treated first as a reduction of the shareholder's basis in his stock and, to the extent the distribution exceeds the shareholder's basis, the distribution is treated as a capital gain. Distributions which are treated as a capital gain will

either be treated as a short term or long term capital gain depending on the time period during which the shareholder has owned his stock.

34. Section 116 of the Internal Revenue Code provides a \$100.00 exclusion for individuals receiving dividends on corporate stock. This provision is a simplified way of eliminating the double taxation of dividends for the recipients of small dividend amounts. Since the double taxation of dividends has been completely eliminated for all shareholders in a General Stock Ownership Corporation, it was felt that this additional tax concession was unnecessary. Therefore, the income attributable to an individual taxpayer from a General Stock Ownership Corporation is not eligible for the \$100.00 dividend exclusion provided by Section 116.

35. Distributions from the General Stock Ownership Corporation of cash or other property may not directly parallel the tax liability of the respective owners of stock in a situation where a sale of stock occurred during the taxable year. It was felt appropriate to provide the Secretary of the Treasury with regulatory authority to determine the best means of adjusting the relative tax statuses of the seller and buyer and to establish rules for the allocation of distribution rights between the two parties.

36. Generally, in a conventional corporation, the basis of a shareholder in his corporate stock equals the price paid for that stock. Upon a sale of the stock, the shareholder determines his taxable gain by deducting his basis from the sale's proceeds. It is this amount which is referred to in the tax laws as a capital gain. The shareholder in a General Stock Ownership Corporation which distributes its stock free of charge to the shareholders will have a basis in his stock at the time of receipt equal to zero. In the event that distribution of the stock should result in a tax liability to the shareholder because the Internal Revenue Service has imputed income to him from the receipt of stock, the shareholder would receive a basis in the stock equal to the value at which the stock is assessed for purposes of Federal income taxation.

Section 1395 provides a special rule for determining the basis of stock in General Stock Ownership Corporations. Assuming that no income is imputed to the shareholder upon receipt of his shares, he will have a zero basis in the stock at the time of receipt. The basis in his stock will then be increased for the amount of GSOC income which is attributed to him for tax purposes. This means that as he pays tax on General Stock Ownership Corporation income the basis in his stock will increase. The basis will be decreased for distributions from the General Stock Ownership Corporation reflecting the shareholder's receipt of income on which he has paid tax. In the normal course of events, a General Stock Ownership Corporation shareholder will have a basis in his stock which reflects the difference between the income of the corporation on which he has been taxed

less the cash distributions which he has received from the corporation. If the corporation distributes all of its taxable income, the shareholder will continue to have a zero basis in his stock and the entire proceeds of any sale thereof will be treated for tax purposes as a capital gain.

37. In order to assure that the shareholders of the General Stock Ownership Corporation have cash on hand sufficient to cover the tax liability generated by the income attributed to them from the General Stock Ownership Corporation, the corporation is required to distribute to its shareholders at least 90% of its taxable income for the year ending October 31st on or before the following January 31st. This distribution would normally allow the shareholders to have cash on hand to pay their personal taxes for the year ending December 31st on the following April 15th when those taxes become due.

38. In order to insure that the General Stock Ownership Corporation makes the distributions required by Section 1396, a penalty is provided for failure to do so. This penalty is an additional tax (deductible by the General Stock Ownership Corporation) equal to 20% of the amount which the GSOC failed to distribute on a timely basis. Thus, if the General Stock Ownership Corporation had taxable income for the year of \$100.00 and distributed only \$80.00 by January 31st of the following year, it would fail to comply with the requirements of Section 1396. Section 1396 requires a 90% distribution of taxable income and would have required the corporation to distribute \$90.00 to its shareholders by January 31st of the following year rather than \$80.00. A 20% tax would be levied on the difference between the amount which should have been distributed (\$90.00) and the amount which was in fact distributed (\$80.00). Thus, the tax would be 20% of \$10.00 or \$2.00.

39. Section 1397 sets forth special rules applicable to a General Stock Ownership Corporation and a number of technical amendments to other sections of the Internal Revenue Code necessary to the operation of the GSOC provisions.

40. Earnings and profits is a technical term under the Internal Revenue Code and is composed essentially of the undistributed retained earnings of the corporation. Current earnings and profits are determined on an annual basis and if undistributed are added to earnings and profits generally. Distributions by a corporation are treated as dividends and taxed as ordinary income to the extent of a corporation's earnings and profits. Therefore, it is important in dealing with a General Stock Ownership Corporation, whose income is taxed to the shareholders, to assure that income which is so taxed is not included in earnings or profits. This general rule sets forth that position and assures that current earnings and profits for a General Stock Ownership Corporation do not include income of the corporation which is taxed to its shareholders.

41. When the Internal Revenue Service audits a taxpayer, it may find that an overpayment to the government has been made by the taxpayer or that the taxpayer owes additional taxes to the government. It may be several years before an audit of a taxpayer is completed and a final determination of his tax status for a particular year is determined. Normally an adjustment is made in the taxpayer's tax liability for the year being audited and that adjustment is paid by the taxpayer or the government in the year in which the audit is completed.

In the case of a General Stock Ownership Corporation, audit adjustments are treated in a modified manner. Since the shareholders of the General Stock Ownership Corporation are taxed directly on the income of the corporation, any error in the corporation's tax status for a particular year will be reflected on the individual returns of each shareholder. It would be very clumsy and complicated to adjust the tax status of each GSOC shareholder for such an error. If audit adjustments were handled in this manner, it might well happen that hundreds of thousands of shareholders would find themselves being audited by the Internal Revenue Service because of the tax treatment of a particular item by the General Stock Ownership Corporation. To avoid this result, audit adjustments for General Stock Ownership Corporations are to be made at the corporate level and reflected in the income of the corporation for the year in which a final determination of the tax audit is completed. This means that if the General Stock Ownership Corporation understated its income for a particular year due to the error in the tax treatment of a particular item, the adjustment for that error would be made in the year of the final determination and the corporation would have additional income in that year as a result of the adjustment. In addition, the corporation may be liable for interest payments and penalties which will be computed in the normal manner under Section 6601 of the Code. In the event that the General Stock Ownership Corporation overstated its income and therefore the shareholders had tax liability in excess of the correct amount, adjustments would be made in the form of a reduction to the current year General Stock Ownership Corporation income and a cash payment by the government equal to the interest due on overpayments under Internal Revenue Code Section 6611.

42. This provision amends the net operating loss deduction provisions of Section 172(b) to provide for a ten year carryover of net operating losses for General Stock Ownership Corporations. This means that if the General Stock Ownership Corporation for any year should incur a net operating loss (total deductible costs of operation in excess of the current year's income) the corporation can carry this loss over and use it as a deduction against future years' income for a period of ten years from the year in which the loss was incurred.

43. Section 3402 of the Internal Revenue Code provides for the withholding of taxes by employers directly from employees' paychecks. In order to assure that the shareholders of a General

Stock Ownership Corporation are not attributed income on which they are unable to pay the tax, the GSOC is required to withhold from each cash distribution to its shareholders an amount equal to 25% of the cash payment. This amount will be paid to the Federal Government and be credited to the shareholders as an advance payment of the tax due. This provision creates a new Section 3402(r) which sets forth the general rule on withholding and ties the GSOC withholding provisions into the general rules dealing with withholding on wages. Of particular note is the provision in Section 3402(n) which provides an exemption from the withholding provisions for individuals who have filed a withholding exemption certificate with the General Stock Ownership Corporation certifying that the shareholder incurred no tax liability for the preceding taxable year and anticipates that he will incur no tax liability for the current year.

44. This provision simply cross-references the basic provisions for the General Stock Ownership Corporation set forth in Section 1395 back into the general basis provisions in the capital gains sections of the Code at Section 1016(a).

45. This provision sets forth requirements for an information return to be filed by the General Stock Ownership Corporation with the Internal Revenue Service. This return is an information return only as the GSOC itself is exempt from Federal income taxes. The information on the return must include a statement of the General Stock Ownership Corporation's income for the year, investment credits, the names and addresses of the shareholders, the number of shares owned by each, the amount of GSOC distributions to each shareholder, the date of each distribution, and any other information which the Secretary of the Treasury may prescribe by regulation.

46. For purposes of the statute of limitations on income tax audits and crimes, the return of a General Stock Ownership Corporation is to be treated as a return filed under Code Section 6012, which sets forth who must file income tax returns. Other procedural provisions of the Internal Revenue Code are tied into Code Section 6012 so that the General Stock Ownership Corporation will be covered by the normal rules regarding filing requirements, audits and the rights of taxpayers.

47. In addition to filing an annual information return with the Internal Revenue Service, the General Stock Ownership Corporation is required to file its annual report with the Secretary of the Treasury. It is contemplated that this annual report would be significantly more detailed than a normal corporate annual report and would address such questions as the effect of the GSOC on distributions of income and wealth, the level of transfer payments made or required, the social and demographic profiles of GSOC shareholders, the level of economic understanding of GSOC shareholders, and possible beneficial revisions of General Stock Ownership Corporation legislation.

48. This provision simply amends the index and tables of the Internal Revenue Code to provide for the inclusion of Subchapter U.

49. The operative dates for Subchapter U are set forth in this provision which makes it clear that the Subchapter U changes apply to corporations formed within the December 31, 1978 - January 1, 1984 time frame. It is clear from the language in this provision that the tax benefits of Subchapter U will continue after January 1, 1984, for any corporation formed within this time frame and continuing to comply with the provisions of Subchapter U.

INVESTMENT OPPORTUNITIES FOR AN
ALASKAN
GENERAL STOCK OWNERSHIP COMPANY

A REPORT TO THE ALASKA STATE LEGISLATURE

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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

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	<u>173,499</u>	<u>100.0</u>	<u>164,107</u>	<u>100.0</u>

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

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, are 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.

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 to a lack of investment potential, but to 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,

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 will 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

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.

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 is 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

The analysis summarized in Tables 1A, 1B, 2A, 2B, 3A, and 3B, show potential projections for BP Pipelines interest in TAPS. (Corresponding Tables 1C, 1D, 2C, 2D, 3C and 3D show similar situations for AGSOC ownership as discussed later.) 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. 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.

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.

Since AGSOC ownership would change depreciation schedules, tax rates and cash flows, the corresponding Tables 1, 2 and 3, show the effects of various tariffs on AGSOC income and shareholder distributions. For all tariffs except a \$6.35 tariff, cash distributions available for shareholders terminate after ten years or so without tariff increases; however, since operating expenses continue to increase, there is substantiation for tariff increases, especially if new oil reserves are not discovered.

Table 1A

BP PIPELINES

NET INCOME

(\$000)

YEAR	DELIVERY VOLUMES (000 BBL/S)	TARIFF	REVENUES	OPERATING EXPENSES	INTEREST	DEPRECIATION AND AMORTIZATION	INCOME TAX	NET INCOME
		\$	\$	\$	\$	\$	\$	\$
1979	64062	4.68	299810	74000	104735	61580	29748	29747
1980	64062	4.68	299810	79180	104735	61580	27158	27157
1981	64062	4.68	299810	84723	102347	61580	25580	25580
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	103780	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	27071	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

ALYESKA EXPENSE: 60000 DIRECT EXPENSE: 6500

DP PIPELINES

Table 1B

CASH FLOW
(\$000)

YEAR	REVENUES	NET INCOME	DEPRECIATION AND AMORTIZATION	DISMANTLING RESERVE	PRINCIPAL PAYMENTS	NET CASH FLOW	CUMULATIVE CASH FLOW
1979	\$ 299810	\$ 29747	\$ 61580	\$ 7500	\$ 0	\$ 98027	\$ 98027
1980	299810	27157	61580	8025	25400	71362	170189
1981	299810	25580	61580	8587	50000	45747	215936
1982	299810	24964	61580	9188	50100	45632	261568
1983	299810	24146	61580	9831	130500	-34943	226625
1984	299810	26885	61580	10519	50100	48884	275509
1985	299810	25608	61580	11255	53200	45243	320752
1986	299810	24221	61580	12043	53300	44544	365296
1987	299810	22567	61580	12886	53200	43833	409129
1988	299810	20617	61580	13788	53300	42685	451814
1989	299810	18361	61580	14753	53200	41494	493308
1990	299810	15766	61580	15786	53300	39832	533140
1991	299810	12820	61580	16891	53300	37971	571131
1992	299810	9492	61580	18073	53300	35845	606976
1993	299810	5756	61580	19338	38500	48174	655150
1994	299810	887	61580	20692	23500	59659	714809
1995	299810	-5155	61580	22140	23500	55065	769874
1996	299810	-11696	61580	23690	23500	50074	819948
1997	299810	-18773	61580	25348	23500	44655	864603
1998	299810	-26422	61580	27122	22200	40080	904683
1999	299810	-34746	61580	29021	12900	42955	947638
2000	299810	-44162	61580	31052	27000	21470	969108
2001	299810	-53617	61580	33226	8900	32289	1001397
2002	299810	-64674	61580	35552	8900	23558	1024955

INTEREST RATE: 940 TAX RATE: 500 INFLATION RATE: 070
PIPELINE VALUE: 1114200
ALLEGRA EXPENSE: 60000 DIRECT EXPENSE: 6500

Table 1C

AGSOC

NET INCOME

(\$000)

YEAR	DELIVERY VOLUMES (000 BBLs)	TARIFF	REVENUES	OPERATING EXPENSES	INTEREST	DEPRECIATION AND AMORTIZATION	INCOME TAX	NET INCOME	CITIZEN SHAREHOLDER INCOME
		\$	\$	\$	\$	\$	\$	\$	ACTUAL \$
1979	64062	4.68	299810	78400	130000	54167	0	37243	82
1980	64062	4.68	299810	83888	124583	54167	0	37172	82
1981	64062	4.68	299810	89760	119167	54167	0	36716	81
1982	64062	4.68	299810	96043	113750	54167	0	35850	79
1983	64062	4.68	299810	102766	108333	54167	0	34544	76
1984	64062	4.68	299810	109960	102917	54167	0	32766	72
1985	64062	4.68	299810	117658	97500	54167	0	30485	67
1986	64062	4.68	299810	125894	92083	54167	0	27666	61
1987	64062	4.68	299810	134707	86666	54167	0	24270	53
1988	64062	4.68	299810	144137	81250	54167	0	20256	45
1989	64062	4.68	299810	154226	75833	54167	0	15584	34
1990	64062	4.68	299810	165022	70416	54167	0	10205	22
1991	64062	4.68	299810	176573	65000	54167	0	4070	9
1992	64062	4.68	299810	188933	59583	54167	0	-2873	0
1993	64062	4.68	299810	202158	54166	54167	0	-10681	0
1994	64062	4.68	299810	216309	48750	54167	0	-19416	0
1995	64062	4.68	299810	231451	43333	54167	0	-29141	0
1996	64062	4.68	299810	247652	37916	54167	0	-39925	0
1997	64062	4.68	299810	264987	32499	54167	0	-51843	0
1998	64062	4.68	299810	283537	27083	54167	0	-64977	0
1999	64062	4.68	299810	303384	21666	54167	0	-79407	0
2000	64062	4.68	299810	324621	16249	54167	0	-95227	0
2001	64062	4.68	299810	347345	10833	54167	0	-112535	0
2002	64062	4.68	299810	371659	5416	54167	0	-131432	0

INTEREST RATE: 1000 TAX RATE: 0 INFLATION RATE: 070

PIPELINE VALUE: 1300000 POPULATION RATE: 000 POPULATION: 405

ALYESKA EXPENSE: 64700 DIRECT EXPENSE: 6300

Table 1D

AGSOC

CASH FLOW

(\$000)

YEAR	REVENUES	NET INCOME	TOTAL SHAREHOLDER DISTRIBUTION	DEPRECIATION AND AMORTIZATION	DISMANTLING RESERVE	PRINCIPAL PAYMENTS	NET CASH FLOW	CUMULATIVE CASH FLOW
	\$	\$	\$	\$	\$	\$	\$	\$
1979	299810	37243	33519	54167	7400	54167	11124	11124
1980	299810	37172	33455	54167	7918	54167	11635	22759
1981	299810	36716	33044	54167	8472	54167	12144	34903
1982	299810	35850	32265	54167	9065	54167	12650	47553
1983	299810	34544	31090	54167	9700	54167	13154	60707
1984	299810	32766	29489	54167	10379	54167	13656	74363
1985	299810	30485	27437	54167	11106	54167	14154	88517
1986	299810	27666	24899	54167	11883	54167	14650	103167
1987	299810	24270	21843	54167	12715	54167	15142	118309
1988	299810	20256	18230	54167	13605	54167	15631	133940
1989	299810	15584	14026	54167	14557	54167	16115	150055
1990	299810	10205	9185	54167	15576	54167	16596	166651
1991	299810	4070	3663	54167	16666	54167	17073	183724
1992	299810	-2873	0	54167	17833	54167	14960	198684
1993	299810	-10681	0	54167	19081	54167	8400	207084
1994	299810	-19416	0	54167	20417	54167	1001	208085
1995	299810	-29141	0	54167	21846	54167	-7295	200790
1996	299810	-39925	0	54167	23375	54167	-16550	184240
1997	299810	-51843	0	54167	25011	54167	-26832	157408
1998	299810	-64977	0	54167	26762	54167	-38215	119193
1999	299810	-79407	0	54167	28635	54167	-50772	68421
2000	299810	-95227	0	54167	30639	54167	-64588	3833
2001	299810	-112535	0	54167	32784	54167	-79751	-75918
2002	299810	-131432	0	54167	35079	54167	-96353	-172271

INTEREST RATE: 1000 TAX RATE: 0 INFLATION RATE: 070

PIPELINE VALUE: 1300000 POPULATION RATE: 000 POPULATION: 405

ALYESKA EXPENSE: 64700 DIRECT EXPENSE: 6300

Table 2A

OF PIPELINES

NET INCOME

(\$000)

YEAR	DELIVERY VOLUME (000 BBL'S)	TARIFF	REVENUES	OPERATING EXPENSES	INTEREST	DEPRECIATION AND AMORTIZATION	INCOME TAX	NET 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	51846
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	35906	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

ALYESKA EXPENSE: 60000 DIRECT EXPENSE: 6500

Table 2B

RP PIPELINES

CASH FLOW

(\$000)

YEAR	REVENUES	NET INCOME	DEPRECIATION AND AMORTIZATION	DISMANTLING RESERVE	PRINCIPAL PAYMENTS	NET CASH FLOW	CUMULATIVE CASH FLOW
	\$	\$	\$	\$	\$	\$	\$
1979	352341	56013	61500	7500	0	125093	125093
1980	352341	53423	61500	8025	25400	97628	222721
1981	352341	51845	61500	8587	50000	72012	294733
1982	352341	51230	61500	9188	50100	71898	366631
1983	352341	50412	61500	9831	130500	-8677	357954
1984	352341	53151	61500	10519	50100	75150	433104
1985	352341	51873	61500	11255	53200	71508	504612
1986	352341	50486	61500	12043	53300	70809	575421
1987	352341	48833	61500	12886	53200	70099	645520
1988	352341	46883	61500	13788	53300	68951	714471
1989	352341	44627	61500	14753	53200	67760	782231
1990	352341	42032	61500	15786	53300	66098	848329
1991	352341	39086	61500	16891	53300	64257	912586
1992	352341	35758	61500	18073	53300	62111	974697
1993	352341	32021	61500	19338	38500	74439	1049136
1994	352341	27152	61500	20692	23500	85924	1135060
1995	352341	21111	61500	22140	23500	81331	1216391
1996	352341	14570	61500	23690	23500	76340	1292731
1997	352341	7493	61500	25348	23500	70921	1363652
1998	352341	-157	61500	27122	22200	66345	1429997
1999	352341	-8480	61500	29021	12900	69221	1499218
2000	352341	-17897	61500	31052	27000	47735	1546953
2001	352341	-27352	61500	33226	8900	58554	1605507
2002	352341	-38408	61500	35552	8900	49824	1655331

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

PIPELINE VALUE: 1114200

ALYESKA EXPENSE: 60000 DIRECT EXPENSE: 6500

Table 2C

AGSOC

NET INCOME

(\$000)

YEAR	DELIVERY VOLUMES (000 BBLs)	TARIFF	REVENUES	OPERATING EXPENSES	INTEREST	DEPRECIATION AND AMORTIZATION	INCOME TAX	NET INCOME	CITIZEN SHAREHOLDER INCOME
		\$	\$	\$	\$	\$	\$	\$	ACTUAL \$
1979	64062	5.50	352341	78400	130000	54167	0	89774	199
1980	64062	5.50	352341	83888	130000	54167	0	84286	187
1981	64062	5.50	352341	89760	127460	54167	0	80954	179
1982	64062	5.50	352341	96043	122460	54167	0	79671	177
1983	64062	5.50	352341	102766	117450	54167	0	77958	173
1984	64062	5.50	352341	109960	104400	54167	0	83814	186
1985	64062	5.50	352341	117658	99390	54167	0	81126	180
1986	64062	5.50	352341	125894	94070	54167	0	78210	173
1987	64062	5.50	352341	134707	85630	54167	0	77837	172
1988	64062	5.50	352341	144137	80310	54167	0	73727	163
1989	64062	5.50	352341	154226	74980	54167	0	68968	153
1990	64062	5.50	352341	165022	69660	54167	0	63492	141
1991	64062	5.50	352341	176573	64330	54167	0	57271	127
1992	64062	5.50	352341	188933	55890	54167	0	53351	118
1993	64062	5.50	352341	202158	50560	54167	0	45456	101
1994	64062	5.50	352341	216309	46710	54167	0	35155	78
1995	64062	5.50	352341	231451	41260	54167	0	25463	56
1996	64062	5.50	352341	247652	38910	54167	0	11612	25
1997	64062	5.50	352341	264987	33460	54167	0	-273	0
1998	64062	5.50	352341	283537	31110	54167	0	-16473	0
1999	64062	5.50	352341	303384	25790	54167	0	-31000	0
2000	64062	5.50	352341	324621	24500	54167	0	-50947	0
2001	64062	5.50	352341	347345	21800	54167	0	-70971	0
2002	64062	5.50	352341	371659	17710	54167	0	-91195	0

INTEREST RATE: 1000 TAX RATE: 0 INFLATION RATE: 070

PIPELINE VALUE: 1300000 POPULATION RATE: 000 POPULATION: 405

ALYESKA EXPENSE: 64700 DIRECT EXPENSE: 6300

Table 2D

AGSOC

CASH FLOW

(\$000)

YEAR	REVENUES	NET INCOME	TOTAL SHAREHOLDER DISTRIBUTION	DEPRECIATION AND AMORTIZATION	DISMANTLING RESERVE	PRINCIPAL PAYMENTS	NET CASH FLOW	CUMULATIVE CASH FLOW
	\$	\$	\$	\$	\$	\$	\$	\$
1979	352341	89774	80797	54167	7400	0	70544	70544
1980	352341	84286	75857	54167	7918	25400	45114	115658
1981	352341	80954	72859	54167	8472	50000	20734	136392
1982	352341	79671	71704	54167	9065	50100	21099	157491
1983	352341	77958	70162	54167	9700	130500	-58837	98654
1984	352341	83814	75433	54167	10379	50100	22827	121481
1985	352341	81126	73013	54167	11106	53200	20186	141667
1986	352341	78210	70389	54167	11883	84400	-10529	131138
1987	352341	77837	70053	54167	12715	53200	21466	152604
1988	352341	73727	66354	54167	13605	53300	21845	174449
1989	352341	68968	62071	54167	14557	53200	22421	196870
1990	352341	63492	57143	54167	15576	53300	22792	219662
1991	352341	57271	51544	54167	16666	84400	-7840	211822
1992	352341	53351	48016	54167	17833	53300	24035	235857
1993	352341	45456	40910	54167	19081	38500	39294	275151
1994	352341	35155	31640	54167	20417	54500	23599	298750
1995	352341	25463	22917	54167	21846	23500	55059	353809
1996	352341	11612	10451	54167	23375	54500	24203	378012
1997	352341	-273	0	54167	25011	23500	55405	433417
1998	352341	-16473	0	54167	26762	53200	11256	444673
1999	352341	-31000	0	54167	28635	12900	38902	483575
2000	352341	-50947	0	54167	30639	27000	6859	490434
2001	352341	-70971	0	54167	32784	40900	-24920	465514
2002	352341	-91195	0	54167	35079	170000	-171949	293565

INTEREST RATE: 1000 TAX RATE: 0 INFLATION RATE: 070

PIPELINE VALUE: 1300000 POPULATION RATE: 000 POPULATION: 405

ALYESKA EXPENSE: 64700 DIRECT EXPENSE: 6300

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
		\$	\$	\$	\$	\$	\$	\$
1979	64062	6.35	406794	74000	104735	61580	83240	83239
1980	64062	6.35	406794	79180	104735	61580	80650	80649
1981	64062	6.35	406794	84723	102347	61580	79072	79072
1982	64062	6.35	406794	90654	97647	61580	78457	78456
1983	64062	6.35	406794	96999	92938	61580	77639	77638
1984	64062	6.35	406794	103788	80671	61580	80378	80377
1985	64062	6.35	406794	111053	75961	61580	79100	79100
1986	64062	6.35	406794	118827	70961	61580	77713	77713
1987	64062	6.35	406794	127145	65950	61580	76060	76059
1988	64062	6.35	406794	136045	60950	61580	74110	74109
1989	64062	6.35	406794	145568	55939	61580	71854	71853
1990	64062	6.35	406794	155758	50939	61580	69259	69258
1991	64062	6.35	406794	166661	45928	61580	66313	66312
1992	64062	6.35	406794	178327	40918	61580	62985	62984
1993	64062	6.35	406794	190810	35908	61580	59248	59248
1994	64062	6.35	406794	204167	32289	61580	54379	54379
1995	64062	6.35	406794	218458	30080	61580	48338	48338
1996	64062	6.35	406794	233750	27871	61580	41797	41796
1997	64062	6.35	406794	250112	25662	61580	34720	34720
1998	64062	6.35	406794	267620	23453	61580	27071	27070
1999	64062	6.35	406794	286354	21366	61580	18747	18747
2000	64062	6.35	406794	306399	20154	61580	9331	9330
2001	64062	6.35	406794	327847	17616	61580	-124	-125
2002	64062	6.35	406794	350797	16779	61580	-11180	-11182

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

PIPELINE VALUE: 1114200

AL YESNA EXPENSE: 60000 DIRECT EXPENSE: 6500

Table 3B

BP PIPELINES

CASH FLOW

(\$000)

YEAR	REVENUES	NET INCOME	DEPRECIATION AND AMORTIZATION	DISMANTLING RESERVE	PRINCIPAL PAYMENTS	NET CASH FLOW	CUMULATIVE CASH FLOW
	\$	\$	\$	\$	\$	\$	\$
1979	406794	83239	61580	7500	0	152319	152319
1980	406794	80649	61580	8025	25400	124054	277173
1981	406794	79072	61580	8587	50000	99239	376412
1982	406794	78456	61580	9188	50100	99124	475536
1983	406794	77638	61580	9831	130500	18549	494085
1984	406794	80377	61580	10519	50100	102376	596461
1985	406794	79100	61580	11255	53200	98735	695196
1986	406794	77713	61580	12043	53300	98036	793232
1987	406794	76059	61580	12886	53200	97325	890557
1988	406794	74109	61580	13788	53300	96177	986734
1989	406794	71853	61580	14753	53200	94986	1081720
1990	406794	69358	61580	15786	53300	93324	1175044
1991	406794	66312	61580	16891	53300	91483	1266527
1992	406794	62984	61580	18073	53300	89337	1355864
1993	406794	59248	61580	19338	38500	101666	1457530
1994	406794	54379	61580	20692	23500	113151	1570681
1995	406794	48338	61580	22140	23500	108558	1679239
1996	406794	41796	61580	23690	23500	103566	1782805
1997	406794	34720	61580	25348	23500	98148	1880953
1998	406794	27070	61580	27122	22200	93572	1974525
1999	406794	18747	61580	29021	12900	96448	2070973
2000	406794	9330	61580	31052	27000	74962	2145935
2001	406794	-125	61580	33226	8900	85781	2231716
2002	406794	-11182	61580	35552	8900	77050	2308766

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

PIPELINE VALUE: 1114200

ALYESKA EXPENSE: 50000 DIRECT EXPENSE: 6500

Table 3C

AGSOC

NET INCOME

(\$000)

YEAR	DELIVERY VOLUMES (000 BBLs)	TARIFF	REVENUES	OPERATING EXPENSES	INTEREST	DEPRECIATION AND AMORTIZATION	INCOME TAX	NET INCOME	CITIZEN SHAREHOLDER INCOME
		\$	\$	\$	\$	\$	\$	\$	ACTUAL \$
1979	64062	6.35	406794	73700	130000	54167	0	148927	330
1980	64062	6.35	406794	78859	124583	54167	0	149185	331
1981	64062	6.35	406794	84379	119167	54167	0	149081	331
1982	64062	6.35	406794	90286	113750	54167	0	148591	330
1983	64062	6.35	406794	96606	108333	54167	0	147688	328
1984	64062	6.35	406794	103368	102917	54167	0	146342	325
1985	64062	6.35	406794	110605	97500	54167	0	144522	321
1986	64062	6.35	406794	118347	92083	54167	0	142197	315
1987	64062	6.35	406794	126631	86666	54167	0	139330	309
1988	64062	6.35	406794	135495	81250	54167	0	135882	301
1989	64062	6.35	406794	144979	75833	54167	0	131815	292
1990	64062	6.35	406794	155128	70416	54167	0	127083	282
1991	64062	6.35	406794	165986	65000	54167	0	121641	270
1992	64062	6.35	406794	177605	59583	54167	0	115439	256
1993	64062	6.35	406794	190032	54166	54167	0	108424	240
1994	64062	6.35	406794	203340	48750	54167	0	100537	223
1995	64062	6.35	406794	217574	43333	54167	0	91720	203
1996	64062	6.35	406794	232804	37916	54167	0	81907	182
1997	64062	6.35	406794	249100	32499	54167	0	71028	157
1998	64062	6.35	406794	266538	27083	54167	0	59006	131
1999	64062	6.35	406794	285195	21666	54167	0	45766	101
2000	64062	6.35	406794	305159	16249	54167	0	31219	69
2001	64062	6.35	406794	326520	10833	54167	0	15274	33
2002	64062	6.35	406794	349377	5416	54167	0	-2166	0

INTEREST RATE: 1000 TAX RATE: 0 INFLATION RATE: 070

PIPELINE VALUE: 1300000 POPULATION RATE: 000 POPULATION: 405

ALYESKA EXPENSE: 60000 DIRECT EXPENSE: 6300

Table 3D

AGSOC

CASH FLOW

(\$000)

YEAR	REVENUES	NET INCOME	TOTAL SHAREHOLDER DISTRIBUTION	DEPRECIATION AND AMORTIZATION	DISMANTLING RESERVE	PRINCIPAL PAYMENTS	NET CASH FLOW	CUMULATIVE CASH FLOW
	\$	\$	\$	\$	\$	\$	\$	\$
1979	406794	148927	134034	54167	7400	54167	22293	22293
1980	406794	149185	134267	54167	7918	54167	22836	45129
1981	406794	149081	134173	54167	8472	54167	23380	68509
1982	406794	148591	133732	54167	9065	54167	23924	92433
1983	406794	147688	132919	54167	9700	54167	24469	116902
1984	406794	146342	131708	54167	10379	54167	25013	141915
1985	406794	144522	130070	54167	11106	54167	25558	167473
1986	406794	142197	127972	54167	11883	54167	26103	193576
1987	406794	139330	125397	54167	12715	54167	26648	220224
1988	406794	135882	122294	54167	13605	54167	27193	247417
1989	406794	131815	118634	54167	14557	54167	27738	275155
1990	406794	127083	114375	54167	15576	54167	28284	303439
1991	406794	121641	109477	54167	16666	54167	28830	332269
1992	406794	115439	103895	54167	17833	54167	29372	361646
1993	406794	108424	97582	54167	19081	54167	29923	391569
1994	406794	100537	90483	54167	20417	54167	30471	422040
1995	406794	91720	82548	54167	21846	54167	31018	453058
1996	406794	81907	73716	54167	23375	54167	31566	484624
1997	406794	71028	63925	54167	25011	54167	32114	516738
1998	406794	59006	53105	54167	26762	54167	32663	549401
1999	406794	45766	41189	54167	28635	54167	33212	582613
2000	406794	31219	28097	54167	30639	54167	33761	616374
2001	406794	15274	13747	54167	32784	54167	34311	650685
2002	406794	-2166	0	54167	35079	54167	32913	683598

INTEREST RATE: 1000 TAX RATE: 0 INFLATION RATE: 070

PIPELINE VALUE: 1300000 POPULATION RATE: 000 POPULATION: 405

ALYESKA EXPENSE: 60000 DIRECT EXPENSE: 6300

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 is not an interest in the pipeline per se, but is backed up by guaranteed notes from the pipelines' company and/or British Petroleum.

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 has total principal payments of \$53 million or less except for the year 1983 and the year 2007.

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.

TABLE 5
BP PIPELINE NOTES
PRINCIPAL AMOUNTS

		<u>\$MM</u>
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 sublessee'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

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 decrease 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,

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 difference in cash flow at the end of a 20-year period. For comparison purposes, a 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.

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

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.

The number of years of income stream in Table 6, refers to the number of consecutive years from date of investment that AGSOC would have income and cash flow to make distributions. For example, at the \$4.68 tariff, AGSOC would be able to make distributions through 1994, but would not have reportable income after that date. Prior to the time when income becomes reduced, AGSOC could, in fact, apply for higher tariffs and continue cash distributions indefinitely. Alternatively, oil flow may increase to cover such shortfalls.

TABLE 6

<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	-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

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. The cash balances shown in Table 6, indicate the cash remaining in AGSOC after a 24-year period. If the cash balance under a constant tariff were to fall negative, the strategies of AGSOC may be to (1) refinance the project assuming adequate oil reserves, (2) apply for periodic tariff increases, (3) purchase TAPS at a lower price or (4) a combination of the above.

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) - 62.5 yrs?
Net Cash Flow	<u>22,900</u>
Stockholder Distribution	16,100
Cash Surplus	<u>\$ 6,900</u>

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 pro-forma operating statement of the Alaskan pipeline would be as follows:

Return on Rate Base (Excluding Interest)	\$320,000,000
Depreciation	125,000,000
Debt Service	(191,000,000)
Taxes - AGSOC	-0-
Net Cash Flow	<u>254,000,000</u>
Potential Net Profit - Available For Dividends	\$140,000,000
Net Retained Cash Flow After Distribution (Assume 90% Stockholder Distribution)	<u>128,000,000</u>

The return on rate base would be 16% of the \$2 billion investment and would be net of all operating expenses. To the return of \$320 million, adding depreciation and netting debt service of \$191 million (\$180 million interest and \$11 million principal payments) yields the yearly cash flow. Netting interest of \$180 million from the total return of \$320 million yields the reportable income, 90% of which (or \$126 million) is distributed to stockholders. Thus net cash flow remaining in the corporation would be \$254 million less

\$126 million or \$128 million. 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.

A related project, the gas conditioning plant may be an attractive prospect for AGSOC participation. To date, FERC has indicated that the producers must bear the conditioning costs, but this position could change during negotiations for pipeline financing. Guarantees on cost over-runs will be needed from major interests to make the project viable. Until the basic parameters are established, one can only speculate on the possible investment potential of the conditioning plant for AGSOC or the State of Alaska.

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 types of 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)

<u>Year</u>	<u>Revenues</u>			<u>Operating Income</u>	<u>Net Income</u>
	<u>Passenger</u>	<u>Cargo and Mail</u>	<u>Total</u>		
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)

<u>Year</u>	<u>Revenues</u>				<u>Operating Income</u>	<u>Net Income</u>
	<u>Passenger</u>	<u>Cargo</u>	<u>Mail</u>	<u>Total</u>		
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

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)	<u>\$9,900,000</u>
Cost of Fish	
(@ \$.21/lb average all species)	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

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	1,200,000
Interest Expense	11,000,000
Depreciation	<u>8,333,000</u>
Total	\$20,533,000
Net Profit	<u>\$ 3,467,000</u>

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

equipment leased as the lease term expires or if the lessee defaults.

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

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

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.