you don't have to have an offer for sale, but you're going to negotiate with respect to terms for sale that the State has no capacity, no rights to speak to, there's nothing in the lease that can formulate in any sense the __ ___ ___ of the State at the time the Commissioner grants this lease that will speak to the terms of that offer. As I see it, this is one of these provisions is at the North Pole and the other is at the South Pole. For all practical purposes, this provision, if it is the valuable provision that it was deemed to be when this Alaska Pipeline Right-of-Way Leasing Act was enacted, it is totally exhausted--there is nothing really left of a right to purchase.

I would simply think that you might do better without it; actually it tends to double negative really, and one might be better off not to be encumbered by these limitations. Just sit around a bargaining table and bargain. To come to the other point, it does seem to me that very much can be said for the reservation of this right to purchase. It was hoped that this would never have to be exified. I think in the discussions of the joint pipeline impact committee that I recall and in the discussions afterwards, there was never really a feeling that if this act were--and things were accomplished by it by people sitting around the bargaining table in a cooperative spirit that they're bargaining not only for each other but for the good of the people of the State of Alaska, that you would normally come out with terms in the right-of-way lease that would serve both

parties. Each would get something substantial out of it. This was kind of a last ditch reservation--if all else fails, this wouldn't be as good as some other things that were hoped for, but at least the State could enter into the ownership of the line. It could be an equal participant almost in the private sector of our economy. It would be a 20% owner. A 20% owner is fairly significant owner in a joint venture pipeline. While it isn't 50%, one would hope that one would find friends among at least 50 plus per cent of the ownership. There are things that a state could do as an owner of a portion of the line that might make another owner want to join with the State. Its the notion that really as an owner of the pipeline, a part-owner, owner of an undivided interest in the pipeline, that it could reason at the Board of Directors table so to speak. It could know what was going on. It could know hte purposes. It had not been able, let's say, at the bargaining table for the lease to get an agreement to do a number of things that are possible for the commissioner to set up in the lease. For example, he might want to get them to agree as to the rate they would propose in their tariffs to the ICC, which might be at a lower level than they currently had. Which, let's say, the Commissioner might feel was a more reasonable rate--that they really should not have so high a rate. Although it was one they could get from the ICC, if they filed it. But for a quid pro co, theymight agree in this lease to have a more economical rate. That might become a very important

thing, but suppose you could not get that kind of agreement. Suppose you couldn't get an agreement to employ Alaskans--native Alaskans on this pipeline. That you couldn't get an agreement to provide educational facilities, on the job training facilities. This is one of the things that at one time was contemplated to be an express provision. But because it was a new piece of legislation, it was felt that this might well be left to the discretion of the Commissioner. And at the bargaining table, in giving up some things, he might get provisions in here that would be extraordinarily beneficial and the company would see that it was something that it could give without hurting its own interests in the matter. But if these things were not obtainable, that the Commissioner felt were appropriate, the Canadian government for example deem important to put in their arrangements with the pipeline companies, that lease companies find important to put in their arrangements with the pipelines companies, then there was always the possibility that the State could become an owner up to the amount of 20%, which as we know was tailored to the State's ownership interests and the percentage of production that one of its taxes represented. This was that kind of a feature.

It seems to me that the provision has another virtue that it would enable not only the State to participate in meetings of the board of directors and know whats going on, the purposes of decision, it would enable it in a sense to have some kind of weight in those decisions, but in addition it would be able to

get at company records in a very thorough way and just perhaps would have had better information for that reason.

Q. (not clear on tape)

A. I think I would prefer for experts--economic experts like Mr. Lipton to comment upon that. It may very well be a fact--an economic and important fact. It does seem to me speaking from the standpoint of the conception of this law, the Governor had at one time proposed ownership of the entire line. Of course, this is not possible under this provision. This is a portion of that. It was contemplated, I gather, then that financing might be a problem, but financing of the whole line was not that impossible. It was conceived to be feasible. I remember reading a document surely over a quarter inch thick prepared with respect to the feasibility of that and there were arguments both ways, but as I recall, this item was not deemed to be an overpowering item, with respect to feasibility. That financing was possible. I think at one of our hearings we mentioned too that there are some very important and large natural gas pipeline interests in our county, who, I don't know what the fact would be, but I'm just wondering whether they might not be interested in building this line and operating it as a common carrier. Perhaps as contract operators of it. Perhaps--I'm just wondering out loud with you whether past decisions don't relate to this question of feasibility.

I have stated four general propositions about the proposal for amending the Alaska Pipeline Commission Act. I think I really only need to state one proposition with respect to the Alaska Pipeline Right-of-Way Leasing Act, and that is that the Act does not resemble, at all, in any essential respect, what you now have on the books. Indeed, it has a provision in it that I have never seen before in my life, and I have been--in my professional life--in administrative law, administrative process, but I have never, and I may be proved wrong--there may be several of them--but I have never seen a provision with respect to judicial review such as you have in this action. I just think its amazing. And I say its amazing because. . .

Q. Which one are you dealing with now?

A. This is Senate Bill 3 relating to the provision on judicial review of decisions at page 14, subsection b. The only grounds for which judicial review of a decision of a commissioner--I guess they must mean there are to be provided--are failure to follow the procedures set out in this chapter, or abuse of discretion so capricious, arbitrary, or consistory as to constitute a denial of due process. What this really means is that his decisions for all facts and purposes in an impregnable decision. It is rare, and it should be rare when we should reverse someone for violating the Constitution. Its unfortunate when we have a violation of the Constitution by a legislature or a court or by the Chief Executive even. When it comes, we hope always we'll

have the courage to face up in the courts to correcting it, but this doesn't happen very often. This simply means for all practical purposes, there is not the usual statutory standards for review. Its a constitutional law standard for review in a statute. It is confining the scope of review extraordinarily narrowly. By and large, no decision of this Commissioner will be reviewable or reversable. It is almost airtight.

The two comments about this: Whether you want an administrative agency to be so impregnable to reexamination in the courts of the validity of what that administrative agency has done. Anyone can err. They can err in any one instance, and perhaps there should be broader grounds for review and reversal of the decision. It might be unreasonable without being constitutionally unreasonable. By and large thats the standard we have utilized. We've often said there ought to be evidence where it is an administrative agency decision that is to be based upon evidence, it must be relevant competent and probitive evidence to support the determination by the administrative agency. It must be substantial. If there is a substantial evidence to support what has been done before the facts if it is in accordance with the law that is stated in this fashion, why it stands. But this is a broader standard that this very narrow standard, at least as I read it, on page 14. I did want to point that out.

Really, it doesn't make much difference how impregnable the

decision is when you look at the rest of the statute, becuase the rest of the statute really means that there isn't too much the Commissioner has to do anyway. He is not focused upon the problems that the joint pipeline impact committee was focused upon and this is the awful problem of being limited in what the State can do through its regulatory power. After all, what we're dealing with here, is an interstate crude oil pipeline or an interstate natural gas pipeline, both have to be thought about. And there are important problems even with respect to interstate natural gas pipelines. Now the Natural Gas Act of 1938 administered by the Federal Power Commission is an act, as I indicated before the break, as extraordinarily sophisticated, excellent piece of regulatory legislation. It leaves very little that needs to be done as far as regulation is concerned. If regulation should be with the federal government and that was the judgment of the federal government through its authorized decision makers, then it does the job. We can only quarrel possibly there, that the public utility regulation concept may, nevertheless, set rates to high. And this is a comment that has been made about either the common carrier or the public utility regulation concept. These authorities that I've stated, or cited in my memorandum of January and March of 1972 for the joint pipeline impact committee, but it is a very carefully drawn instrument and that's about the only criticism that you could make of that act. Well, obviously, if there are goals which Alaska wants to achieve with respect to

to a natural gas pipeline, but I don't spend much time with that kind of pipeline because I know your thoughts are in another direction. But if you do, at some time in the future, want to do something for Alaska with respect to the activities of natural gas pipelines, you cannot utilize by and large your Alaska pipeline commission Act. You're excluded. The only hope that you have, the only way that you can deal with it is through another means--regulatory means. It was for that reason that the joint pipeline impact committee conceived the concept, not a new one,of the use of the State contract and the State property control and property disposition power, and this is an extensive power. It has been extensively used by both the federal and state governments. It has been termed really a power of government that has gone unnoticed as its been utilized more and more and more. The constitutionality of the existence of this power, the constitutionality of its exercise has long since been established and it is the device that is utilized here. But having this power, this authority to deal with the matter by giving something and receiving agreement back for giving something, that's essentially what its all about. Having this power, this package, so far as the kinds of economic problems and social problems, civil rights problems really even to which this package was addressed, these are not touchable with respect to Natural gas pipelines without what is in the current existing form of the Alaska Pipeline Right-of-Way Leasing Act. With respect to crude oil pipelines, there was some authority, as we indicated earlier this afternoon,

fairly considerable authority for dealing with activities at a local impact, even though they were activities of an interstate crude oil pipeline carrier. It was on the view that nevertheless the use of the contract power and the property control and disposition power of the State was to be preferred. It was to be preferred because it would make less questionable, it would largely take out itself of the realm of constitutional questions. If this power was utilized rather than the regulatory _____. Moreover, there were aspects, activities of the operation of an interstate crude oil pipeline company that could not be reached through the exercise of the regulatory power--holding out over "do this" don't do this" and then sanctioning that pipeline with civil penalties, civil sanctions for violation of the rule. For that reason this was the route adopted by the joint pipeline impact committee and submitted to and adopted by the legislature. There are many many things that are wrong. I would say that the crucial provision of the act are those that are required covenants. I would say one of the most crucial parts of the act are those covenants set out in Sec. 38.35.120. These are dealt with in this act at the page we--the section we were referring to--but which begins back here on page 4 and then continues forward for several pages--I would like really to begin with two--subsection 2--which is as I see the proposed legislation, completely removed as is subsection 1.

One of the principle purposes of that required covenant was to give the State a continuing kind of leverage, with respect to the lessee under a right-of-way--a pipeline right-of-way lease. It was just simply felt that no Commissioner, however wise, however experienced, even as the present Commissioner is so wise and so experienced, no one at the outset could decide everything that needed to be decided here. A lease was going to be executed that might be in being for 25 years or 50 years and what goes into that lease at the outset, simply may not be all that it should have been. At least, with respect to detail. Even so far as the route that the pipeline was to take and the physical specifications of it. This provision was designed to permit some negotiation, some flexibility after the general guidelines were laid down for this route or the pipeline. The specifications of the construction so that if a problem developed, they could sit down at the table again, and before certification of a specific kind of construction or acquisition was made that the parties could agree and there would be this leverage in the State to say, well look, consider this before we're willing to issue this further certificate, we want this kind of arrangement. Of course, here is a place where other parties would have to face each other at the table and they would have to bargain it out. Still another was this notion of the common carrier. We've seen already in the discussion before the break how important the status of common

carrier is. Again, to mention natural gas pipelines, there is nothing in even the most sophisticated Natural Gas Act of 1938, which makes a natural gas company a common carrier, it can become a common carrier in several ways. It can do the kinds of things that under the law would make it a common carrier. One of the ways is that it can agree to become a common carrier. That has always been recognized as one of the ways. If you want it later on, you discover vast resources of natural gas here, and if it becomes important to the people of Alaska to have that natural gas pipeline; deal with people who own natural gas and are producing it, who have no pipeline, no way to get it to market--there's no way they're going to get it to market. Not under the federal act, unless you have an Alaska Pipeline Right-of-Way Leasing Act which says to someone who leases this land and does it for pipeline purposes that they agree before they get that lease to be a common carrier--then, they are a common carrier. Then you have an impact upon the federal act. This isn't in conflict with the federal act. The federal act doesn't speak one way or the other. Its quite possible for a natural gas company to be a pipeline company, to engage in interstate transportation and not be a common carrier at all. Most of them are not. But Alaska may be different. There are some natural gas companies operating interstate which are common carriers. This was here as a hedge, as an anchor to windward for the future.

It will be very important someday perhaps, depending upon what you discover of your natural resources, to be able to say to a lessee carrier--look, you have agreed from the beginning for your crude oil pipeline to be a common carrier. There's no question about it and you're to perform the duties of a common carrier. With respect to natural gas pipeline company, you'd say, well, you don't have to be one unless it is determined by the Commissioner sometime after the lease that its appropriate for you to operate as a common carrier because they had agreed at the outset to be a common carrier, if that determination was made, then they would have to be so if the Commissioner so found.

As I read this provision that replaces the common carrier provision, Section 3 which is set out at pages 5 and 6, there is a total loss of the capacity to require a lessee carrier which will operate a natural gas pipeline to be a common carrier. What will the people do if this develops? I don't know whether it will develop or not. What if they want to produce it themselves or someone to whom they convey an interest in their land who wants to produce that natural gas and they're not pipeline owners. How are they going to get that gas to market? There's no way you can take care of it in the Alaska Pipeline Commission Act. The only way it can be taken care of by the Natural Gas Act of 1938, the only way it can be taken care of is by a provision such as in Section 3. That's lost entirely.

Now, with respect to a crude oil pipeline company, its made discretionary with the Commission. It simply provides now that if the lessee will perform all of its functions under the lease as a common carrier if the Commission determines at the time the lease is issued or, if at any time after the execution of the lease, the Commissioner after public hearing determines that assumption of the status of common carrier is required in order to serve the public interest. Now, that at least has the merit that it might be required, but also it might not be required. It was felt that this was such an important problem that it should be required. Specifically, I might say, the federal government, when it leases its lands has this provision, state governments typically, in either giving the power of eminent domain over to pipelines or when it leases its lands, at least a considerable number of them do have a similar provision to what you have here. That the common carrier status will be assumed. So that is law.

The notion of common purchaser, as it was originally in the statute, it was required that the lessee expressly covenant that it will assume the status of and shall be a common purchaser of crude oil and natural gas depending upon the kind of pipeline involved. Now, basically, I think we can say the common purchaser covenant, like the common purchaser statutes, contemplate that a pipeline in or near an oil fielt is required to purchase

gas in the case of gas or crude oil in the case of crude oil fields from owners of that gas or crude oil upon some reasonable equitable basis. This provision would be an affirmative duty. It would be an affirmative duty at the outset of the execution of the lease and it would be triggered, of course, again, by a determination afterthe execution of the lease by the Commissioner at the public hearings that assumption of this status at a particular time is required to serve the public interests. That, I gather, is lost entirely. Now, what will that mean with respect to natural gas pipelines? Its clear under the decisions of the Supreme Court today that you cannot impose by a regulatory act utilizing your regulatory powers setting out a rule that you shall do this and then applying a civil or criminal sanction for not doing it. Its clear that such an act of imposing the status of common purchaser upon an interstate natural gas pipeline subject to the jurisdiction of the Federal Power Commission under the Natural Gas Act of 1938 is unconstitutional. There's just no way that you can do it. And yet, if it is important for you to achieve this end, the only way that is available to you is by an agreement with the lessee to assume voluntarily this obligation because of the value of what they are getting from the state. I say again, this is the kind of thing that the federal government has long since done since 1920--there's nothing particularly new in this. Where I personally learned about it was

reading Title 30, United State Code, Section 185. Its not the best statute in the world, but in the first statute that was the federal government acting through its Congress put such a provision in the right-of-way act, with respect to pipelines being put on federal lands. It seems to be that this is a very great loss. It may be very important with respect to natural gas lines for people who want to get their gas to market to be able to have it purchased on some equitable, ratable basis by the owners of a natural gas pipeline.

The same arguments can be made with respect to crude oil pipelines. There, there is no constitutional inhibition upon the State of Alaska, anymore than on the State of Texas or another state imposing the common purchaser requirement by a regulatory statute. If that's what you want to do, even with respect to an interstate pipeline, I would suggest that you can do it. There is a proposal to do that in the Governor's spectrum of bills. Then the question would become, if that's the way you want to do it, rather than through the Alaska Pipeline Right-of-Way Act, the question is how wise is this particular proposal. What will be your gains, if any? What will be your losses? I certainly would be happy to speak to that. I can--perhaps it would be wise to speak to that now, if you think so Mr. Chairman.

I have in one hand the Texas Statute, again, its an old

statute, but its worked pretty well and its been--I won't say its a model of perfection for other states--but it has been copies and by and large its administration has not caused many problems. It creates the statutory duty, even with respect to interstate crude oil pipelines to be a common purchaser, along the lines that I've described, but it doesn't have any if, ands and buts about it. Its a duty of a person whose covered by this act. "Every person, association of persons or corporations who purchases crude oil or petroleum in this state which is affiliated through stock ownership, common control, contract or otherwise with a common carrier by pipeline or is itself such a common carrier, shall be a common purchaser of such crude petroleum." That's the one with respect to crude petroleum, and we have a similar one that applies to a similar situation with respect to natural gas. But it places the duty to be a common purchaser with respect to those covered by the bill and it isn't dependant upon an administrative agencies later determination about it. Its a harsher provision than was had in the Alaska Pipeline Right-of-Way Leasing Act, but it was felt that it was not appropriate, that the situation in Alaska should be studied first before you imposed this. That there should be the agreement that it should be imposed, pursuant to administrative determination.

One of the interesting things that I find in this statute beyond that point is this provision. I'm not sure I fully understand it. I must study more and I'll certainly report back to

your chairman if he so wishes. A rather remarkable provision is the second page of Senate Bill 7, its Sec. 31.15.020(c): "A purchaser cannot be ordered to be a common purchaser on the basis of purchases of oil taken in kind by the United States of the State of Alaska." Now, let us go through and see what the draftsman has done. Let us assume that the State of Alaska under its leases obtained its royalty payment in kind. You will have done that because, of course, you have decided as a State that you're better off to take that in kind for some economic reason. It may be important to the economy or it may be important to the State treasury. So you've taken the oil, rather than the royalty payment in dollars and cents and you want to do something with it. You don't have a pipeline, you don't have even a portion of a pipeline; that has been given up by this proposal. You don't have a 20% interest--undivided interest--in the pipeline. You're not about to build a pipeline to carry that oil. There's no other pipeline. Suppose the lessee says that we're not going to build anymore pipelines, we're not going to loop it, we're not going to expand it--it may not even connect up to take your oil. What do you do with your oil. You're not going to build storage tanks to keep it there; and I suggest to you that this means--I don't know what it means with respect to the State--they don't say that they won't buy from the State, it doesn't say that here, so I suppose they would buy from the State.

Perhaps thats the answer, I don't know. I have a question. Would they refuse to buy from the State if you take in kind under the leases? It doesn't say one way or the other. It's only implied, and maybe if its implied I would surely hope they would honor your taking it in kind and then purchase from you, the state. Suppose you sell to someone else? And someone else sees a value in that oil. Usually it will not be the State itself that sees a value but in its selling to someone else. The purchaser from the State of Alaska doesn't have any __ _____, that's the way I read it. I will study it more carefully. It just simply means that he doesn't get anywhere. I hope I'm wrong when I raise that question.

Then it goes on to say "or on the basis of the payment of royalties, overriding royalties, net profits, interests or _____ ___ __ interests, whether in kind in value, or on the basis of a producer taking his own production. A very unusual provision. Maybe it has a __ _____. I would certainly want to study it for you and report back what it means as its likely to be in litigation.

Moving on to other parts of the required covenants. Its unusual to see something go out of the act with respect to exchange of crude oil and natural gas. This is number six of the Pipeline Leasing Act. This goes out and even five goes out--Sec. 38.35.120 at page seven. These two go out. One wonders why the lessee would not agree to accept convey and transport or purchase crude

oil or natural gas without unjust or unreasonable discrimination. Suppose there was no obligation to transport or to purchase but still if there weren't actual transportation or purchasing, one would think that the State would be able to require that it be done without injustice and without unreasonable discrimination. So that could at least have stayed, it seems to me, even with the typing out of the assumption--the covenant with respect to assumption of the common purchaser or common carrier provision.

Six refers to a covenant to exchange crude oil or natural gas, depending on the kind of pipeline involved, with each like common carrier in providing connections and facilities. This has been replaced in part, modified by, as I see it, the section ten. At least its connected with it. I really don't see the counterpart, Mr. Chairman, of six anywhere. It could only possibly by some kind of implication be included in the new modified ten. My judgment is that the required convenant to exchange crude oil and natural gas with each like common carrier has gone by the board. Again, . . .(background conversation inaudible on tape) Well, ten of course, is not a covenant to actually exchange. Its a covenant to make connections and facilities on the pipeline subject to the lease.

Q. Am I to understand then sir that if the pipeline is built, for a non-producer to buy it, then the producer is not required to sell?

A. Let me be sure I understand you. If a non-producer. . .

Q. Let's go back. Build the pipeline--they do not produce gas, they carry it--they buy it and they carry it. Am I to understand then, that under this new bill, they will not be able to get the gas?

A. I'm still not sure I understand fully the implications of your question. This act is not speaking to what a lessee may not do by way of obtaining gas. There's nothing in it which speaks of that.

Q. I know but of course, by an exchange--you go to common carriers, but the exchange with the common carrier has been taken out.

A. Thats right.

Q. Therefore there's no exchange with common carrier. . .

A. I see your point. This, so far as a lessee-carrier here who takes out the duty , they required duty that has to be filled out in a covenant. It takes that out of the lease that is there by the present act and El Paso Gas in the situation that you have posed, would not be able to take advantage of such a covenant, because its no longer there; and the exchange could not be compelled under this express provision of the lease. Of course, it might be very important for El Paso to be able to effectuate that, and it might be in the State interest in many instances to facilitate that exchange. And that was the purpose of this provision.

The connection, of course, this is something that probably was handled in the Alaska Pipeline Commission Act. That is, you do have a provision there which does state for the problem of connection. It may be that this is something that you could handle by the regulatory approach. But, of course, you can always hope to obtain more by bargaining with people than you might be able to do by regulation. That was the idea of this provision ten in this same section; that we see in the original act. It provides, as it currently is in the law, that the lessee carrier covenants it will provide, where economically feasible and consistent with the primary function of the line, connections and facilities on the pipeline subject to the lease--both on state land and other land in the State for the purpose of delivering crude oil or natural gas, depending on the kind of pipeline involved. The persons desiring to purchase who are located in municipalities in the vicinity. The change is that the word "land" is substituted for the word "pipeline" in the sentence I've just read. So that covenant only relates to connectio.s to the pipeline on state owned lands, in light of other portions of the revisions of the statute proposed. So that is a very limiting factor. It would not anymore require that, as it presently does, that the connection be made with respect to the portion of the pipeline that happened to be on fedeally owned lands. Or that might be approrpiate to some municipality in the vicinity of the pipeline in the State.

The new language is added in the proposed Section 10, that the expressed covenant is that if the lessee carrier will provide. . .and so forth. . .a connection on the land subject to the lease for the purpose of delivering crude oil or natural gas, depending on the kind of pipeline involved, to persons contracting for the purchase at wholesale of crude oil or natrual gas transported by the pipeline. In order to meet the requirements of this covenant, the lessee shall not be required to enlarge the pipeline system and extend the pipeline, acquire additional right-of-way, or incur additional obligation or incur any cost or liability associated with the connection or connected facilities or assuming obligation inconsistent with that federal law. This is in line with the earlier deletion that there is no ability in the Commissioner anymore to seek after a covenant for increasing the facilities, increasing the size of the pipeline. Of course, it is limiting still further this provision and its effectiveness.

Finally, I'd like to point out with respect to covenants that Sec. 38.35.130 of the original Act is also dealt w' h in the proposal and I'm going to skip for the moment some ·rtions in the bill we're now considering to page eleven. The whole notion of Sec. 38.35.130 was that you couldn't spell out many of the provisions that might be appropriate for protecting the people of the State and the interests of the State; and that there should be an opportunity for the Commissioner to achieve

these additional covenants. It might be as I mentioned earlier, a covenant with respect to the maximum rate for transportation that carrier would ask or file for with the applicable federal regulatory commission. It might be with respect to labor conditions, employment of employees that a covenant might be on. Excuse me, I should be referring to .150--that's the one that I want to refer to now--38.35.150, it is the provision that is most intimately related to the required covenant section. It is the optional covenant section, and that is repealed. Its all done for. And certainly the joint impact pipeline committee contemplated that there would be some very important valuable convenants that could be gotten at the bargaining table by hard bargaining, by collaboration between the parties at the bargaining table and that it might be as vital as anything that would be placed in the lease. It would not be a required provision, it would be an optional provision and it might become very important say five years from today, or ten years from today. Now authority is completely and totally wiped out. We have instead of a flexible instrument a very inflexible one. That device was conceived by the joint pipeline impact committee to be a very vital feature.

The point about the rentals I think perhaps needs to be mentioned next and then I will be through, its been a long session I know for all of you. This is Sec. 38.35.140, which is set out

on page twelve. The--You do have a provision for the payment of the higher of two rentals. Essentially, one of them--and the second one is related to the annual net earnings of the lessee carrier. The whole problem here is one of whether the State as a lessor is entitled as a lessor to do what any lessor in the private sector is l'kely to do and certainly can do in leasing his, her or its land. And that is to realize the value of the productivity of the land in light of its use while its being rented. This is the very notion of the commercial percentage lease. That's why it was developed. Land is not just worth what it is when it isn't used. Its worth what its worth when its used. This is a concept that is not new, its notradical, its a very conservative notion. If you're the owner of the land and someone wants your land for a valuable use, which you typically do if you're in the private sector and you're a cattle businessman, business person, business entity, you try to capture in your rental, whatever the form of rental, you try to capture the value of the productivity of that land in the hands of the lessee. In The Alaska Right-of-Way Leasing Act that precisely what the joint impact pipeline committee was trying to do, what it proposed for the legislature and what the legislature adopted. It provided for a formula here which would bring to the State, like it does to any owner of land the rental value in light of the productivity of the land in the hands of the lessee. And you can talk about shopping centers if you want to, you can talk about leases

of the land for the production of minerals. This is what you think about. And that's what was done. Now, what is a good way of capturing the productivity of the land in the _____ - of a lessee who is going to put it to a new use, that perhaps the lessor knows nothing about whatsoever. This is the position of many lessors in commercial percentage leases. The best example is a widow whose husband ran a grocery store or a business in a small building. Some business house comes to her and says we'd like to rent your premises. One of the best leases that the widow can make often is a commercial percentage lease which will tie her rental to the business done, the gross receipts taken in by a business that has leased her premises, a certain fair proportion of those gross receipts and added to her rental. Perhaps there are other provisions that you would put in there because of special circumstance of who the lessor is to protect her, if you were her lawyer. And your percentage rental would not be something that would be arbitrary, yo would take it light of other percentage rentals that are charged for that type of operation. This would vary depending upon the business that was to be operated--a parking lot, it would be very high, if it were some other kind of operation it might be relatively low.

In the case of the State, why is it not entitled to base a rental upon the productivity of the land in the hands of the

lessee pipeline. This is not _____ that lessee pipeline may be a wholly owned subsidiary of the producer company, its accepted operation. Its a separate business. Indeed, the oil industry has told us its a separate business. It is incorporated separately. Wouldn't you have separate pipeline companies that are not operated by a producer company. So we're justified in _____ ____ is a separate oppration. Its different from leasing the land for producing the minerals in it. Its another business. Its true that some companies integrate and they have both operations and its true that sometimes that incorporate two different entities to handle one business, to handle both businesses separately. So, this doesn't represent a reason for treating the State any differently from any other owner of land where that land is going to be devoted to a profitable use. So this is an answer here to measure the kind of rental that the State is entitled to obtain in light of the productivity of the land in the hands of the lessee for the use that the lessee is going to make of it. And it is tied to annual net earnings and to a percentage of them.

Of course, Alaska had a special problem and that was that this could not be so high as to affect adversely other _____, that the State had in mind. And this was a central factor in the discussion. This was cut down, not once, but as I recall, several times in the discussion of this committee and the committee

of the legislature that processed the bill.

What we have substituted for it in the bill that you have before you is a notion that is called the annual fair market value. You have in here _____ that this is a departure from the usual principle _____ all local owners of land including the State as a kind of a second class citizen in the economic world. It says this--the appraised fair market value of the land leased for right-of-way shall be determined "without regard to any enhancement in value attributable solely to the pipeline facilities on the land or the use of the land for pipeline purposes." Here you have a fundamental difference in philosophy. Is the State entitled to operate like any entrepeneur in the market place for the rental of land or is it not. The legislature decided in Sec. 38.35.140 that it was entitled so to do, and this is an effort to calculate some kind of minimal rental on th bases of that philosophy.

A final thing I guess I should mention. This is the provision that you see Sec. 38.35.160 on page twelve of this act that is proposed. This provision states that no lessee may

(tape recorder unplugged for awhile here)

I think that concludes my presentation, Mr. Chairman.

MR. CHAIRMAN: Thank you. Are there any questions? Yes, Senator Groh:

Q. Professor Witherspoon, I'm trying to establish in my own mind, the _____ here so we can deal with them rather than with what I call the peripheral issues. Insofar as the gut issues are concerned, you are the main draftsman, wouldn't you say, of the right-of-way leasing act of 1972.

A. Under the direction of the joint pipeline impact committee which made many many fundamental changes.

Q. And which changes, as a practical matter, the 1973 amendment that is SB 3 as produced here by the Administration is substantially changes the philosophy and content of that act.

A. Yes, its essentially gone, I think.

Q. Is it--or I assume its essentially gone because the administration and/or of course the administration's advisors, experts and in the litigation, there's some question in their minds as to whether they're going to be able to sustain it. Would you say that that's a fair conclusion?

A. I have been not that privileged to them. But I would imagine having them come to some negotiated settlement with the plaintiff's through challenging it that that's a fair conclusion to draw.

Q. It seems to me that the State thinks they're not going to win the litigation, and that they think the legislation ought to be changed. And their most expert advice, the administration, the Attorney General, whoever's working for him, the Profs.

Williams & Meyers, and whoever else they've hired indicate that they're not sure they're going to win and they therefore want to change it. But they also had participated in the litigation so they know whats transpired in that and you haven't. . .it just seems to me that we'd get the balance--you know if we put it on scale that I've got to tilt in their favor just a little bit. Would you agree with that--that it would be a reasonable conclusion?

A. No sir, I would not.

Q. I see. Can you tell me on what basis you make that statement.

A. On the same basis that we once had a Dred Scott decision which said that a Negro with a piece of property in a free state and it took a Civil War to correct it. And for the same reason that the Supreme Court in the case back in 1964 decided that the ___ ___ ___ state doctrine prevented an American citizen from doing something about property that was confiscated under the Castro regime. Just recently the Supreme Court turned completely around. Justice While the sole dissenter. In 1964 and 1972 the Court turned around.

Q. As a matter of fact, many of us are worried about the Supreme Court of the United States, those of us who, like myself, have been pretty active in the field of civil rights. One decision rendered this year, for example, a person who agreed to do an

article saying that this is just not the way constitutional law is to be administered by the Court. So I'm just simply saying to you that if the Court can go one way or a judgment of lawyers can go one way, but it can be very very wrong.

A/ After all, I think the ingredient that we have to face here is, that we have substantially this act on the books--the principle of the act on the books at the federal level since 1920 even with respect to pipelines. There hasn't been a hint that its unconstitutional, its true its the federal government not the State government. But the __ _____ we have indicates that the power of state goverament _____ ___ be the first to agree. But the decisions we have indicate that the power of the state is similarly broad and you won't find many decisions, I know of only one, and this could be a faulty analysis. . .I know of only one that has said to a state your exercise of state contract powers is unconstitutional and that was because Texas discriminated. They discriminated and they discriminated obviously, overtly and unfairly. And they should have been held unconstitutional. We've tried to hold back in this provision from discriminating in any way is possible. Maybe there is a discrimination. If so, it should be struck down, but the basic power is an extraordinary power. I would suggest Senator that this is perhaps something that has been on the books to be done by State's since the Supreme Court decided the case of

United States vs. Lee Butler, when it recognized that the power to control and this ___ ___ _____ power of government is a totally different kind of power from the regulatory power of government. And that it opens a new way in which we can begin to cooperate instead of making an industry almost an outcast, sometimes to regulation we can sit down and bargain, maybe you can bargain with people and get them to do more.

Q. So you're best judgment, you're best advice to us is that so far as you're concerned we should continue to litigate, is that right?

A. Yes, that is right.

Q. And if our own experts tell us that that is not appropriate you iddicate, as I understand you, that we should not listen to them and make our own judgment and go ahead and litigate.

A. No sir, you asked me my own question--I think you asked the only one person who can make up the mind of the--or the one group of persons who can make up the minds for people in Alaska, and those are the people & their decision makers like yourself. And I think you just have to make a judgment. Whether the merits of this notion, this concept, both on the Alaska Right-of-Way Leasing Act brings so many benefits and potential benefits to this State and solves so many problems down the line, that its worthwhile trying.

And perhaps there are other expedients that remain possible, raising the funds that are needed by Alaska apparently. I for one, if you don't mind my speaking in a kind of side response, I would wonder why you need the consent of the oil companies to tax them, for example.

Q. Well, we're not going to get into that. We don't as a matter of fact. I agree with you.

A. Then, secondly I would wonder why the Governor's proposal does not assume new importance--his original proposal does not assume new importance--if you have a problem of constitutionality. And I would wonder why if _____ might be innovated and created by a way of setting up a task force to find the business people who will do this without litigation. And to enact the special legislation that would be appropriate to admit them to put this together, perhaps to _____ from these oil companies and pipeline companies that part in their investment, take them out from under so that their expenses are taken care of to the extent that there are things here that can be utilized--there are studies, there are material, and so on--and take people who are really expert in constructing pipelines and perhaps they would be willing to help Alaska here to do this.

Q. Well, I know that we could intellectualize on it and perhaps devise other schemes, but I think that you will have to concede with me that it is pretty tough to go on ahead to litigate if your own experts and your own administration indicate to you that it's their best judgment that you are going to lose that litigation.

A. I can understand that.

Chairman Q. Since we have to be the judges, we have to look in depth as to how they litigate it with what type of experts, and the periphery of your comments on this bill, I think are just as important as the total policy contents, because it shows the negotiations that went on and the specific small items that may either have been negotiated for or given up.

Prof. Witherspoon: Also this was, generally speaking, a legislative creation, not an administrative. Administrative independently now seeks to change legislative creation. This is important, but it is a side comment.

Chair: Are there any further questions for Prof. Witherspoon? Senator Rader.

Q. Professor, insofar as our regulatory bill is concerned, we are exercising sovereign powers of the state which are not subject to negotiation, property rights or anything else. If we repealed that portion today, it wouldn't make any difference. We could re-enact it next week or next month or years from now and still be in the same standing we would, if we had it on the books today. Is that correct?

A. As I understand your question, yes.

Q. Now, the only parts of this then that are critical, where we are at critical decision making process, is that portion which depends upon our rights as a land owner?

A. I would think so, Senator.

Q. Right now those portions are: No. 1, the option to purchase 20%.

A. Yes sir.

Q. And the fee that we are going to charge, the commission -- What did you call it?

A. Percentage rental.

Q. Percentage rental. Now, is there anything else. Let's see, a common carrier status.

A. I would think the common carrier/common purchaser status, at least in future in the sense that right now they agree that when the commissioner makes determination,in the case of a gas company, that should be done. It's automatic in the case of a crude oil company with respect to common carrier.

Q. It's your thought that we will not be able to get a handle on that through our sovereign powers? That the best way to get a handle--or is it the only way, or the best way, or what is your judment?

A. My judgment is that for many of these the only way that you can hope to get it is by bargaining and by exchange of goods between the lessee and the lessor.

Q. Now, insofar as the accelerated rental is concerned, you don't really see that as a revenue measure as much as you do an incentive to hold down the tariff?

A. As a matter of fact I had even at one point argued for it being more flexible than it is. That is, it would be a bargaining tool that you would cut down on it if you got a _____ that was of value to the state, but here is a case just where I had a view that was not accepted by the committee. I think the committee was probably correct and I was probably wrong.

Q. Now, are there any other items than these three that you think they are inherently based upon our contract right? Of course a contract right is necessary now because once we issue the permit it's either in the contract or it's not.

A. That's right, that's right.

Q. And if we don't do it now, it's forever lost.

A. I would at least retain the ability in your commissioner, who's had long experience and a very able administrator, to be able to include other convenants that here today you and I, as we talk and we calculate what should be in there, might in this lease be very important because of knowledge he has that he gains after the act is passed, and I think your 150 option as it is now, is a very excellent thing. It's essentially what's in the federal act. We hope you would keep that.

Q. We're dealing with some oil companies that are maybe skittish about what we might require in that regard and perhaps we are hopefully only months or weeks away from dealing with this. What kind of an optional convenant do you think would be reasonable for him to put in, let's say within the next three or four months, that we don't know about today or that he can't tell us about today?

A. I would certainly hope that he would be able to bargain for providing education and on-the-job training for residents of Alaska - native of Alaska - and to employ even a percentage. If this were done regulatorily, you have serious constitutional questions. Done by the contract power and the property power I don't think it's any serious problem at all.

Q. Well, is that something we should write in there today as we are with these others? Again, we are talking about a industry which for either good reason or bad reason is skittish about the imposition of optional demand type of things - and I

would like to see it stated and I frankly would like to consider it if we knew it.

A. Yes sir. Here, again, myself and the committee disagree and they may have been correct. I think they didn't necessarily disagree as it was a question that they knew a lot more about that than I did--what could you get the legislature to accept. What was an acceptable package that would make sense to a majority, and one of the things that seems worthy to be considered as a mandatory requirement was a covenant with respect to the rate that was proposed to the Federal Regulatory Commission--transportation of either crude oil or natural gas by the common carrier. It would seem to me that it is very difficult to make a mandatory provision about it because again you need to have a formula there and we felt that the best place to keep that was 150. 150 as it now stands would permit the commissioner in bargaining to work out a formula that would be good throughout the history or period of the lease with respect to this.

Q. That would be submitting to our rate regulation then, would it?

A. It would be submitting not to rate regulation.

Q. Well, if you submit, you submit to only one rate tariff, then we decide what that is.

A. Yes, but it still remains possible for the federal government to say we disagree and then its decision is final with respect to that rate. If this is a common carrier, if it is subject to the jurisdiction, let's say the ICC with respect to the transportation of crude oil, then the ICC has the

power to speak to this rate for transportation of crude oil in this interstate crude oil pipeline, and it would have the final power to disagree with the agreement between the pipeline company and the commissioner. And if so, it would control, but by and large it might agree--it's not been an active commission--so this represents a tremendous opportunity for the state to be able to go to the pipeline company and get this agreement with respect to a rate at a little lower level than they might get as a maximum under the present guidelines administered by the ICC.

Q. What is the property right of the state to, in effect, build a wall around the state and to defeat the ICC clause of the constitution? For instance, and I know there must be some reasonable point here, but could the state of Kansas condemn in the public interest a strip of land around its borders a mile wide and then require any interstate activity to cross its right-of-way? Not on a highway. I understand that if it's a highway they can't contract with passage and the rest of it, but anything that wasn't on a highway, then it holds the contractual relationship which would in effect change the United States of America from a broad tree-frayed area just to defeat the ICC. I wonder at what point does that sort of thing obviously become a fraud and a hoax that would not be permitted to stand. At what point would you say the state of Alaska as a property owner then, with that very substantial right, is more substantial than Interstate Commerce Commission clause?

A. The only judicious and prudent answer I can give for that question is that we haven't reached that point yet. I think if you are discriminating and its clear that your are discriminating, that's wrong. I think the Supreme Court would probably uphold that to be discrimination under the thesis of the

recalls something like this the

discrimination, and in the case

I have those case citations here for you today.

Q. The argument would be -we're not going to discriminate against one pipeline - any pipeline it crosses would have to be

A. It's an evil that the state is accomplishing there. I think we have the decisions that would say that you cannot

interstate commerce, and that isn't what this act does. This act facilitates and it clearly is a decision that interstate commerce or foreign commerce of the United States and this wonderful product is of

and its selecting who and if this isn't the group that is willing to do it then either the state can do it itself or find other willing people to do this. No one person, no one industry can claim special privilege relative to what is owned by the state. The state can't block it but the state can certainly select and establish reasonable conditions which seems to me what have been set up so far.

Q. As I understand it - you do agree though that we using this property right to place a burden on interstate commerce which if you place it on interstate commerce without a property could be considered improper?

A. If you did it by a rule of law which said that someone violated would go to jail or would have to be _____ a criminal or a civil penalty would be assessed against them for not obeying the law, you could not do it. But this is not a rule of law, it's not a statutory rule of law, it's not a criminal sanction, it's not a civil sanction, it's a contract between two parts.

Q. Do you agree or do you not agree that we are imposing a burden on interstate commerce by virtue of our property ownership which would not be permitted except as a contractual agreement?

A. No, I do not agree. There are many of these burdens that can be imposed without them being. Now we distinguish between burdens. I have cited two cases early which show that even today under regulatory authority in the 60's the Supreme Court has held in one case that the only test to apply with respect to the negative implications to the commerce clause is the state power to regulate interstate commerce, is that it not discriminate against it and that the state be pursuing in the legitimate end of local government--like safety--like welfare of its people.

Q. Our right-of-way leasing which is intended to be an _____ to reduce a tariff below what is permitted by the federal agency--would not that be considered an unreasonable burden on interstate commerce were it not connected to our property right here?

A. No, I think not, because of nature of the federal regulation and the federal regulation is not a regulation which tells

the interstate pipeline this is what you shall charge. It puts the burden on the carrier to make its choice to what it wants to charge and that can stand and often does stand throughout the life of that tariff as the legal rate. It is called a kind of a private law. The only time the administrative agency may get into the picture is when there is a complaint about it being unreasonably high and then it would investigate this - hold a hearing perhaps and if it made a decision and then reduced it to what it deemed to be a reasonable rate. So we are dealing with a method of federal regulation from the beginning which is not imposing upon the entity in the private sector regulated. The duty to charge this rate in this fact or that is positively determined by the agency. So this leaves an option - it was built that way to leave an option of choice in the _____ as to what it was going to charge but having left it with that option this is something that it can make an arrangement with respect to. We have three states today that have essentially the concept of the Alaska Pipeline Right of Way Leasing Act. These are as I recall, Connecticut, New York and New Jersey. They face the problem of commuter passenger traffic. The federal congress gave the right to interstate railroads to withdraw completely from interstate passenger traffic. This would have been catastrophic for your large metropolitan cities in those three states. An so, they passed an act -- I didn't know about it when I proposed this idea to the joint pipeline impact committee I found it out later. They essentially did the same thing. They simply utilized the contract power and in one instance

they even utilized the lease notion by which they contracted or dealt with an interstate railroad and said 'give up your right to go out of interstate transportion of commuters for a period of five years.' Frequently it was funds that they appropriated to make up the deficit in operation. Now you may want to distinguish that and there are ways that you can. I won't argue with you on that. But the point is, it was the use of the contract power in one instance -- two instances -- and another two instances it was the utilization of the property control and disposition, and bargaining at the table, something that was satisfactory to the government and to the interstate transportation agency and profession and they went further. They really had them forego a privilege which they had but the reason I think it was obviously constitutional is— the reason I think this statute is obviously constitutional in this respect that we're now discussing. They can elect the level of the rate they want to suggest. The only time you'd come to the problem of collision would be if the ICC said after a rate was filed 'thats unreasonable'. Now how is that likely to happen. Well, I don't think its very likely to happen, because its lower than what the statutes requires and the ICC is not in the business somehow of protecting companies against going bankrupt. It just really isn't that kind of an agency.

Q. Professor, I know you don't hold yourself out to be an economist. We had some suggestion that the right-of-way leasing formula might not work as a deterrent for the reason that taxes or fees paid for rental of the right-of-way will be a legitimate part of the rate base and that therefore no matter what the fee charged, that the owners of the pipeline would go to the ICC, if that were the regulatory agency, and get the allowable eight percent on capital committed to the project with the allowable expense of the fee. Have you any comment on that?

A. Sir, this is why the dollar that you have focused upon is probably the most central point in the entire act and it also illustrates why I felt there should be a required covenant in addition to those that were listed, and here the committee, as I say again, disagreed with me and felt it was not something that would probably _____

can agree with respect to the rate they are going to propose you have a lid on the problem. Without it you don't have a lid. That's why what you've said is absolutely correct and why it is a problem and it should be some kind of provision that allows the commissioner to address himself to it. I couldn't agree with you more. But it can be handled and under section 150 of the act as it now stands, the commissioner can deal with that and he is very familiar with that--our original memoradum.

Q. The optional covenant you mean?

A. Yes sir. And that's why I'm almost pleading with you not to throw that out, because not only can you not now foresee

the problems that will be there down the line you can and all too readily foresee like you've just indicated in this verbal presentation, a problem that is there right now and there is not a required covenant. I think the pipeline impact committee was correct in its judgment even though we disagreed. I agree with the committee--it was too difficult a provision to write. I don't think I can write that provision in a statute except in part of it tied down and part of it you're going to have to leave to the judgment and discretion and good sense and prudence of your commissioner. And little more thinking has to be done about that. I think it can be done and one way would be periodical renegotiation--seems to me that perhaps you could talk in terms of a (as we do in some commercial leases) that given this rate it can't be in dollar and cents more than, say 15 percent, beyond what it was in a five year period. Something like that.

Q. The problem of periodic renegotiation appears several times through here and you usually refer to it as making flexibility to the instrument and to the regulatory scheme. The problem of renegotiation here is from the point of view of those being regulated. I don't know what you mean by periodic renegotiations. Does that mean that if they don't agree with the state do we force them out? What does the right to periodic renegotiation mean? They can always turn you down?

A. I would think that there should be some kind of formula worked out which would enable the commissioner to determine, say every five years, how well that formula has been

realized in light of experience of that five years. This is something where I think the economists have something to offer--a concept for inlining a rate charge for interstate transportation of gas or oil with some kind of a reasonable return vis-a-vis the people that are having to pay for it. We've done a lot of complex things in regulation. This would not be regulation. This would be a provision in a lease but certainly what we have done with respect to analagous problems would be useful to an economist and a lawyer sitting down together with the commissioner. I have no doubt it could be solved by some kind of formula that would be applied, say, once every five years. It would be fixed for five years and you would come back and reexamine in light of that formula what would need to be done, let's say for the next five year period. But it would have to be a formula. It would have to be some kind of formula that we could say in the long run for the usual life of the lease and could be defended.

Q. If we were talking about public utility type of regulation, where there's almost a body of common law as to what's an appropriate return and what isn't, we define our public utility law very briefly (the statutory end of it) and we depend upon a long custom usage as to what can be deducted, what can't and what the regulatory body can do. And I can see why, if you're undertaking a major project with that body of common law behind you that an investor or a pipeline company or a utility company would be able to invest, but I'm not sure that without that body of law behind you to tell you what's reasonable and what isn't reasonable that you

would be able to finance something as unusual as this pipeline--or not finance but even want to undertake it if there were something in the middle of it that said that a state official had a right to _____ the pipe to disagree with you and forfeit out your position in effect.

A. I agree with you. It has to be an original lease, Senator, and to that extent I don't have any disagreement with what you are saying.

Q. I am skeptical of turning over to the commissioner the obligation of drawing a formula three months from now if he can't tell me now what it is now so that I can sit here now and agree or disagree with him, and I am skeptical of his ability to do it then with the lawyers or the economists if you can't do it today, and I think it would be less unreasonable with the oil people here if you didn't say that we shouldn't submit them to that, that if there is such a thing that should be done that it should be done now, with this legislature disagreeing so much with what our administrators have proposed to us. Now with something that is this important, maybe it is a good thing that we do it here and now sitting across the table with everybody around instead of secretly handling these things, reaching a package and then coming out with a misunderstanding on it.

A. This might well be something that you would want to go into session with your commissioner. He is not here. Perhaps he has been thinking about this. I am sure that he has been aware of the problem from the original memoranda and possibly others have talked with him orally and have

communicated with him in writing and I would think that in addition economists with this problem, with this type of problem, I would put it that way, would sit down. I think we deserve their expertise. I think honestly, Senator, it was not focused upon because it was a complex act to write. It was written within a certain time frame, and I know you recall what happened, and this was one of those things that we thought it would be capable to be dealt with and it's something that the legislature itself could speak to. I don't see any reason why you can't limit this commissioner by subsequent act to pick the principle that you put out before. You were speaking then in a regulatory context, but I think that you can speak about this act too. If you are dissatisfied with the administration of that formula that you worked out you may work out, correct it, or you may cut it down. And that is the direction it seems to me that it is likely to go. That you would be worrying about the pyramiding, in effect. And I don't see any reason why the legislature can't sit in review on the Alaska pipeline Right-of-Way Leasing Act and reconsider this. I don't think that one problem that seems insoluble at all, I mean you might have a less good judgment than a better judgment but I would be willing for all the good that is here to go forward and see what he does. Maybe you would want to give him special economists or make sure he has an economist there and perhaps others to help him. This is not an easy task. I don't know what the appropriation situation is. But I just feel that there is enough good here. There is so much that will stand

scrutiny that perhaps this we should see what he could do. That the legislature can make its adjustment. It can simply say, this is too much--let's adjust it downward over the agreement, and this will be, I would think, so long as it is within the limits that the Interstate Commerce Act spells out, perfectly acceptable from the federal government.

Q. Mr. Chairman, I want to ask about the state's option to purchase again. This is one of the big objections that Mr. Spahr brought forth the other day. Mr. Lipton suggested yesterday, if I understood him correctly, that we might want to consider putting in conditions in terms under which the state would pick up that option in such a way that we would still have an honest-to-goodness option, and yet they could not feel or say anyway that we were taking advantage of or waiting for a moment when financing was easy, and all that sort of thing. But it seems to me that the important thing, if we felt that we needed to pick up an interest, we should be able to do it even if we pay a little premium.

A. Yes.

Q. Do you think we could write in something?

A. I would think so, Senator. That is certainly something that can be done. I think there is no intention here in any sense to take advantage of the company. I think while you could possibly agree to a formula that the House has set that would be reasonable at that time, that the state would not want to be unreasonable. And again, here is this value of the suggestion that you have made, Senator, which is that you could speak to this either specifically by later legislation and say this is to be added, and if there isn't enough

authority in the commissioner to give what seems to be fair and I think originally you could write in there what is the measure you want--the industry has used fair market value, and I would not feel at all adverse to putting that in. As a matter of fact, I think that is appropriate. That's a simple way--fair market value of this interest. Then you would probably have to have a board of arbitration. We all know the problems with a board of arbitration, selecting the people to sit on a board of arbitration, but it seems to me that the state ought to pay what it is worth. And it is getting something that is of great value at that point is what we would have said earlier in the joint pipeline committee is correct.

Q. On this leasing business, I was just thinking that assuming that sometime after a right-of-way is granted and an oil line is constructed it is bound to be feasible to construct a natural gas line from the fields to the market. And assuming that it would be compatible to use the same right-of-way for a gas line for ecological reasons and all of the reasons that make it difficult to obtain a right-of-way in the first place, would the state have any handle on that or would that be a question where the original lessee would be dealing with the gas company for example? Is there anything in this legislation that would give the state a handle on this?

A. At one time, Senator, there was in this legislation something that would have done it. I don't have, nor do I imagine the committee have, the original draft of this

legislation but it gave the commissioner authority to construct and operate any pipeline when the carrier is unwilling to undertake and complete such action within a reasonable time. Addressed to the very situation that you have just talked about. I think we were thinking more about another crude oil pipeline being essential. An additional line that they couldn't negotiate sufficiently with the lessee carrier to get them to undertake to build this, yet it needed to be built. There was at one time in the draft legislation this provision, and I felt very strongly that it was needed, but I think that this committee felt that this was something that could be addressed by subsequent legislation also. And I think it is something that you could do, but again I think that we could say secondly that under section 150 you could negotiate about this and it is possible that a lessee carrier would be willing to undertake some kind of obligation. Maybe not a fairly precise one, but some obligation with respect to building a natural gas pipeline. If I understand your question.

Q. No, you don't. I am assuming someone completely unrelated to the original lessee is interested in constructing a gas line from the oil fields, and because of environmentalists and ecology people and those who object to highways and going across country, if you will, that it is feasible to use a right-of-way that has been previously granted to an oil line.

A. Yes, yes.

Q. It might be just as valuable as the original right-of-way.

A. Exactly, Senator. This would be something, Senator, that would have to be spoken to under the statute as it is now stated through the optional covenants provision. You would simply reserve to the state in an explicit expressed covenant the authority of the state to deal with another outfit for a natural gas pipeline. Something similar to this has been done.

Q. Yes, but it might be going across, then paralleling the original lease and I wondered in that case if the state would have any handle on it.

A. Well, it wouldn't unless it reserved the right to do it.

Q. Well, has it done it in any of this legislation?

A. It has in this federal regulations and the regulation implements the federal pipeline right-of-way act.

Q. I'm speaking of the proposed legislation.

A. No, I don't see it, Senator.

Q. Is there any place there where we give that right away?

A. It seems to me it is given away by the repeal of section 150. I think that's right, Senator, it is given away. That's a very good point. It is given away along with other optional covenants. This goes back to your point too, Senator, how important it is. There are things that are either difficult to spell out or unforeseeable or something that you can foresee but it isn't presently on the table so you don't need to speak to it this year. This optional covenant provision is just, it seems to me, an utter essential and it would speak to Senator Butrovich's point--a very valid and important point. We had an example of what he's talking about, you know of a

major oil line,crude oil line, that was converted over to a natural gas line. Now that isn't going to be in the lower forty-eight. Now that isn't going to be feasible here so the only solution would be in all probability to have a natural gas line on the same right-of-way. And your optional covenants provision allows your commissioner to make that reservation.

Q. Would it be wise irrespective of that in the optional covenants to put i in there as a standard covenant? Giving them the first right but for a non-interfering use?

A. I would prefer it, Senator.

Q. We certainly don't want to do this twice.

A. Providing that we don't allow giving away on the rights of transit to begin with, which is what happens ... It seems to me while we've got thorny problems Senator Groh has mentioned one of them. I'd just like to see a district court decisions, I'd like to see a federal court.... It just might clarify a lot of the air about how constitutional this thing is. And then secondly we need some experience under this act. The opportunity gives you later on to substitute lessees if you have to, and maybe get to a point where the people would like to get out from under, and they want to sign, maybe you would be better at a point down the line to have this lease assigned to other people - might be agreeable to all three parties, a new party and the two old parties that you have a substitute lessee carrier come into the picture. The point is it's very important to have this optional convenants and devices

as a way as best you can for anticipating the things and for dealing with things you can't anticipate. And then putting into the required covenant those things that you now determine should be there - and to keep them there.

Q. It seemed to me one of the overriding statements by Standard of Ohio was that if we don't pursue with this package and negotiate, move on rather quickly, they may well lose some of their people involved in the pipeline package because then they would be subject to consideration of anti-trust, more subject to it, a big concern that would delay everything. Do you feel inclined to comment on this?

A. I think again when Mr. Lipton was here maybe...I know he felt that a qualified answer most of question. I would just talk from one standpoint that perhaps I have a little qualification to speak from and that is in terms of opportunities that this general device gives the state, if that were to happen this just might make very important this provision about the state exercising it's option to acquire and suppose you do have six percent or eight percent pull out and the state might want to acquire it at that time--that would not disturb any of the interest would it? And you certainly would want to have it not in the sole discretion of the other members of the joint venture whether the state could buy it up. You want this line to go ahead, and after all the federal government once owned eight percent of the Bank of the United States, you know back there in Jackson's day, and before and after. It's nothing unusual for a certain percentage of interest in a private concern to be owned by the U.S. government and I would certainly hope, in fact this I think highlights the

importance of having the Right-of-Way Leasing Act, so you can buy up as a state and take up the slack.

Q. That would alleviate the possibility of anti-trust action?

A. I suspect it would. The case of Parker vs Brown is a case where this kind of question came up. California was trying to prorate the selling of raisins(and that seems a long way from what you're talking about) but it decided the principle that you could not, although the producers came to the state and got them to impose this arrangement. The fact that the state did impose this arrangement through law was said to immunize it from anti-trust prosecution and I think we actually discussed this on the joint pipeline impact committee for a little time that some of you can perhaps recall better than I do, that the state being in here might make the federal government a lot more willing to accept this under certain circumstances than others.

Q. Mr. Witherspoon, I think we all recognize that if an individual believes he cannot do something it's highly probably that he cannot do it. The mental attitude is more important than you think. I've been told by what I thought were reliable sources that the expectations and probabilities as far as the state winning its case on different points--in some cases the probability was as high as 70 percent and in no case was it less than 50 percent on any of these points--let's assume that that was not correct and that the state attorneys were convinced that they would lose. Whether they are right or not I would suspect then that they would lose. As far as probability is concerned.

A. Excuse me, Senator, that's what we call a self-fulfilling prophesy.

Q. There are two differing assumptions. One is our attorneys feel that we have had a reasonable _____ and another is that they do not. Let's take the second one and assume that it is case and then what suggestions do you have to offer.

A. It seems to me some radical surgery is necessary.

Q. Is it reasonable to go outside of the subsistence the legislature is convinced that we do need to conclude this litigation or that we need to carry it forward in the courts to a conclusion in court and that our own attorneys would not be affected _____ points of the law. Is it reasonable to go outside of the attorneys office?

A. Typically this question arises. I am arguing a case on the 5th of November in Boston in the first circuit of appeals for the Attorney General of Rhode Island. It's a state--it's a very small state and involves a law that was enacted March 13th of this year and there's a real question about its constitutionality. I will say that it ought to be held to be constitutional. I lost at the District Court level, I expect to lose before the Court of Appeals, and maybe the reason you take it to the Supreme Court of the United States is that you may pick up one judge or two judges. It's just essential litigation in terms of getting the country to face up to a major civil rights issue in protection of the human person and the life of the human person--it's gotten down to that unfortunately--I mean that we are really having to litigate

whether a human being has its life and protect it. Many of us have been in the civil rights battle fight now for a good many years and it's never been felt that we would be fighting that battle before the Supreme Court to protect the human being and the life of the human being, but that's where we are. But I'm just saying that this was a cooperative arrangement; the attorney general called you in and he's on the briefs and he's there at the trial but private attorneys conduct litigation for the state. The firm of _____ of Rhode Island conducted that trial for the attorney general with the assistance of the attorney general sitting there and then with myself assisting the firm, and I wrote the briefs and this is not unusual in our state--we call in people by consent and agreement of the attorney general to handle the litigation, and that's one way to get people in who believe we can win and to work for it, and I'm sure your attorney general is working to win. I don't have any doubt about that and I'm sure every effort in his command, as a professional lawyer, is being directed toward doing that. I'm just saying this is an arrangement which can be worked out and which has worked out. I'm just simply saying that Rhode Island has too small a staff to do the work in this kind of complex case. I've had to study your problem here in the state and I'm sure your attorney general could advise you quickly about any constitutional law problems that could be presented--a separation of powers provision--I'm just not confident at this point to fully answer.

Q. Your recommendation is then that we should continue this litigation to a conclusion.

A. Yes sir.

Q. And that's both in a regulatory measure as well as the right-of-way leasing?

A. Yes sir - I would so recommend.

Q. Do you make this recommendation with the knowledge of the states pending financial crises?

A. No I can't say Senator that I honestly do. That was one question which I asked. I asked of someone just in ordinary conversation - in no kind of formal conversation whether there was a financial emergency upon the border or the horizon now that we are all talking about and seen. I just don't know the answer to that and you would know that far better than I but I could see if it is then this would be a new dimension.

Now I don't know how much of a dimension and how you would work from it but I would have to be quite honest and respond to you - Yes, it could make a difference.

Q. In your best judgment how long would it take to carry this to a conclusion - say to the Supreme Court?

A. I would at least want a Court of Appeals decision just simply because it could perhaps give you at least a regional response of judges drawn from over a region as to the validity of this legislation. I don't really think there is a problem with your regulatory act - in fact, I just don't see any problem at all. My honest opinion is that there can be no serious question about its constitutionality.

I don't want to be unkind but I think it's hardly arguable. But on your Alaska right-of-way leasing Act there's a resonable argument on the other side. In the sense, and please understand me - I'm stating that people are not being unreasonable and saying that there's a question, but then again, you have the strength, and it seems that the strength is very strongly in favor of its constitutionality.

Q. If the federal right-of-way permit is issued, say as early as January, and it's our decision to reject the governor's proposals and continue litigation - do you think we would be permitted to continue that experiment in the light of the national energy crisis?

A. I'm not sure that my focus and concentration was adequate to capture your question perfectly - would you restate your question, please.

Q. If the federal permit is issued at an early date, say January or February and in the meantime we choose the course that you recommend - recognizing it's going to take awhile to get to the court, do you believe that we would be permitted to continue this exercise to its conclusion - recognizing the national interest involved as far as energy is concerned?

A. Yes, I think I understand better your question - it's the latter part of it that worries me in giving you a good answer in light of the energy crisis. Are you asking what would be the weight in the judicial decision making? I'm not sure this is what you are asking.

A. No. Wouldn't in fact the energy crisis be at such a point that the whole process would be taken out of our hands?

A. You mean by the federal legislature?

Q. Right. We are advised that there is interest in our litigation on the part of Congress.

A. Senator, I think that this has so many imponderables that it is very difficult to answer - so my answer would be a guess, and I'm far from being an expert.

Q. Thank you. That's all.

Chrmn: Before we wind up for the day, would you comment on Senate Bill No. 8? Lease and sale of state lands for pipeline purposes.

A. Yes, I did look at that and I just really have one reaction. It's a piece that I would want to study further, but I wondered whether or not having committed yourselves as a state to the Alaska Pipeline Leasing Act, whether in moving along this line the lease device ought not to be utilized? I can understand the problem which is here and I don't think this as really undercutting the Alaska Pipeline Leasing Act principle but I do think and do suggest that it would be preferable to utilize the leasing device, the more typical leasing device for this purpose, simply because it would be closer to the Alaska Pipeline Leasing Act. It might permit a latter judgment of bringing the two kinds of leasing together. This might be made for a limited time. I am not familiar with the context in which this is set with respect to time. If you have a limit on time provided for - the commissioner might in his discretion make this for a limited time. It seems to me you would have a better chance of getting this Act and the Alaska Pipeline Right-of-Way Leasing Act together at a later time. I certainly do not feel stronglyagainst this at all.

If there is a special legitimate reason, local reason, for this it makes sense to both the state and the industry and I could certainly see that that could exist without having investigated the facts-this represents an option which might make very good sense.

MILTON
LIPTON
10/20/1973

STATE OF ALASKA
THE LEGISLATURE
LEGISLATIVE AFFAIRS AGENCY

POUCH Y - STATE CAPITOL
JUNEAU, ALASKA 99801

October 31, 1973

The attached transcript contains the remarks made by Mr. Milton Lipton on October 20, 1973 before the Senate Resources Committee. It is a verbatim transcript of Mr. Lipton's remarks. There is occasionally a word missing or other minor gaps in certain places, which are due to the speaker's testimony being indecipherable at that point. However, it is believed that these occasions are rare and the transcript presents a fair picture of the thoughts expressed by the witness before the committee.

Senator John Sackett
Chairman
Resources Committee

SENATE RESOURCES COMMITTEE

Special Legislative Session

October 20, 1973

Mr. Lipton

I'll try to get my introductory remarks to the point of the issues which you are considering here with respect to the legislation submitted by the Governor. First of all it is very obvious that there is considerable urgency in getting on with the construction of the pipeline. This is clearly evidenced by Congressional action to authorize construction. And I think the action by Congress implies not only an appreciation of the hightened concern by the nation as a whole for the potential contribution of North Slope oil to the nation's precarious balance in essential energy supplies, but also a feeling that it is imperative at this stage to avoid further unecessary delays on account of litigation in the courts. And I think that the same spirit, the desire to avoid unecessary delays, is reflected in the negotiations between the Governor and the companies. There is no doubt but that the State and the companies have a very common interest at least in getting on with the job.

You must independently review the proposed legislation in the light of the many issues involved so in my introductory remarks I would like to address myself to the question - what have been the major concerns which have impelled past legislation, to what extent are these concerns still relevant to the State of Alaska, and to what extent do the proposed changes in the legislation adequately take care of the concerns of the State and to what extent may you want to consider variations, deviations, or at least review what is being proposed.

The first thing that I would like to stress is the public interest that is inevitably and irrevocably involved in the pipeline. This is a circumstance which is unique to Alaska, it is of tremendous importance to Alaska and it just does not obtain elsewhere. This is one of the reasons why in your legislation you must be circumspect to a degree that perhaps other states need not be. The contrast between the pipeline that is proposed to be built along a corridor from the North Slope to Valdez contrasts with any other transportation circumstances in the lower 48 states. There was never a time when it was not possible, quickly and expeditiously, for any crude oil producer having a significant flow of crude oil without access to pipeline capacity to undertake to build a new pipeline. Or for any refinery without access to pipeline that would bring crude oil to

his refinery not to undertake the construction of a pipeline. There is today for example a very serious shortage of pipeline capacity into the Midwest area. CAP line, which until Alyeska was the largest undivided interest crude oil pipeline in the United States is expanding its capacity under different investments by the various companies participating. Its not a proportional expansion of capacity but to reflect their several needs. There are refineries located in the mid-continent area of the United States that have historically drawn their crude supplies from Oklahoma and Kansas where crude production is going down that are prepared to build their own pipeline from the U.S. Gulf area into the mid-continent area. There was a new fairly large capacity pipeline just completed to carry products from the gulf coast area to new consumer markets in the mid-west. So that although individual pipelines have, in a sense, a monopoly over their own rights-of-way and are regulated, the circumstances of investment construction in the lower 48 make it possible for competing or alternative forms of transportation to be provided. This is simply not the case with respect to the crude oil resources of the North Slope and the access to export markets in southern Alaska. That pipeline corridor will convey to whatever company builds that pipeline an

an irrevocable right for the transportation of crude oil. The state has tremendous interest in this pipeline. It has interest in seeing that the facilities are operated in the most economical, efficient fashion. That the facilities, whatever their capacity, may in due course be expanded to meet the needs either of incoming production or facilities provided to expand the delivery of crude oil, for example, to intermediate points within the State, such as Fairbanks. My point simply is that company interests may not always correspond in toto, or at a moment in time to the concerns that are of primary interest to the State.

I had the privelege of listening to Mr. Spahr's testimony before this Committee yesterday afternoon and I was quite impressed with his very careful and precise statement of how a company balances all of its investment decisions against their many alternatives, which means in effect that the economic interests of the State, from time to time and in various respects may not coincide with the inclinations of the individual companies who are participants in the pipeline.

There is no way in which the State, through its regulatory machinery, can impose arbitrary or capricious demands upon the pipeline, either to deny them the right to do things or to compel them to do things, because the pipleline always has recourse to the state courts, under the due process of law, against capricious, arbitrary or confiscatory demands

made by a regulatory authority. There is likely to be a wide range of business transacted by that pipeline which involves intra-state commerce and which involves State interest in the totality of its commerce. And, to the extent that the State has an interest and can exercise jurisdiction, it would seem to us that the legislation enacted by this legislature should claim for the State such jurisdiction, subject both to the prior jurisdiction that the ICC may have, and subject also to court review of how the State exercises such jurisdiction as is available to it. But, I would not think that the claim by the State, in its legislation, to exercise regulatory jurisdiction, should be such a disabling factor that in advance they would say that we will not submit to the legislative exercise of this power and go ahead with the construction of our pipeline unless it has been previously reviewed in the courts. The exercise of the State regulatory authority is always available to them subject to judicial review. I would not think that this one, among the many issues would be the one that would be such a stickler that it would involve prior litigation and unecessary delays on the subject of the construction of the pipeline. This bears upon aspects both in the proposed amendments to the Pipeline Commission Act and certain proposed amendments in the Right-Of-Way Act.

The second overwhelming interest of the State I think is in the tariff which the pipeline will eventually establish.

The estimated costs of the pipeline goes up by leaps and bounds. The figure that is now being used in the range of 4 - 4 1/2 billion dollars which makes it both an incredible industrial undertaking and private investment. But it ought to be seen in context. There has been over the past three years, according to estimates, an increase of 3 billion dollars in the construction costs of the pipeline. On the other hand, the increase in wellhead values in Alaska, as measured only by the increase in postings already put into effect in California, are on the order of 60¢ a barrel, and 60¢ a barrel on 10 billion barrels of recoverable oil, means at least that the capital assets which underlie all of the incentives to construct this pipeline have gone up by about 6 billion dollars in the same period of time. Insofar as the economics of the pipeline are irrevocably tied in with the economics of crude oil production, the increase in the construction costs of the pipeline, occasioned by inflation, environmental considerations, regulation, etc. are not disproportionate to the tremendous increases in the value of Alaskan oil, which have already obtained by virtue of the run up in energy prices and crude oil values in California, and also with respect to foreign oil at the price which it can be

brought into the United States.

These higher wellhead values, reflecting world oil prices, are no reason for the legislature to have less concern than before about the relationship between a pipeline tariff and a wellhead price at which their severance tax and royalties are assessed. The mere fact that the oil is worth more is no reason for you not to insist that the maximum worth accrues to the State, and that it not be unecessarily depressed, even if its depressed from an unexpectedly high level by virtue of the tariff which is established on the pipeline.

It is not the issue that one questions the good will or the economics of the company. The real question has to do with how the State, given its economic interest, exercises its responsible legislative authority to protect the interests of the State in the event that company interests, for one reason or another, are found in such a way that the State feels its own interests are being bypassed. It is for that reason that we have felt very strongly that the State should be looking at a package of legislative means that not necessarily by themselves but together, would always conduce to the most favorable tariff, in light of the States economic interest.

One of the specific issues involved is one that came to the fore in the Right-Of-Way Leasing Act of 1972 was the percentage lease rental and the many provisions associated with it. If you recall our testimony last year, this was

one area in which we had certain reservations. It certainly was, to our mind, an imaginative approach on the part of the State, since the main intent and purpose of the percentage lease rental formula was not to raise revenue for the State. Quite the contrary, the intent and purpose was to hold out an alternative of pains or rewards to the pipeline participating companies. Pains in the form of a very high lease rental if they set too high a tariff, and rewards in the form of an appreciably lower lease rental if they set the lower tariff. We had however, considerable uncertainty as to what the company response would be to it. It was then very, very difficult and it remains very, very difficult to compute, company by company, the way in which the impact of the percentage lease rental would fall upon the company, not knowing in advance what the ultimate proportions would be between a company's equity in the pipeline and a company's equity in the crude oil, that is whether they were a net buyer or a net seller. And not knowing what the tax exposure was of individual companies with respect to income earned on production, which has the advantage of depletion allowance and the disadvantage of severance tax royalty, or what their income tax exposure might be on pipeline operations given accelerated amortization, investment tax credits, etc. This is a very difficult corporate computation. So there was considerable uncertainty as to whether the incentive that was intended in the percentage lease rental would actually

work.

Then there was the second problem about the pyramiding of lease rentals. Any rental payment that a pipeline company makes, insofar as it is subject to ICC jurisdiction and insofar as it sets its tariffs subject to the Icc rate making rule, if it pays a rental it is in effect able to recover that rental payment through the tariff. So that the higher the rentals are the higher the tariff would have to be.

Third there was the legal issue, and I think that, under the circumstances, where this has been made by the industry, one of the pivotal issues in their litigation I suspect that the legislature would want to consider very. very carefully the extent to which the percentage lease rental formula and all the provisions associated with it are essential to the interests of the State or whether there are other alternatives.

The second innovation that was introduced in the legislature last year and is now subject for your review, is the option of the State to buy up to 20% equity in the pipeline. Last year we were rather negative on the subject of 100% state ownership for reason which we would still enunciate. But we did feel that there was a very cogent reason for the State to have an option to buy a participation in the pipeline. in due course. What we had recommended, and what was enacted into your legislation last year, was an option to acquire up

to a 20% undivided interest in the pipeline. The reasons for that were, if the State exercised its option, it could use its ownership of some percentage, and it does not have to be a very large percentage, it could be less than 20%, to utilize its ownership of transportation facilities to leverage all tariffs downward. The State could set a tariff and say that this is an appropriate yardstick that others can follow. Or the State could set a tariff and if the tariff were lower than the company's tariff presumably all shippers would elect first to move their oil where the transportation charge is least, and on that basis the State would be in a position, with its relatively lower tariffs, to say that this is what determines the value of oil on the North Slope, and use that as the basis for its severance tax and royalty calculations, with the onus being on the company to prove that a higher tariff is necessary. Or if all else fail alternatively for the State to say we too will charge a high tariff and in effect we will recover in the profit on the oil that we move through our share of the pipeline what we may have lost through severance tax and royalty revenues because a high tariff depresses the value of the oil on the North Slope.

The attractiveness of the option provision was that having the option it would not have to be exercised.

That what the State could do by its option, plus what it might do through its taxing authority, that all of these would be conducive to a reasonable agreement between the companies and the State as to what a reasonable tariff would be, which might very well be at an ICC rate, depending on what ICC rate making policy is in 1977 and 1978. Or it might be somewhat lower, but at least it provides the State with a negotiating leverage and it would be one of those tools which hopefully the State would never have to exercise. The negotiations between the Governor and the industry have changes quite substantially the whole concept of the State's right to acquire an interest in the pipeline. Last year the company representatives were absolutely adamant that State ownership or State participation or State option were absolutely unacceptable and this was very largely couched in terms of the financing problems that would be posed.

I would like to call attention to arrangements that have been made elsewhere which involve government participation in a pipeline and a government option to buy. I'm referring now to an arrangement which has been made between a consortium of oil companies called SINCRUDE and the Province of Alberta in Canada having to do with the right to produce and transport a synthetic oil processed from the tar sands of the Athabascan tar belt. Will have to be a pipeline which connects the Athabascan Tar Sands Development

Project with the City of Edmonton where the oil will then move into other pipelines. The Province of Alberta is given, de nova, from start, an 80% equity in the pipeline. The companies which are participants in SINCRUDE commit their shares of the oil to that pipeline, without reservation. Secondly, and this does not have to do with pipeline but it has to do with an option, the Province of Alberta has an option to acquire, after the start of production, an undivided interest in the production itself, of not less than 5% and not more than 20%, with a formula that determines in advance what price will be paid by the Province of Alberta for the acquiring of that option.

I must be very careful to distinguish between the magnitude of what is involved here. The Alyeska Pipeline with an investment of some 4 - 4 1/2 billion dollars is a much larger pipeline facility than either the Athabascan pipeline or even the producing operations. There are differences in the magnitudes and degrees, but surely the principle of a definite participation in the pipeline, or the option to acquire a participation is not without precedent. If there are problems involved in the financing of the pipeline because there is an outstanding option for the State to acquire it, I would believe that those financing problems could be resolved if the terms and conditions of acquisition

under the option were spelled out. That is to say their investment, their costs, plus interest on their investment up to the time of the States taking over the pipeline, will be paid to them, and that the State thereafter undertakes commensurate obligations for whatever the outstanding debt may be.

The principle of an option to buy is not without precedent. This consortium of oil companies, who together constitute the SINCRUDE group, contains within their membership of four, two; the Exxon Corporation, through Imperial Oil in Canada, and Atlantic Richfield, who are major participants in the Alyeska Pipeline. So that insofar as the purpose of an option still commends itself to the Legislature as a significant factor in the protection of the State interest, which probably may never be exercised but which nonetheless represents a prudent approach by the Legislature. I think it may also be considered that the precedents which have been transpired, and if necessary, agreement by the State in advance on what the formula for payment will be, so that it is carefully spelled out, I would think that at that stage of the game it should not be a completely inhibiting factor with respect to the financing of the pipeline.

The third broad area at issues has to do with taxation. Obviously the taxing power of the State is the ultimate power that the Legislature exercises with respect to any of the

issues which may be involved with respect to Alaskan oil.

There is now tabled before you two major tax measures, an ad valorem property tax and an amendment to the severance tax. No legislature can bind itself through its term of office, let alone bind future legislatures, so whatever is enacted in terms of tax legislation is susceptible to amendment at any time. Certainly an oil company, more than any company in the world, is aware of the taxing power of sovereign states or States. In the context of the package of legislation that is submitted to you, it would appear that any tax legislation that you enact in this Special Session of the Legislature, implies some kind of a commitment. Here there have been negotiations, tax proposals have been made, in a special session of the Legislature you are being asked to amend or pass legislation which seems to be part and parcel of a whole package of legislative items, and certainly the industry, no matter how much it feels is subject to amendment in the future, will not be remiss is recalling to this or subsequent legislatures, that what you enact today was part of a package.

Therefore it seems to me that this particular legislature ought to be especially careful in what it does in terms of their tax decisions, and certainly the legislative record ought to show that a present enactment represents the sense of the Legislature to the extent that it is able to look ahead and see the circumstances under which the tax will be

operative. From the visibility of today, I submit that 1977 and 1978 might not look at all the way you or I think its going to look with respect to the economics of North Slope production or the economics of exploration and development elsewhere in the State. So in a sense, if you are enacting tax legislation today, you must also be alert to the fact that the interests that the State will be looking at 3 - 4 - 5 years hence may appear very differently than the best perspective any of us can hope to have on the future from today. So that the tax legislation will be subject to review, no only as a matter of legislative perogative, but also as a matter of very basic equity as circumstances may be changing.

There are three categories of taxation which are relevant to your Legislature.

(1) The first is a severance tax with amendments set before you. We have always looked on the severance tax as a tax which captures for the State a portion of the economic interest in its natural resource, and which was sufficiently broad guaged so that it really wasn't directed to the production of one specific company or the production of any specific _____. Two to three years ago we felt that what the legislature did ought not to be constrained by the particular circumstances of Cook Inlet at that time, nor ought to be so flamboyant that it was directed entirely to the hectic

expectations of North Slope development, but that in a sense it represented a fair and equitible tax given the circumstances of current, prospective and future production out of Alaska. Out of that came your tax which was the percentage of wellhead value and which contained four different brackets which related to average wellhead activity.

Last year your severance tax underwent substantial change with the introduction of cents per barrel which was designed as a floor below which the State's revenue would not fall whatever transpired with respect to wellhead value of the oil.

There are two different ways of looking at the cents per barrel aspect of the severance tax. One is as a means of offsetting depressed wellhead values. That is to say, if the pipeline tariff is high and the wellhead value is depressed, then if you can't get it as a percentage of wellhead value then you get it as cents per barrel. It is a response to what you might have considered an unjustifiably high tariff which depressed wellhead value and hence your severance tax. Of course you can get that also by changing your schedule in percentage of wellhead values. But as an offset to cents per barrel, or the severance tax however its enacted, as an offset to the lowering of wellhead values through the high tariff, it is a blunt instrument because it affects every producer in the State with higher severance tax obligations irrespective of whether or not that producer is a member of the pipeline or not.

As a revenue measure, every severance tax bears on producing profits. But it bears on it indirectly, that is to say it is a percentage of gross value. And as a revenue measure it comes out of producing profits, but it can be a different proportion of producing profits depending upon the relationship for individual fields and individual companies and individual circumstances, of the relationship between gross value and net value of the oil. Therefore it is not an income tax though it does fall upon it. It is a revenue raising measure that is always available to the State and is susceptible to whatever rates the State may want to impose, which the State can adjust whenever it chooses if it is dissatisfied with wellhead values. But this is an economic judgement.

The royalty offset feature in the last amendment of the severance tax was obviously a legal issue of considerable general concern to the industry. Because what it implied to the industry was that here in Alaska, and potentially elsewhere, royalty payments which they entered upon by virtue of contractual lease arrangements, might in effect be changed by the State enactment of severance tax legislation.

You can of course achieve whatever level of tax income from the State directly for severance tax or even higher severance tax to offset what you consider to be a loss of royalty income, not by a royalty offset but simply by a high

severance tax.

The legal attack upon your last severance tax enactment could be voided by a very simple amendment, that is to simply eliminate the royalty offset and leave all the old schedule, in which case the industry would be paying a very considerably higher severance tax than they paid under their old tax or they are paying under the governments proposed legislation. To avoid the legal issue of the royalty offset is something I think well worth considering, because you can exercise your severance taxing power at any time.

(2) The ad valorem tax is very clearly to raise revenue for the State and particularly as an interim source of revenue and is one among various ones that you might consider. The only thing that I would like to mention about it is the observation that an ad valorem tax imposed upon a pipeline is recoverable by its tariff. It is a cost of doing business by the pipeline and under ICC regulations, and I suspect under your own State of Alaska Public Utility regulations, an ad valorem tax becomes a cost of doing business and therefore can be added onto the tariff.

By way of rough calculation, on a 4 1/2 billion barrel pipeline a 20 mill rate would yield about 90 million dollars per year in tax revenue ad valorem tax on the pipeline itself, which in effect would mean about 20¢ per barrel addition to the tariff. The ad valorem tax would be passed on to someone else in the tariff of the pipeline. Insofar as the pipeline

tariff is higher and the wellhead values are lower, the State itself would bear 20% of the burden of the tax because it would reduce the royalty severance tax income. The tax would become a burden on those producers on the North Slope who are not participants in the pipeline but who have to transport oil because the tariffs to them will be higher. They would bear a portion of the burden in proportion to the amount of oil that they produce and ship relative to the amount of oil that is produced and shipped by companies who are also participants in the pipeline. The rest of it would be borne by the pipeline companies themselves as its passed back to the cost of transportation of their own crude oil.

The same holds true not only for the ad valorem taxes that the pipeline will pay in 1978 when the pipeline is in operation, but I suspect that the same thing holds true for all the cumulative ad valorem taxes that the pipeline will be paying between 1974 and the start up of operations, because those taxes are also recoverable costs of doing business and in due course will have to the companies as pipeline operators in their tariff.

All of which is not a reason in and of itself for you to say no more ad valorem tax. This all depends on when you want your revenues and how you best decide the State can raise its revenues.