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on the part of the legislature to avoid extensive litigation on the royalty offset feature which we think is of very little interest to the state of Alaska, in any case.

Now, the severance tax of course is one of your important weapons. I mentioned in previous hearings before this committee and elsewhere, that eventually your income tax is an important thing but that's not up for discussion. It's not an appropriate time for the legislature to review your state income tax legislation although I strongly urge that at one of your sessions you review with your commissioner of revenue your entire concept of corporate income taxation here in the state. The conservation tax bill which is before you, I think is unncessary. We had recommended that the conservation tax which had been on your statute books in the past be eliminated and simply subsumed within your severance tax. It's an added piece of legislation that we don't feel strongly about one way or the other, but it complicates the whole process of paying and collecting monies as between the state and the industry. On the ad valorem tax, as we see it, this is a revenue measure designed largely to yield income to the state over interim years before Prudhoe Bay production begins, before the pipeline is completed. It falls within the province of the legislature to decide how, when and under what conditions it wants to raise that amount of money.

It's the combination then of a strong regulatory bill and the fact that you have continuing flexibility and authority

to tax via your severance tax or eventually through your income tax that we believe yields the greatest control by the state over the operations and the tariff determinations of the pipeline so as to protect the interest of the state.

Now let me get on the Right-of-Way Leasing Bill. We have gone through this bill chapter, book and verse, section, sub-section and paragraph and I think we are prepared to sit down with this committee and other committees of the legislature to discuss it in detail. I don't believe we have time to go through each and every aspect of this here, but I will report on those which we feel are most critical to whatever compromise package comes out. The first issue, as we see it, involving any amendments to the Right-of-Way Leasing Act is how much of the regulatory power that the state wants to exercise shall be done by indirection in the form of stipulations and agreements as conditions of leasing. The industry is challenging the 1972 Right-of-Way Leasing Act in the courts on constitutional grounds, claiming that in effect regulation achieved by indirection which cannot be exercised by the state directly is an illegal exercise of the leasing powers of the state of Alaska. This is one of the major issues under litigation. We obviously are not in a position to pass any judgment whatsoever on the merits of the case in litigation. I think there is a spirit of compromise abroad, I see it very much in the proposals of the Governor's Office, I'm not quite sure I see that much spirit of compromise

in what the companies are proposing in their package, but nevertheless, there is a spirit of compromise abroad and certainly we would feel strongly, and I hope the legislature does also, that it is desirable to avoid unnecessary prolongation of litigation, and the possibility that such continuing litigation may delay the start of construction. So if it is possible to avoid litigation without unduly sapping the legislative enactments that are vital to the state interest, we would feel that there is some merit in the legislature going ahead with the executive departments decision that a compromise is now in order. So on then to the question of the regulatory items which are introduced into the Right-of-Way Leasing Act by virtue of stipulations as a conditions of lease. One, the most important one in our opinion, which is largely eliminated is in section 120 (a) (3) that's the common carrier section. For many reasons it is of importance to this state that it is understood beyond any doubt that the transAlaska pipeline is a common carrier; a common carrier not only for purposes of regulation of interstate oil movements by ICC but a common carrier also for purposes of regulation by your pipeline commission. There is merit, that as a condition of the lease the pipeline stipulates that it is a common carrier period --without reservations, without qualifications, or anything else. Now this is so common, this is so common in state and federal regulation, that it is really surprising to me that any amendment to the existing Right-of-Way Leasing Act should in effect qualify the common carrier status here. It says first of all, that there will be common carrier if the

the commission so determines at the time the lease is issued. I don't think this should require a determination by the commissioner. Under these circumstances the pipeline is a common carrier -- without hearing, without determination, or anything else. Secondly, I don't think it is necessary in the Right-of-Way Leasing Act to stipulate what obligations fall upon a common carrier and certainly not to qualify the obligations incumbent upon a common carrier. 120 (a) (3) says that it will accept, convey, transport without discrimination, crude oil. This is something which will be covered by your pipeline commission in the course of regulation if it is a common carrier. Certainly not in advance to limit the jurisdiction over a common carrier by your own pipeline commission by saying that the imposition of common carrier status does not require the lessee to accept tenders of crude oil, except at points where there exists public, etc. etc. Do not qualify the obligations of a common carrier. This is a function of your regulatory agency and insofar as your regulatory agency in its individual decision from month to month or year to year may either deny rights to a common carrier or impose obligations upon a common carrier which the pipeline owning companies feel are unduly onerous, they have recourse to the courts. So I don't think that one should qualify the obligations of a common carrier. I think that your 120 (a) (3) should simply stipulate that as a condition of obtaining a right-of-way over state lands, the lease for the right-of-way over state lands, the pipeline carrier itself, submits itself as a common carrier. Not only for the ICC

jurisdictional purposes but for the purposes of the exercise of jurisdiction by your pipeline commission.

120 (a) (4) in the recommended legislation removes the common purchaser provision from your 1972 legislation. At that time it was a permissible feature of your law. In place of the removal of the common purchaser status as a condition of leasing, the Governor has sent down a special bill that would make it possible to establish under certain conditions and subject to certain provisos, common purchaser status for companies owning the transAlaska pipeline. We do not feel now and we felt for a long time that there is real doubt as to how important common purchaser provision is in the state of Alaska, under the conditions where your oil is being produced and transported. Common carrier, yes, because it provides access to transportation and an equitable basis for everybody who is able to achieve production in the new state. Common purchaser for many reasons we have reservations about whether to leave it or not. The bill which is proposed to you we think is a weak and rather attenuated version of a common purchaser act, as it is applied in other states in the United States. Our recommendation at this stage of the game would be that you can afford and should yield the common purchaser provision as a condition of right-of-way leasing and probably simply pass over this special piece of legislation which establishes a common purchaser provision and hold that over to future sessions of the legislature as not being important at this time. When and as common purchaser provisions become meaningful in the conditions of the state of Alaska, at that

time to enact not the legislation that's proposed by the Governor, but a strong common purchaser act which is appropriate to the circumstances at such time. You will have ability and time to do that in the future. I don't think it's an essential point of the compromise, either from the companies' standpoint or from the State's standpoint.

I'm bringing before you here only major things or illustrative aspects of it. 030 - 040 -- these are repealed in the proposed amendment. In the proposed amendment to the Right of Way Leasing Act 1972, section 2 repeals 030-040. Now, 030-040 in the act that is now on the books governs the abandonment of or reduction or impairment of service and temporary emergencies services, and so on. It has to do with the authority that the state claims for itself and buttresses that authority by virtue of this being a condition of the lease. I would think that it might be appropriate, again in the spirit of compromise, that 030 and 040 be retained but that the language be rewritten to say that insofar as these are imposed upon the carrier, that they are in accordance with the jurisdiction and orders of the Interstate Commerce Commission or the Alaska Pipeline Commission, as is appropriate to the case. Which means in effect that the companies, although they are governed by these two clauses, nonetheless know that these two clauses are in accordance -- what is obligatory upon them is in accordance with the regulations that may be promulgated, either by the ICC if it involves interstate commerce or by the Alaska Pipeline Commission if it involves intrastate commerce. I put these out only as illustrative of the

aspects of regulation within the Right of Way Leasing Act which is at issue in the courts -- where we think either the state should stand firm, such as in the matter of common carrier, or where we think the state may very well yield. In general I would think that insofar as the state can achieve a right of way leasing act which avoids litigation but does not give up essential rights which the state still retains through, and I repeat, the combination of a strong regulatory bill and the ultimate enforcement of state regulation through its taxing power, that the legislature can yield on certain of these items in the Right of Way Leasing Act.

This by no means exhausts the regulatory aspects, but in the interest of time I want to move on to other things and as I said we're prepared to go through section by section with our specific recommendations to you.

The second major issue in the Right of Way Leasing Act is the percentage lease rental formula. There are two different impressions abroad as to the purpose of the percentage lease rental formula. Prof. Witherspoon yesterday afternoon suggested that he looked upon it as a revenue measure for the state. That if, in fact, the value of state lands were to be appreciated by the construction of the pipeline then the state like any other owner of land should be in a position to bargain for a fair share of the value of the land when it is being put to a superior use. I have no quarrel with this in principle; however, our position always has been that the leasing of state lands for pipeline right of way should not be regarded as a revenue device by the state of Alaska. We have always recommended that the interest of the state of Alaska is in the lowest possible cost transporta-

tion and the state of Alaska should not in and of itself undertake measures which inherently tend to increase costs of transportation, insofar as producing operation in the development of Alaska's resources provide the base for state taxation. It should be other than through the rentals of the right of way leasing of state land. So we have always urged the lowest reasonable rental for the commitment of state land to right of way. I would point out, for example, that even private property insofar as it's condemned by eminent domain for public utility or pipeline purposes does not convey even to a private owner any right or any entitlement to the enhanced value of land if it's put to other use. So we would recommend that however one looks at the rental for right of way lease that this not be regarded by the legislature as an aspect of its taxing power or as a means of gaining state revenues. That comes from other taxing devices in the state.

The other aspect of the percentage lease rental provision in the right of way leasing bill was that it was to be looked upon as an alternative -- either pain of paying or inducement to the companies to bring their tariffs down to a level which is compatible with the interests of the state; that is to say, a tariff that is lower than the maximum it might obtain under the ICC rate-making rule, certainly high enough to be rewarding for their investment and their risks but a level which is appropriate to the circumstances of pipeline operation in the state. And insofar as they increased their tariffs above a certain level, they were in effect subjecting themselves to the pains of progressively higher lease rental.

This was the percentage lease rental formula. This is one of the major items under litigation. For very obvious reasons the companies regard this as not only as something which is onerous to their circumstances in the state of Alaska but a precedent that if it were followed could lead to all kinds of things in their operation elsewhere. We have reservations about the effectiveness with which the percentage lease rental formula would operate for its major purpose, that is to say, in and of itself to induce the companies to bring the tariff down. It might for some companies, it might not for others. The extent to which it does for any of them would be largely contingent upon their respective equities in the pipeline as sellers of transportation services and in production as buyers of pipeline transportation services. There is an element of unpredictability in the operation of it. And while it was from the beginning, in our opinion, an imaginative and constructive approach and we're not saying even today that if properly effective it might not be a useful tool in right of way leasing legislation; but in the context of the violent litigation associated with this aspect of the right of way leasing bill, with the chances that continued litigation over this aspect of the bill may delay construction of the line, and on the presumption that what you have is not an emasculative regulatory bill but a strong regulatory bill, then we would feel that the legislature could give on the percentage lease rental and adopt the alternative to it as is proposed in the amendment to the Right of Way Leasing Act of 1972 by the Governor's amendments. Again, I say

that there are questions about how effectively it would operate in practice. Notwithstanding, there might be reasons for the state to hold to its case, to fight through the issue of litigation, if there weren't such a sense of urgency about getting the pipeline built, if there might not be such a large cost to the state in litigating. And whatever is done by way of amending the Right of Way Leasing Act in order to assuage the fears and concerns of the pipeline companies, either because of what it does or the precedent that it sets, I would say that what the legislature may do in terms of amending the Right of Way Leasing Act, in our opinion should be contingent first upon the retention of a strong and effective regulatory bill, that is to say Alaska Pipeline Commission Act. A strong regulatory bill which is backed then also by the state's taxing power and so that although you yield another tool in the entire package of legislation which was designed in 1972 to effect and enforce the state interest, really yielding to industry concerns, you do so here in the interest of avoiding undue litigation and the danger of delay on the pipeline.

The third aspect of the Right of Way Leasing Act to which I'd like to refer is the option to buy a percentage interest in the pipeline. The option to buy a percentage interest in the pipeline. I will not take time now to review the reasons why we have supported the insertion of the option to buy in the 1972 legislation. I think they're fairly familiar and

they've been reviewed I believe in previous sessions of this committee. We still feel that the option to buy a percentage interest is an important feature of right of way leasing. I think that insofar as the companies have allowed the purchase by the state of an interest in the pipeline to appear as a condition of the lease, even in the proposed amendment by the Governor, suggests that it is not a disabling aspect of the legislation from the standpoint of constitutionality of the legislation -- I don't know. But certainly the alternative which appears in the legislation which is section 120 (a) (7), the alternative which is substituted in the proposed legislation in our opinion represents nothing whatsoever for the state.

I think to amend the Right of Way Leasing Act to include the amended 120 (a) (7) would be to retain nothing for the state in this respect. I certainly would not recommend that part of the amendment. An opportunity to negotiate for an equity in the pipeline under highly qualified conditions, means that the state has an opportunity to negotiate when it serves the interests and purpose of the companies, which is really not what is intended in the option to buy as contained in the existing law. We do feel, however, that the legislature should give very serious consideration to the advice laid before it by Mr. Spahr of Standard of Ohio, that the option as it stands in the

legislation today may pose difficulty to the financing, or at least the financing at attractive terms, of the pipeline. Because of the uncertainty in the minds of prospective lenders as to what the capacity of the state as a possible future owner of a share of the pipeline may be to carry out obligations for the debt that is incurred at the time of construction which carries over and then may have to be shouldered by the state if the state buys the pipeline. I can appreciate that concern. But I would like to point out first of all -- and I have said this in general and I like to be very specific -- that there are precedents for this. The illustrations that I have made before various committees of this legislature the last two days, I would like to refer to very specifically here. There is the agreement between a consortium of oil companies called Syncrude and the province of Alberta in Canada which determines the basis upon which they get the lease to produce oil from the Athabasca tar sands and transport that oil via pipeline from Athabasca to Edmonton where the oil would enter into the major pipeline systems that traverse Canada and enter the United States. First of all, this has to do with ownership of the pipeline. This synthetic crude pipeline shall be constructed and owned as to an undivided 80 percent thereof by Her Majesty and/or an entity or entities hereafter formed by Her Majesty.

So that from the start, the province of Alberta is being given 80 percent participation in the pipeline. Now, an eighty percent participation in the pipeline--where is the oil going to come from? The province of Alberta is going to inance its 80 percent share of the pipeline just as a private company would. But how do you finance construction of a pipeline if you are not sure you are going to have the oil to put through? The lessees, and her Majesty, and the respective assignees of any interests in the Syncrude projects will dedicate their respective shares of the Syncrude oil recovered from the project to the Syncrude pipelines. That is to say, where the oil being produced by that project is committed to the pipeline irrespective of the fact that Her Majesty's government, that is to say in the province of Alberta, has 80 percent interest in the pipeline. So the percent of interest in the pipeline is there, the difference, of course, being that the state of Alaska in its Right-of-Way Leasing Act had wanted an option.

Now the issue of an option comes up. In this same agreement between the Syncrude consortium and the province of Alberta, the lessees, the Syncrude group including Exxon through Imperial Oil Canada, Atlantic Richfield (these are familiar names to you), Cities Service, and Gulf Oil--these lessees hereby grant Her Majesty an irrevocable option to acquire an interest in the Syncrude project. This is in the producing operation including the project sites, the leases and rights granted thereby, and all facilities acquired or constructed as part of the Syncrude project, which interest may equal undivided percentage interest of not less than 5 percent and up to and

including 20 percent. The option may be exercised at any time during the period from the date hereof and up to and including that date which is 6 months after the date of start of production or the 31st day of December 1982, whichever is the earliest.

Now as to how this is paid for, the payment by the government of Alberta to the members, the private companies, that make up Syncrude: Such costs shall be computed (in accordance with the accounting manual) on the basis of all of the costs which they, the companies, have incurred up to the date of the exercise of the option and shall include interest compounded annually at 8 percent. No portion of such costs shall be attributed to the reserves of leased substances. The province of Alberta could thus be buying in at what is the investment costs of the company plus the payment of 8 percent interest for all time that is elapsed. An interest in the producing operation of between 5 and 20 percent.

Why do I introduce this? Simply because I'm trying to suggest that there is precedence where the companies are prepared to undertake both to accept government participation in the pipeline and whereby companies are prepared to accept an option for governments to participate in what is essentially private operation. That the financing of this project does not seem to be inhibited whether by the government's participation in the pipeline or by the government's option to acquire an interest even in producing operations. Now I grant you that there is a very significant difference in the capital costs of the two projects. The TransAlaska pipeline will probably involve an aggregate initial investment on the order of ten times as much as the Syncrude operation. But that doesn't mean that

individual bond holders are lending ten times as much money. The problem of the bondholder, whatever the number of dollars, always is what security lies behind; what security is there which insures that the viability of the operation will provide for interest and sinking fund contributions. To get back to the crucial point, if the option is retained in the Right-of-Way Leasing Act, the existing legislation may be amended so as to stipulate in advance, first of all, what the basis of compensation will be so that there is clear protection that no member of the Trans Alaska group will in effect suffer deterioration of its capital position by virtue of the exercise of the option by the state. And that in negotiating that option, the commissioner shall be prepared to enter into such stipulations by the state as provides the assurance necessary for the indebtedness that bondholders will be entering into prior to any possible exercise of the state's option. We feel that the right of the option to obtain an equity is a useful aspect of the entire package of legislation which you enacted in 1972. We think there may be a question about the way it is now written, whether or not the companies have as much, what shall I say, protection for their borrowing capacity as they would like to have. This protection can probably be provided both in the legislation where it refers to the terms at which the price will be paid and in the lease negotiation itself where the commissioner is authorized to give certain commitments on the part of the state of Alaska. Existing legislation also requires considerable other steps before an option can ever be exercised, including the positive act by the legislature and a referendum by the people of the

state of Alaska if there is to be debt financing. So I think there can be fair protection all around.

This again, represents in our judgment an approach to the issues which confront the state of Alaska. The issues being, must you continue litigation and risk the fact that prolonged litigation may result in delay in the pipeline? Or must you accept a negotiated package of legislation such as submitted to the legislature by the Governor? Or is there an alternative package of legislation which in your judgment represents the protection of the vital interests of the state of Alaska insofar as resource development and pipeline development is concerned, and probably represents a package which the industry can accept? It may pose uncertainties for industry but insofar as they may be obliged or feel they want to litigate, they need not do it in advance but can start construction of the pipeline and be prepared to litigate specific aspects of it as they become relevant. For example, if your pipeline commission, sometime in the future, issues an order which is deemed to be an unreasonable, in violation of due process, the companies can protest such order in the courts, and upset it if their protest is upheld. I think that what we are suggesting here is in the spirit of the negotiations between the Governor and the companies. It certainly represents a yielding on the part of the legislature, if our recommendations are followed, which go a considerable way to meet the issues posed in litigation by the companies. But I do believe it retains for the state of Alaska in two critical areas--namely the regulatory bill and the ultimate ability to enforce the intentions of regulation by the state's taxing

powers. Plus the retention in the Right-of-Way Leasing Act of certain conditions including the common carrier provision. It means yielding on what had been one of the most provocative and imaginative aspects of the legislation which is percentage lease rental. It means compromise on the option to buy so as to provide certain added protection for the companies. In our judgment, I think that this combination of action by the legislature would secure the interests of the state, and in our judgment (of course we are not in a position to speak for the companies) might not be wholly attractive to the companies, but we would think that they would not litigate to the extent that it would involve delay in the construction of the pipeline.

5 Bev

MEMORANDUM

October 29, 1973

To: Members of the Senate Resources Committee

From: Arlon R. Tussing

PROPOSED AMENDMENTS TO AS 38.35

As requested yesterday I have drafted some amendments which retain the spirit and intent of the 1972 right-of-way leasing act, but which I believe remove its troublesome complexities. These amendments are based upon two elementary and uncontroversial propositions: (1) a right-of-way lease is a contract whose terms are binding upon the parties, and (2) everybody is expected to conform to the law.

The main problem with the 1972 act is that it asked the applicants to stipulate as a condition of getting a lease, to things they believed it was beyond the state's police power to require. By signing the lease contract, however, they might prejudice their right to challenge either a stipulation or a later order they deemed illegal. This is the reason they went to court immediately and spoke of not building a pipeline until the controversy was settled. These provisions attempt to meet the companies' legitimate concern in this regard, without however prejudicing the state's right to challenge what it believes is an improper federal invasion of state jurisdiction.

Unfortunately I did not have time to go through the entire act using this approach.

[A.T. AMENDMENT NO. 1 --- DRAFT OF 29 OCT., 1973]

1 Sec. 38.35.020 GRANT OF RIGHT OF WAY LEASE. (a) Rights-of-way on
2 state [] land inculding rights-of-way on, over, under, along, across,
3 or upon the right-of-way of a public road or highway or the right-of
4 way of a railroad or other public utility, or on, acrross, upon,
5 over or under a river or other body of water or land belonging to or
6 administered by the state may be granted by noncompetitive lease by
7 the commissioner for pipeline purposes for the transportation of oil,
8 products or natural gas under those conditions prescribed by law and
9 by administrative regulation. Except to the extent authorized by an
10 oil and gas lease or unit agreement approved by the state, no person
11 may engage in any construction or operation of any [] part of an oil,
12 products or natural gas pipeline, which in whole or in part is or is
13 proposed to be on state land, except in conformity with the terms
14 of a right-of-way lease of that land, issued by the commissioner
15 under this chapter [].

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17 COMMENT: This language provides, as do both the 1972 act and the governor's bill, that the builder or operator of a pipe-
18 line in whole or in part on state land must have a right-of-way lease from the state. It also specifies, however, that
19 all construction or operation of such a pipeline, by whomso-ever, must be in conformity with the terms of the lease.

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21 This provision clearly imposes the conditions of the lease (which include the information and plans in the lease appli-
22 cation) on any successor to the original applicant.

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[A.T. AMENDMENT NO. 2 --- DRAFT --- 29 OCTOBER, 1973]

Sec. 38.35.020 Add a new subsection, viz, (b) The commissioner may by regulation exempt the construction or operation of field gathering lines or any reasonable classification thereof from the requirement for a right-of-way lease under this chapter.

COMMENT: The proposed subsection recognizes that some so-called gathering lines may already be provided for in the terms of oil and gas leases, that others might best be exempt ftom the terms required for pipelines under this chapter (e.g., to be common carriers) in order to maximize wellhead prices, while others might best be brought under its terms. Under this reading, sec. 38.05.330 might be amended to allow the issuance of permits, etc. for "field gathering lines [] not subject to AS 38.35."

[A.T. AMENDMENT NO. 3 --- DRAFT --- 29 OCTOBER, 1973]

1 Sec. 38.35.030 ABANDONMENT, [] REDUCTION OR IMPAIRMENT OF SERVICE OF
2 PIPELINE []. No lessee [] may abandon any portion of a pipeline that
3 is [] subject to a [] lease granted under this chapter, or operation
4 or transportation service or sale by it, or reduce or impair service,
5 except in accordance with the terms of the lease [].
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7 COMMENT: This language applies to abandonment, reduction or impairment of service the same standard applied in section 020 --- that any such action be carried out only in conformity
8 with the terms of the right-of-way lease. Section 38.35.080 is not necessary if the new language is adopted.
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[A.T. AMENDMENT NO. 4 --- DRAFT --- 29 OCTOBER, 1973]

1 AS 38.35.050 is repealed and re-enacted to read:
2 Sec. 38.35.050. APPLICATIONS FOR RIGHT OF WAY LEASES. (a) A person
3 or persons desiring to engage in construction, acquisition or
4 operation of a pipeline which is proposed to be located in whole
5 or in part on state land, shall apply for a noncompetitive right-of-
6 way lease of the state land under this chapter.
7 (b) Applications under (a) of this section shall be made in a
8 form and manner prescribed by regulation, and shall include any and
9 all data, information, plans and exhibits which the commissioner
10 determines are necessary to prepare the analysis required by section
11 080 of this chapter and to make a decision under section 100 of
12 this chapter.
13 (c) The application filed under this section shall be incorpo-
14 rated into any right-of-way lease issued thereupon, and shall become
15 a part of the terms and conditions of the lease. Any amendment to
16 an application filed under this section which constitutes a subs-
17 tantial change in the application is subject to all provisions of
18 this chapter applying to an original application.
19
20 COMMENT: Subsection (a) is substantially the same as the gover-
nor's proposal. Subsection (b) requires the filing of relevant
21 information demanded by the commissioner. Subsection (c) in-
corporates into the lease itself the lease application and any
22 statement of intention therein (even where they concern actions
to be taken off the state-issued right-of-way). These state-
23 ments of intention then become contractual obligations of the
lease and of continuing to hold it. Any substantial modification
24 of conditions based upon the application must be processed like
a new application.
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[A.T. AMENDMENT NO. 5 --- DRAFT --- 29 OCTOBER, 1973]

1 AS 38.35.060 is repealed.

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3 COMMENT: The intention of section 060 is carried out by the proposed language of section 030, which prohibits abandonment, etc., "except in accordance with the terms of the lease."

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[A.T. AMENDMENT NO. 6 --- DRAFT --- 29 OCTOBER, 1973]

Sec. 38.35.120. COVENANTS REQUIRED TO BE INCLUDED IN LEASE. (a) A noncompetitive lease of state [] land for a right-of-way for an oil or natural gas pipeline valued at $1,000,000 or more may be granted only upon the condition that the lessee [] expressly covenants in the lease, in consideration of the rights acquired by it under the lease, that

(1) it will construct and/or operate the pipeline in accordance with applicable state laws and lawful regulations and orders of the Alaska Pipeline Commission. *Provided, however:* that the terms of a right-of-way lease issued under this chapter shall not be deemed to permit or require a lessee, the commissioner or the Alaska Pipeline Commission to take any action that is in conflict with federal law or with lawful regulations or orders of the Interstate Commerce Commission or the Federal Power Commission.

COMMENT: This proposed covenant incorporates as a condition of the lease itself submission to the state's regulatory jurisdiction ("police power" and/or "economic"), whatever the limits of that jurisdiction may be. The companies are not required as a condition of a lease to stipulate to some condition that may be prohibited by federal law, and thereby to waive the right to challenge that condition. At the same time, in contrast to the governor's bills, the state reserves the right to challenge federal actions that might invade the state's lawful regulatory jurisdiction.

The remaining covenants would be renumbered and amended to remove duplications or conflicts with this clause and proviso.

Sale by the State of Alaska of Rights to
Receive Future Production of Royalty Oil and Gas

State of Alaska legislation in 1974 provides a procedure with respect to the sale of the State's royalty oil and gas. The Commissioner of Natural Resources of the State can sell royalty oil and gas received in kind at the time of its production. He can also sell the State's rights to receive future royalty oil and gas production and receive payment for all or part of it now in the form of an advance sale.

Such sales must be made with the prior written approval of the Alaskan Royalty Oil and Gas Development Advisory Board and with the prior approval of the Legislature. These sales are not sales of oil or gas in place. The Constitution of Alaska prohibits sales in place.

If the State made a sale of its rights to receive future production of royalty oil or gas, the following questions come up:

1. How would such a deal be structured?

2. Would the State lose any of the increased market value of oil sold in this way between the time of sale and the time of production?

3. What portion of the State's royalty from Prudhoe Bay would have to be committed to the repayment of, say, $100 million, over a 3½ year period, commencing with the startup of production?

Structure of the Transaction

A transaction of this type would involve at least three parties--seller, buyer and a financial institution. The State of Alaska, as the Seller, would contract to sell oil to a Buyer and deliver it as it is produced. The Buyer would contract to buy the oil and would pay for

it in advance. Since it is quite unlikely the Buyer would have money available for such an advance payment, he would very likely borrow it from a group of banks. The Seller and the banks can be readily identified. However, a Buyer cannot be so readily identified.

The Buyer could be an oil company who has use for the oil, however, it is doubtful that there are companies with the money available, or the willingness to incur the debt necessary for such an advance payment. Therefore, the Buyer would likely be a financial vehicle created for this purpose, perhaps a company owned by a charitable organization.

If the Buyer is owned by a charitable organization, the questions arise as to why it would be in such a transaction, and how it would use this oil. It would be in the transaction for the financial gain it would realize. It would probably enter into an agreement with another party, a fourth party in this transaction, to sell the oil as its agent. Such fourth party might well be the working interest owner of the properties from which the oil will be produced. This overall arrangement is outlined on the attached exhibit.

Market Value of Oil

The State should lose nothing in terms of market value by making such a sale. The terms of the agreement would be somewhat as follows: "Seller agrees to sell to the Buyer that quantity of crude oil representing __ percent of its royalty interest in leases ______, ______, and ______, until the market value of that oil at the time it is produced is equal to $______." The quantity of oil to be delivered would include oil to cover interest for the use of the money which the Seller receives in advance and for any profits which the Buyer would make on the transaction. Such profits would be small in terms of the whole transaction.

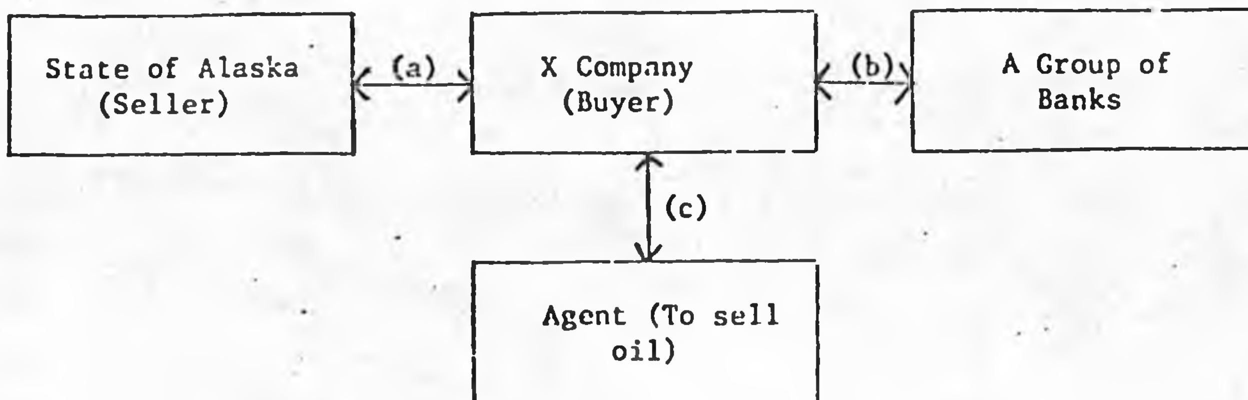
Portion of Royalty Dedicated to the Sale

If a sale of $100 million of Prudhoe Bay royalty oil were made on July 1, 1976, and if production commenced at Prudhoe Bay on July 1, 1977, the advance could be paid out of about ~~15~~ 17 percent of the State's royalties during the period July 1, 1977 to December 31, 1980--that is, a period of three and one-half years. The ~~15~~ 17 percent applies to the State's royalty after payment of 2 percent into the Native Claims Fund. A wellhead value of the oil of $5 per barrel and a production rate of 600,000 barrels per day for the first six months and 1.2 million barrels per day thereafter have been assumed. With an assumed interest rate of 8 percent, the State would deliver 25.1 million barrels--20 million to repay principal and 5.1 to pay interest. Thus, about 20 percent of the ~~15~~ 17 percent dedication (or 3 percent) would go to interest.

2/20/75

ADVANCE ROYALTY SALE BY
STATE OF ALASKA

1. Agreements

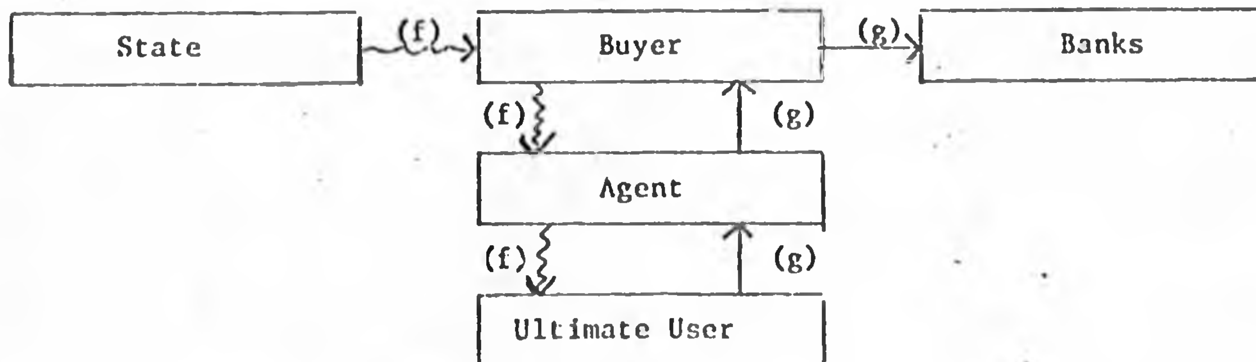


(a) State agrees to sell oil to Buyer.
(b) Buyer makes credit agreement with Banks.
(c) Buyer appoints agent to resell oil to ultimate user.

2. Flow of Money on 7/1/76 (e.g.)

(d) Banks lend money to Buyer.
(e) Buyer makes advance payment to State.

3. Delivery of Oil (⟿) and Flow of Money (⟶)--7/1/77 to 12/31/80



(f) State delivers oil to Buyer who resells and delivers it to the ultimate user, by using an agent to make the sale.
(g) User pays for the oil and Buyer repays the bank.

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PRUDHOE BAY ROYALTY AND SEVERANCE
PRODUCTION COMMENCING 7/1/77; 600 M B/D
AVERAGE FIRST SIX MONTHS, THEN 1.2 M B/D
(Millions)

		1976	1977	1978	1979	1980	1981
1.	Production (B/D)	0	0.6	1.2	1.2	1.2	1.2
2.	Wellhead Value Per Barrel (a)		$5	$5	$5	$5	$5
3.	State Income--No Advance Sale						
	Royalty (b)	0	69	274	274	274	274
	Severance (8%)	0	38	153	153	153	153
	Total	0	107	427	427	427	427
4.	Effect of Advance Sale on State's Royalty Income	+100	-10	-39	-39	-38	0
5.	State Income--With Advance Sale						
	Royalty (b)	100	59	235	235	236	274
	Severance (8%)	0	38	153	153	153	153
	Total	100	97	388	388	389	427

(a) Project Independence Blueprint of the Federal Energy Administration makes reference to "Minimum Acceptable Prices" of $5.16 to $6.15 per barrel at the wellhead to stimulate development in "special regions," (including the North Slope of Alaska). See Table B-1 in Part 2 of FEA publication dated November 1974 entitled "Task Force Report - Finance."

(b) Includes portion going to Native Claims.

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