

ALPETCO

CONTRACT

BRIEFING

6-2-81

# Alaska State Legislature

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## Senate

### Committee on Resources

June 2, 1981  
3:00 p.m.

Courtroom A  
Court Bldg.

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Joint House & Senate Resources Committees

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Briefing on the "Alpetco" contract

#### TESTIFYING

Robert LeResche, Commissioner of Natural Resources  
Dudley Parker, President, Charter Oil Company  
Zeke Zechella, President, Alaska Oil Company

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Attached please find an unofficial transcript of the June 2, 1981 briefing by the Department of Natural Resources, Charter Oil Company and Alaska Oil Company.

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JOINT MEETING OF THE SENATE AND HOUSE RESOURCE COMMITTEES  
June 2, 1981 Transcript (From Tape)

Chairman Betty Fahrenkamp: Today we are very appreciative of the fact that the Alaska Oil Company and Charter Oil Company have volunteered to come up and report on what's going on. We will start the testimony today with Commissioner Bob LeResche.

Commissioner Bob LeResche: Thank you. We thought it would be a good idea for me to take this opportunity to get the Committee up to date basically on the history and some of the technicalities that have occurred over the last three or four weeks for Charter Oil and the Alaska Oil contract which is known affectionally to most of us as the Alpetco oil contract. In addition I want to take the opportunity to suggest to the Committee some lessons that I hope the State has learned from the experience. Basically everyone here remembers first hand that a year ago last month the State and Alaska Oil Company then Alpecto did renegotiate the original supply contract of 1978. We made several changes in it to reduce the volume of crude oil that Alpetco would take initially from 150,000 barrels to down to half of that, 75,000 barrels a day. In addition we set a new deadline by which Alaska Oil was required to come to the State not only with a complete design and configuration, product slate, site plan, permits and several other things, but also and most importantly with the refinery the financing documents executed and the construction contract executed that is to show us that the money was committed to actually begin construction. Furthermore, on the December 31 date the State withheld the sole discretion to decide within 60 days of that time whether or not to allow the contract to go ahead

or cancel it just summarily at that time, even if the benchmark had been met. At about the same time about a year ago, Charter Oil or Alpetco also began taking delivery of the 75,000 barrels a day of the crude allowed them under the contract. They started taking these deliveries under the terms of the contract as to say they gave the State six or seven months notice which was passed on \* to the producers under the contract. They paid the in-value price that is exactly the same amount the State would have gotten if it sold to the producers, they established rather severe credit requirements that is, letters of credit for 90 days of crude oil which is running right now at about \$185 million of revolving letters of credit for Charter. Part of the contract that allowed them to take the crude oil before the refinery was constructed as you all know has been quite a controversy. The original Alpetco partners as well Charter hoped that this taking of crude before completion of construction would allow them to turn hopefully at least a modest profit which they would then use as money for the project. Many people and, frankly myself was one, could not understand how an \* oil company could be forced to take crude at a price that the producers were earning for a like amount or larger volume for the same type of crude and turn a profit on it. Unfortunately, they have proven to be right. . . . anyway back to last year. At the time of the renegotiation because of the distrust that was rampant in Juneau, Mr. Parker and other representatives of Charter Oil promised the Administration that if the failure of the project was imminent and if it was clear enough to them that they knew that there was a very very small chance of actually meeting the December 31 requirement, they would come to us and return the oil to the State. Under the terms of the contract that (unintelligence-not apparently important). This seemed to be a very important promise at the time because many people were concerned that the right to take this crude was a great and valuable asset for Charter and they wanted the State

\* to take it back if Charter wasn't going to build a refinery. Again, recent events have made us look again at whether it is such a good deal to have \_\_\_\_\_.

In any event, they did promise that they would let us know ahead of time, ahead of December 31, if the contract or if construction would be impossible. Two weeks ago they came to town and so notified us. After trying very hard to my knowledge and looking practically everywhere to my knowledge they concluded that the project was not financeable under \_\_\_\_\_. They offered of course to return all the crude immediately and asked of course that we do whatever we could within the best interests of the State to take the crude back at a time before the 7 month notice. We agreed to help them under certain conditions. The first condition is that Charter denominate now under the contract, that is give us the 7 month notice we need to give to the producers the 6 month notice that we wish to return the oil to the producers. Secondly, we agreed that they would relinquish or release any rights to the crude that they would have in order for us to be able to sell to anyone else. And thirdly, we agreed that if we were able to place all of the crude, that they would terminate the contract prematurely and not hold on to December 31, just for the sake of holding it. I spent the last two weeks trying to sell the 75,000 barrels a day of crude oil. We contacted first instate refiners: Tesoro, Chevron, North Pole Refinery. We contacted second those firms that supply products in the State. Chevron of course is one, as is Shell and Union. Third, we contacted the producers who, of course, have a close relationship with the State. Fourth, we contacted Dow Chemical and the United States Strategic Petroleum Reserve. We did not, of course, call nationwide to contact 700 companies. We only contacted those with which sales would accrue and add a (unintelligible), rather than just a sale to let Charter out of the contract. The results have been extremely disappointing.

Tesoro would not agree to take any of this crude oil. Chevron would agree to take some only if we could give it to them for 15 years, which of course was not acceptable to the State. MAPCO and North Pole Refining not only would not agree to take any, but asked me to please try to get back part of the volume which they presently take or will be taking in very few weeks. Instate suppliers, Shell and Union both of them of course did not respond to our option and did want one extra drop at this time. The producers Exxon refused to take any crude back, Sohio has agreed tentatively to take back their share that is 53% \* of Alpetco's volume which should come to 39,750 barrels per day under in-value \* conditions. We are still having somewhat of a misunderstanding with them about what the in-value price shall be pending our lawsuit, which has been kicking around the courts for several years. So we have not made an arrangement with Sohio, they have tentatively agreed if we can work out the price to keep the State whole. Arco has agreed to take for sure 10,000 barrels a day. You probably all know that one of the buyers in our option in December is Energy Coop Corporation is going bankrupt so we really have a problem with that and those are the first barrels to sell. Arco has agreed to take those and we know if they will take a bit more. I doubt seriously if they will consider taking any more than 10,000 barrels a day. So that leaves Charter with the burden to take up to or at least 40,000 barrels a day and continue taking it for several months. We could ask them but I am sure that they will continue to fulfill their obligations under the contract. The right to take crude oil under our contract is not only a right but also an obligation that we review very carefully.

\* Let me make just a few personalized remarks about what's happening. I won't be repetitive. There are some things to think about. Ever since Prudhoe came on line, ever since the State first took large volumes of crude oil we have all been working under the assumption that oil is scarce, that it's easy to sell, and that long term contracts have some kind of residual value above the price of the oil. We have all been very leary of people who want long term contracts because I think a lot of us labored under the impression that they got a better deal than we ever realized. We have also worked under the assumption - the assumption is strong enough that it has been written into statute - that there shall be a presumption that the State to take every barrel in kind and the Commissioner must make a finding of State's interest in order to take in value. That presumption has been that in kind taking is always better than leaving it with the producers and taking (cash?). I hope all of us will pause and consider some of these previous assumptions in light of what's happened. Basically it's not to say that we thought before isn't sometimes true, but it's sure as heck not always true. Right now - believe it or not and it's hard to switch your thinking - a long term contract with the State of Alaska is no asset: it's a heck of a burden. Most of the people who have long term contracts with us now are trying to return crude oil to us more quickly than the contract allows: Charter and Mapeo. The question really comes down to is how much can a company, small or medium size company afford to lose over the six month period or seven month period it takes to give our oil back if they guessed wrong. Secondly, we are seeing frankly what some of the producers have been trying to say all along and I still maintain it's not always true, but it's true right now, that

our last and safest refuge is taking in value, the taking of money, leaving the burden of sales on the producers. Right now for example, rumors in the industry are that Sohio, who holds the Lion's share of Prudhoe Bay crude is actually able to sell their crude for \$3.00 - \$3.50 more than Charter is able to sell, sell the in kind share. So again the presumption of always taking in kind doesn't always follow, depending on what's happening in the market. Secondly, when the announcement was made that Charter finally could not do financing, Representative Malone came out and said, very strongly well that ought to teach us to look very carefully at any offers that we get. Well I couldn't agree more, frankly I don't think it is a lesson we need to learn, I think we have learned it. There are only two ways to look at whether an offer is a good one and whether a project is actually going to happen. The first way which some people favor is having an academic hired as a consultant, hire a professor, and try to look 20 years down the road and tell you whether or not you can finance the thing or not. The second way is the way we chose, and I sit here today feeling just as strongly as I did three years when we chose the right \_\_\_\_\_. That route basically is market test. You create as risk-free a contract as you possibly can with the most competent firm you can, with performance terms, you give them the incentive, the very strong incentive to make the project work; but you hold the State whole in case the project doesn't go. Be sure the contract is very tight in terms of pricing, you ensure delivery of the crude is taken at Pump Station #1, to keep the State out of the shipping business. Be sure that the 7 month notice provision is written in the contract, to allow us to return to the producers or to continue the burden the buyer will take (the obligation to take it). And, of course, you would have very strong security. Now under the market test of finding out whether the project is really feasible, nobody is promising

ultimately that the facility will be built. Certainly the public and press have gotten the idea that everyone promises for it to be built. A thorough review of the record, I don't think you will find one statement that makes this promise, but that they will try, what they have done is try, and I think that the State finally understands that a big refinery these days is not going to be financed and built in Alaska. Fourthly, I hope recent events have underscored the policy which we have always had, that is to keep the state out of the spot market; to keep us out of the short term sales agreement (anything under a year if possible). Keep us out of the shipping business. Don't let us get stuck with crude oil. The concern and nature of all of our contracts to date have reflected that fear and, believe me, what we have gone through in the last couple of weeks has just underscored that in spades. The State should not be dealing with \_\_\_\_\_. One other comment I would like to make. There have been comments during the last two weeks during the time everyone currently shifted from how could you let Alpecto keep taking this oil to how can you let them give it back to us, there have been a lot of comments that well if we had just chosen somebody else they could have made this happen. Well, think back three years. There was nobody else of the stature of Alaska Interstate which was in the initial majority partner and certainly no one else with the stature of Charter. I suppose it is possible that someone else might have been able to handle it but its highly improbable. Today in America there are 17 million barrels of oil a day of refinery capacity. 13 million barrels a day are sitting there on the ground that no one is taking. A recent Oil and Gas Journal has a list of 8 or 10 refineries that are for sale or shut down, 70,000 roughly barrels a day. These are not Charter Oil

Company refineries, or Alaka Interstate refineries or Mapco refineries. They are Amoco, Texaco, Gulf, Mobil, Conoco, Dow, Petrofina. Those people can't make money on a refinery these days, so I caution you into thinking that we chose the wrong partner. Its the market. Certainly you all understand whats happening. Its  
\* not a matter of incompetence, its a matter of foresight. In short, let me just say the State hasn't lost a thing on this contract and I don't want to sound like I am apologizing too much, because I am not. We took the best chance we had three years ago and maybe we shouldn't have taken any chances. We did. We didn't take a chance with our money and we didn't take a chance with our crude  
\* oil. We received every cent we would have received from that oil if we had  
\* chosen someone else or taken it in value. But we have gotten the feasibility study which costs several tens of millions of dollars according to Charter and this feasibility study was done not by a consultant, not by a university professor, but by somebody who has \$40 million bucks risked on it and therefore somebody who had the greatest incentive of anyone to make it happen. And with that Madam Chairman, I certainly encourage you to listen to Charter tell you exactly why the \_\_\_\_\_.

Chairman Betty Fahrenkamp: Thank you Commissioner LeResche. Dudley Parker - Here with Charter Oil will now speak.

Mr. Dudley Parker: Madam Chairman, members of the Committee I speak for Charter which really owns 93% of Alaska Oil Company of which is the project in the joint venture in which evolved from Alpetco. I am President of Charter Oil Company. I have with me today sitting on my right, Zeke Zechella, who is President of Alaska Oil Company, and the young fellow sitting up at the table, Frank Smith, who is Vice President of Operations of Alaska Oil Company. I

appreciate the statements Commissioner LeResche made and I appreciate the opportunity to appear here today. We do not come from the standpoint to apologize. We do not come from the standpoint to ask any favors. We hope when we leave this room today, that we would have told the story, a story that started many years ago of which we were not a party of, but more closely we would like to take and tell that story of the last year after Charter got involved in it and really came about to the amendment in what has transpired in that year's time. And I again would add from the standpoint to what Bob said not only in the amendment of that contract we agreed and did provide reports to the office of the Commissioner on a quarterly basis and later on a monthly basis to keep the Commissioner and his staff completely apprised of what we were doing and to all aspects of this project. Its going to be divided into two parts. The first part I am going to ask Mr. Zechella to handle and let him tell you as far as the project, the refinery, the petrochemical facility or processing unit, whatever you want to call it, to let you understand that why there was \$40 million spent and why to the extent that this refinery would have and could have worked. Also, Bob read a list of the refineries that were shut down. I think testimony will prove that we made the statement that a facility to survive in today's market and into the future must be a very sophisticated highly conversion complex facility. That was the design, that was intended to be built, not a topping plant, not a means of just a sham to take the crude oil and run at the end of it. And I hope when we leave the room today that there will not be any doubts in anybody's mind as to the intention of Charter and the other partners towards this project and towards the State of Alaska. And with that Zeke I would like to turn it over to you.

Mr. Zeke Zeehella: Madam Chairman, I think that possibly the best way for me to bring this joint committee up to date is to list the items of the contract which were required to be submitted to Commissioner LeResche by the end of this year. If I could have some light, thank you, I will quote these items right of out of the contract and then discuss them to the degree I think is necessary for your to understand what we have done. The first requirement was that we configure, engineer and design a 100,000 barrel a day refinery. This requirement of course came after the amendment. The original requirement was for 150,000 barrel a day facility which had been almost completely designed before we had the amendment. So when the amendment came, we had to redesign a great portion of this refinery to utilize 100,000 barrels a day. As Mr. Parker stated, our study showed that to build a topping plant was sheer folly, absolutely no economic way that it could be made to work. We hired Foster Wheeler Engineering Company, one of the leaders in the field in petrochemical design, in conjunction with the German firm of Thyssen Technique as a joint venture to do this design work. And we designed a high conversion very high thermal efficiency, refinery. We made it as flexible as we could so that our product slates could be varied from time to time to meet the market conditions as they changed, but essentially our product slate was 43,000 barrels a day of gasoline, 26,000 barrels a day of jet fuel, and 25,000 barrels of diesel (Arctic and regular diesel). We made no residual fuel oil. We installed a flexicoker which is a state of the art process primarily because at the site in Valdez we had no access to any powerplant of the size sufficient to furnish the necessary power to run a refinery of this size. And with this flexicoker we made low btu gas which we then channelled to our powerplant to furnish the energy we needed to run the facility. And, as Mr. Parker said, this was not a topping plant as you can see.

As a result of our engineering design we have produced 29 volumes of engineering data and drawings. We didn't bring them with us but they would extend from me to that table over there. These volumes include every system necessary to make this refinery work with the latest state of the art processes, many of them licensed processes from various engineering and petroleum companies. In addition, we completed a product dock design in a very precarious seismic area as you know. That design is complete and ready to be built. So we think we have met that first requirement of configure, engineer and design a refinery. As part of that, you see before you a very small portion of the model which is a part of the design effort. As someone said that would cost \$2 billion, obviously that isn't what cost \$2 billion. That model is a scale or that portion of the model I should say the total model would not fit into this arena area here is a part of the refinery referred to as the crude unit. That is a scale model and it is utilized by the engineers to enter the coordinates of each piece of equipment and the design parameters of that equipment into a computer so that the pipe runs and the pipe stress analysis and the insulation and all the instrumentation and everything else that it takes to build that refinery could be used, could be developed with a computer model. So we brought that little piece of model here just to show you that it is an excellent design tool and its only the first step in modeling. The next step in modeling goes far beyond this block model what you see here, into a detailed scale model of every piece of equipment in the refinery. The second thing we were required to do is to obtain the permits and licenses. I got out them a little out of sequence there, I will go with that sequence. The construction contract - lets talk about them and where we stand. I mentioned before that we had hired Foster Wheeler/Thyssen

as a joint venture to not only design the facility but the input from Thyssen which is a large German steel company basically, but they have had many large projects throughout the world and they are expert in international financing. This combine was supposed to furnish to us a firm fixed contract for the construction of this refinery in Valdez. We worked very closely with them, we traveled with them around the world to many of the industrial countries \_\_\_\_\_ price contract. So as a result of that we terminated that negotiation, however we did tell them to continue to do their work until they had finished the design to sufficient position to where they could give us a firm fixed price estimate. We had to have some sort of an estimate as to what this refinery was going to cost. They gave us that estimate and it was \$3.42 billion. This obviously was impossible for us to accept and we did have from them a construction schedule which is required by the contract which showed start up in January of 1986, three months before the contract requirement of processing oil through the crude unit on March 1 of 1986. So we did have a construction schedule and we had on our own established a total project control where we used computer techniques for the controls of construction and costs. We used the so called critical path technique of scheduling. Now let's go back and talk a bit about the permits. We have obtained all the state and federal permits including the Corp of Engineer permits. We have completed the environmental impact statement. As a matter of fact, the EIS was cited by the EPA as a perfect example of how industry and government could work together to produce an environmental impact statement in a short order time which was acceptable to all parties. So we have met that requirement. And the next requirement was \_\_\_\_\_ of real property for the site. I feel we do not have to dwell on this for very long. You have all read in the newspapers. We have a site, we have

a 99 year lease that is signed with the City of Valdez. Last summer we cleared that site, we built the dikes for water control and we built access roads and bridges. \_\_\_\_\_ borings and geophysical work is completed and we are ready to build on that site. Now what remains. Obviously the last item is \* financing. As Mr. LeResche mentioned that part of the program was to include a reasonable profit on the interim crude oil, which was going to be our equity, a portion of our equity contribution to this facility. Now let me spend some time talking about our financing effort.

The first thing we did was we had a feasibility study conducted not by Foster Wheeler (the people who had a vested interest in keeping the project alive because of the engineering work required, but by the Pace Engineering Company. Now Pace is a highly accepted engineering consultant firm in the oil industry. We hired them to make this feasibility study, we asked them to review our configuration and our product slate. They confirmed that the configuration was right, our product slate was correct and that the cost estimate, by their estimates, this refinery should be able to be built in Valdez for \$1.5 billion. Several things came out of that study. One was that the refinery built in Alaska, as a stand alone investment without any interim crude, was a marginal investment at best: they showed a return on equity of 13 percent. Why did we continue this, why if we knew in our Pace study that the feasibility showed that this was a marginal return, why did we continue? Well first of all, the study was very conservative. We asked Pace to make a study of the refinery standing alone with no crude oil profits on the front end, no investment tax credits for the construction because we didn't know who our partners might be and what tax

credits were available, and also at the time we didn't know what our financing program would be so we asked them to do it on a 100% equity basis. So it was a very conservative estimate and therefore we felt as conservative as it was the 13% return was a reasonable risk to take to continue. In addition to this, we constructed our own internal economic model which was a very complex model and I will just show you, these pages is the output of that computer model. We have 42 different parameters that we have into this economic model and it goes from the number of plant workers all away down to the inflation rate estimates. This model included in it a barrel profit on the interim crude which we thought at the time was a rather conservative figure. This model also chose a 25% equity contribution and a 75% debt. This model will produce a profit and loss statement and a balance sheet and will compute the return on the equity investment. Our model showed a 22% return based on these parameters that we assumed in the model. Therefore we had a little more feeling of confidence that we were on a project which made some sense. The third thing we did was we hired another consulting firm called the Petroleum Industry Research Associates headed by Mr. Lichtblau and Associates and asked them to make a study of the market area in which we were going to have to work with our products, mainly the PAD V area which of course as you know is the West Coast, Alaska and Hawaii. Using the product slate that we had determined for our refinery, and the crude prices which they projected they confirmed the product slate to be correct. They did point out that there was excess refining capacity in the PAD V area and that we would be selling in their estimate 80% of our product in that area and only 20% in the State of Alaska, but nevertheless they concluded that it was a risky but feasible project. So the reason I went through all this was to point out to people that we didn't just say we are gonna build a refinery in Alaska. We did some very detailed analyses of why we thought this project would

work. In addition we went to four different Wall Street investment houses for advice and finally settled on E.F. Hutton as our financial advisor primarily because they had originally been a part of the joint venture and knew the project very well. Commissioner LeResche mentioned the fact that we had established a credit facility to handle the interim crude \$185 million required by the State of Alaska and as I mentioned before we had worked with the Foster Wheeler/Thyssen group and Thyssen had agreed that they would furnish \$750 million of export financing to help us with the equipment financing. We worked with the City of Valdez and we submitted to the Internal Revenue Service the request for tax exempt revenue bonds to the extent of about \$750 million. So we made every effort to put this thing together in a conventional manner. And I might like to just for a minute go back to what Commissioner LeResche said and express to you in the change of attitude that took place over the months we were working in the financial community. When we first went to the financial community and we said that we have a long term 20 year after start up interim crude guaranteed contract from the State of Alaska, invariably they said that is an excellent asset and should help the financing of this project. Now the attitude is how much are you going to lose on that crude oil and why do you think it is an asset? Its exactly what Commissioner LeResche said. So we had many changes in the course of this period of try and finance. When we terminated our efforts with Foster Wheeler, we went on and hired the Ralph M. Parsons Company and they are currently still on our payroll and they are doing and are continuing to do some of the design work and the further estimating of the cost of the refinery. But we didn't give up, we continued to work, we looked for partners. For a company the size of Charter to take on a \$2 billion project

alone is foolhardy. We knew that at the outset and one of our prime purposes, prime efforts I should, say was to find a partner who would join us in the equity position on this refinery. I don't think it helps to say who but I can say we talked to some majors, we talked to some smaller companies, we talked to some non-oil companies and in every case the high risk of doing construction work in Alaska - the Pipeline syndrome - how do you know your estimate is good? - what makes you think your better than the majors who were working on the Pipeline?

These are the kinds of things we ran into. The other thing that happened of course is that many of these people we went to for partnership consideration felt that they had other projects with less risks, with better return that they could put their money in. The result was we were unable to find anyone willing to join us in this project. And I guess the final blow in the financing effort really came when you look at the fact that when we started the project the prime rate was 15%. The prime rate today as you know is 20% and those five points add \$100 million to the first year of operation of this refinery. When you add it all up even though we spent \$40 million on the work that has been done to date and we are estimating, and I use the word estimating a probably \$5 to \$7 million profit on the crude and Mr. Parker will discuss that in more detail later. These numbers that I have quoted here the \$40 million and the \$5 million to \$7 million are certainly going to turn up in the audit that is now being conducted. The State Auditors have been in our office for the past two weeks, we have cooperated with them and made everything available to them so that they can verify these numbers. We have nothing to hide, we are not here apologizing, we came here, we had a learning experience, albeit an expensive one and now Mr. Parker is going to discuss some of the other economic factors which strengthen our conclusion to return the interim crude to the State of Alaska. Thank you very much Madam Chairman.

Mr Dudley Parker: Thank you Zeke. That reason was that we came to the closest conclusion that we could not finance that project and I will emphasize again that as Zeke indicated your talking about an expenditure of \$40 million and that's an expenditure that is continuing to go forward and your talking about an estimated profit and estimated at this point in time is through June of this year with actual as far as we are able to determine. And I will cover the reason why its hard to determine your actual profit a little bit later in this. I might also add that we will erase from anyone's mind in that we are talking in this case both about Alaska oil and you say well there was a sale to somewhere else in Charter they ran it to the Bahamas and they ran it to Houston refinery and these are mirrors rather than the true facts. As Zeke said they are down there auditing the books, there has not been any crude oil run in the Bahamian refinery, Alaskan crude, you cannot export it and I will add to that so you don't pursue that questioning there has not been any crude oil in exchanged for other crude oil that has run in the Bahamian refinery. I will go as far as to say that the partnership agreement that we have with our partners there is no provision to calculate a split of profit based on running any facility that Charter has in addition to Houston. As far as running this crude oil in Houston there was an amount due to having to go through a storage problem and as it came out of there some hills in the tanks and the amount as I was told today was approximately 40,000 to 50,000 barrels - not a day of barrels, somebody could make that calculation it probably comes out less than one-half of one percent of the total. So I will emphasize that has not been run in any of these profit calculations or shadowed by something that is put elsewhere within Charter. Okay we say why couldn't we finance it, what has changed? The first one I will start with is demand. And you really need to pay attention to this. In 1979 I

\* think that the use and consumption of petroleum products peaked, in 1980 it

showed a decrease roughly 5%. You can read many places today that they are anticipating an additional 5% (I didn't know we were getting that high) so it looks like that the demand for petroleum products has peaked and is continuing down, that is products and crude oil and I will quote from Platt's Oil Gram on May 15 which says that U.S. Imports 35% total domestic deliveries, the lowest level since April of 1973, comparing 1973 April to April of this year. So we establish from the standpoint that the demand for both crude oil and products is decreasing. The second factor is refinery utilization, which I will define as throughput or the amount in which you run through a delivery. There is a draft showing coming out of the API weekly showing a decline in the utilization of refining capacity. Now along that line in January of 1980, you were using your refining capacity at 82% in the first quarter of 1981 the refining capacity was approximately 71% in April the refining capacity utilized was 61.9% and in the first half of May it has averaged 66.8%. And that's the reason why the list the Commissioner read as far as refining capacity is being shut down. We basically had a tremendous decrease in the utilization of refining capacity in this country and continues to drop. The third factor: refinery margins. If demand is down, refining utilization is down, there isn't any questions that the profitability of refining crude oil and selling products has to also go down. This is based on Arab light and shows the decline in refining origins. In January of 1980 the refinery margins were \$7.46 per barrel whereas it has been reported in March of 1981 as \$2.50 per barrel. Now refinery margins are not profits, its not after taxes, its not after operating expenses. The difference between the cost of the crude oil and the value of the product produced and that is what has happened to the refining industry in the U.S.

The next item: we have had a decrease in demand, we have had refinery utilization go down and profitability go down and what has happened to crude

oil? We have continued to produce crude oil and we are continuing today, we  
\* have created a tremendous inventory in this country of crude oil. In January of  
1980 there were 300 million barrels of crude oil in U.S. inventory, in April and  
May of 1981 there is 405 million barrels of crude oil in existence today. We have  
a glut of crude oil, who would have predicted that when you were looking at this  
in 1979, 1980. I would like to give you an example setting up there on the plane  
I read from the standpoint, the May 22 Platt's Oil Gram, U.S. crude stock is at  
408 million barrels refiners running at 67.6% and you end up in the standpoint  
and gave a comparison of the week ending May 15, 1981 and I will again read  
crude inventory stocks was roughly 408 million barrels the week before May the  
8th, the inventory was 399 million barrels, a year ago the inventory was 386  
\* million barrels, they just recently had the meeting in OPEC and they are now  
looking at a cutback as far as production instead of continuing to produce that  
crude. You can read everyday of companies that are trying not to take crude  
oil that are backing away from countries yet we continue to produce that crude.  
Along those same lines that note in this Oil Gram said that on the week ending  
May the 15th that there was 34.2 million barrels of Alaskan waterborn crude  
included in there. The week before 5/8 there was 30.7 million barrels and a year  
ago in May of 1980 (May 16) that week ending you had 10 million barrels, you  
\* basically have three times as many barrels included in that inventory coming out  
of the State of Alaska than you had in 1980. The item right below that says all  
majors are now posting \$34 a barrel for domestic crude oil and they are speaking  
in this case of west Texas that's a drop of \$2.00 per barre!. Crude prices are  
going down and the reason why you don't have the demand, with that you have  
no refining capacity that is being utilized and we absolutely are drowning in  
crude oil. And I might also add that this occurred during that time frame when

we had our oil interrupted between Iran and Iraq. What would happen if their production was stacked on top of that? There are other factors in addition to this and I do not want again to make excuses, but the government helped us in this project, we started taking crude on July 18. August 1 they enacted the special entitlements covering Alaskan crude, the bottomline on what that did was to increase the cost of Alaska crude to a refiner and it is not hard to figure out if his cost goes up and his product prices don't go up and the desire for that crude goes down where the profit margin decreases.

\*  
In addition to that in December of 1980 they established what was referred to as a crude reseller margin and they established that maximum rate at \$.20 a barrel, \$.20 a barrel - and they solved that problem when they decontrolled in January of 1980. In addition to that we have had a customer of which had a contract, that customer chose to breach the contract has left us with 40% of our crude oil to come back into us to place under today's conditions. We had it contracted to sell, and they chose to walk away from it. One other aspect  
\*  
of this and that's the pricing of ANS crude. Commissioner LeResche indicated that maybe some of the others could get \$3 a barrel more, we would be glad to sell ours and share in that profitability. But not only from the standpoint that we are out there to peddle that crude and we told you an estimated profit of \$5 to \$7 million. You know one of the reasons why we can't tell you what that profit is? We do not yet know what our price will pay in the month of April - How would you like to be in a position that you sell your crude or your product or you are widget and 60 days later somebody tells you: here's what it costs. That's basically what's required in the way it works under the contract. Included in that pricing is very little detailed support. It's required by the contract that

certain support be put into that billing - we don't have that. We are concerned from the standpoint as far as the relative market prices of this crude that we basically being billed by. So it we must still stay with that estimate that again the audit is there and the audit will show basically what that profitability will be. Those are some of the reasons we chose to come back and return that crude to the State of Alaska and asked Commissioner LeResche to work with us. And we are working with him under the confines of the crude oil contract attempting to redeliver this crude back to the State as provided under the contract and also to operate under our rights under that contract. I guess and I hope from the standpoint that times change, you people control a very valuable asset, you control a commodity which this State should use to better its industry, to provide jobs but it should also realize that there got to be from time to time incentives for companies and projects to come into the State of Alaska. I hope from the standpoint that all of us will recognize that there is very seldom a one way street or as we used to say back where I came from: Its a long worm that never turns. From the standpoint I challenge all these projects as they come forward, please review those with that in mind, but its not from the standpoint that this refinery was not built that you should be concerned. But its from a standpoint that those jobs are not available in the State of Alaska. WE like Alaska, we have been treated quite well, we have enjoyed the dealings we have had regardless of what people may think with the Legislature here and many members of it and we appreciate it very much. And the City of Valdez and the leaders of Valdez community and the other Anchorage cities across your great State. We like Alaska and we will continue to pursue and hopefully to be able to do something within the State of Alaska because we think not only from the

standpoint having paid the price, the education to go through this, we understand a little bit more about Alaska and we very definitely hope to become a very good corporate citizen of the State of Alaska. With that I will open the floor to any questions and I really request that if anyone has a concern let's ask it because if we walk out of this room, let's don't second guess the path in which we took the Legislature, the Department of Natural Resources and Charter as a partner to this project.

Chairman Fehrenkamp: Thank you Mr. Parker. Does anyone of the Committee have any questions?

Ms. Sturgulewski: Mr. Parker, from what you said and what we early heard the Commissioner say that everybody did okay, but its world economic conditions that have cost us, in otherwords we haven't received information that would say either from your point of view or from the State's point of view we should done a great deal differently? Is that a correct assumption?

Mr. Parker: I don't think that we could have done a great deal differently, and I think that Bob said and I was not there at the time they chose the Alpeteo people to go forward, he indicated that that was the best that was available at that time. I dont know what else could have been done on this project in Alaska. It is not all consumed on the West coast, it must move to the Gulf Coast and rid a worldwide glut for crude oil. It must compete at alternate values.

Mr. Zechella: May I comment?

Mr. Parker: Absolutely.

\* Mr. Zechella: A company does not go bankrupt if they are making a profit, and I think that the fact that particular company did have many of the same problems we have. We don't know what their internal management was, whether they were doing a good job or bad job but the bottomline is you don't go back up when you make a profit. I think the contribution of the problems they have had with the Alaskan crude where probably part of that.

\* Mr. Gardiner: Madam Chairman this question may be both for Mr. Parker and Mr. LeResche. I am not quite sure exactly legally what the status of the contract is now and when the Commissioner talked about the fact that the deadline of the contract is not here and Alpeteo \_\_\_\_\_ to return it, so I wanted to get it straight in my own mind where exactly we are at in terms of the legal provisions in the contract in terms of the State and company's point of view.

\* Commissioner LeResche: Let me say first, the contract is still in effect, given that it's still in effect, Charter still has the right to denominate all or part of the crude oil given its 7 month notice. They haven't done it and it's impossible for us to do it now and until we know about number 3, which is the amount of crude that we are voluntarily trying to place at no loss to the state back with the producers.

Mr. Gardiner: So the status is, rather than a formal process of Alpeteo's denominating and setting that in motion and at the end of the 7 months the State taking over, whether they have anything lined up or not we have an  
\* informal process with the contract still in effect Alpeteo told us what there chances are and the State is trying to arrange something to do with Alpeteo.

Mr. Parker: Let me answer your question. We are working with Commissioner LeResche. The contract is in effect, we are attempting an orderly winddown under that contract of the provisions that will provide an end - that's what your talking about. You pick one item, the contract is in total, we are in the process of working that as an orderly winddown of that contract.

\* Commissioner LeResche: Not instead of that along with the formal denomination process, that will occur in one day or three days - the formal denomination. But along side of that, we are trying to help them place the crude back with the producers if we don't lose anything on it.

Mr. Gardiner: Between now and 7 months.

\* Commissioner LeResche: Yes, its going to be now, I mean that what we agree on this week is what happens. They're not going to take any back in the middle of the seven months - its a one time offer.

Mr. Gardiner: Okay but at some point you said within the next few days there will be a formal denomination.

Commissioner LeResche: The formal denomination will be: Charter's released to their right to that portion of the crude which we have been able to place.

\* There is no contract provision for that but both members of the contract can sign such a release. And it will be their agreement that the contract shall terminate absolutely actually 60 days after they take the last delivery of crude from us. That is the billing period.

Mr. Gardiner: Okay, there is a formal denomination and then at that point  
\* legally have 7 months before we legally take back the oil?

Commissioner LeResche: Yes, of course, that's just wrapped in with the unit agreement, because we need to give the producers six months unless they voluntarily take it before.

Mr. Gardiner: But between the 7 month period what we have is something that is not an arrangement within the contract its a different arrangement you are working out now?

\* Commissioner LeResche: That's right.

Mr. Parker: Its within the contract.

Commissioner LeResche: The denomination is within the contract, but then there are two side agreements: one is that the contract shall terminate on the

date that all of our obligations are mutually satisfied; the other is that they give up the right to the volume of crude that we placed and also of course we agreed not to renominate that crude at any time while the contract is still in effect.

Chairman Betty Fahrenkamp: Anyone else with questions? Mr. Parker, you mentioned something that \_\_\_\_\_ our report that was very interesting to me you said that in order to make this contract work to make Alaska's oil more valuable, we needed to offer incentives, would you like to extend on that anymore?"

Mr. Parker: No mam, not under these conditions.

Madam Chairman: Okay.

Mr. Parker: Let me say that, I didn't mean for that to come out wrong is that that was sort of a personal preference that I set in this room almost a year ago and we talked about at that point in time we had spent several millions of dollars being geared up to meet a benchmark required under the existing contract and we ended up with an amendment to that contract. And we hoped from the standpoint that the amendment of that contract was one of the reasons why there would be a more favorable atmosphere for us to continue forward with. It greatly improved but it did not solve all the problems. And I do not believe from the standpoint to try to go in today to give any indication that we would like to renegotiate that contract that which the Commissioner may have been erroneously quoted was not our intention. We have never asked for that and from that standpoint I think we need to address the issue today and that is

that the Royalty Contract has the provisions, the rights, etc and that document should fold down to be put to bed forever. So if I came in from the standpoint that you should create this incentive and that then I do not want that to be misconstrued as an attempt to renegotiate that contract.

Madam Chairman: That is not what I had in mind. I was thinking future contracts with other parties.

Commissioner LeResche: I would like to make a personal comment on that, that I have been wanting to say and its a little sour but I am going to say it anyway. Here is a company that is the successor that were the holders of a very controversial contract, and since Charter has been in, since the contract has been in effect, don't hold me to these figures but the they spent 40 billion dollars and made 5 to 7, that's a loss of 35 million dollars more or less. They have operated under what they figured was a contract. Now a contract in the real world - non government world - its not a treaty, its not a statute, but its an agreement in which both sides undertake an obligation in good faith. Now as far as I am concerned, every company that has been in charge and involved in the Alpeteo side has certainly operated in good faith. As far as I am concerned the State has operated in good faith, but just sit back and think, you are a company that might want to do business in the future with Alaska sometime, and you see what happened to these guys: they lost \$35 million, fine they made a bad contract; from a Monday morning quarterbacking point of view, but meanwhile they tried to finance a very expensive thing in a world where people and Wall Street are reading newspapers. Various Alaskans in public

positions are expressing their cynicism, their suspicion and speaking very derogatorily about this contract and the company that is trying to take care of it. Some people acting in their private capacity certainly have not behaved as a partner in good faith in this contract. If there is an incentive the State can offer I think it is to argue about contracts before we sign them, but let's support them for a change after we sign them. That's an incentive that doesn't cost us a thing.

Senator Bradley: Madam Chairman, this is directed to Mr. Parker. Mr. Parker with the oil and gas corporate tax made any differences to the success of the contract. (?)

Mr. Parker: I am not familiar with that tax at all. I do not believe it played a part in this project because it does not —.

Madam Chairman: Are there any other questions from members of the Committee?

Rep. Gardiner: Mr. Commissioner, you went through the list of all the people that you have been trying to negotiate with to see if there is any interest in some kind of deal, what terms have you been negotiating with them in terms of a short term, in-value price?

\* Commissioner LeResche: Yes, we offered it for one year that is July 1 through June 31 then it would come back to the State at the time our next solicitation, if there are any contracts resulting from this would take effect July 1, 1982 at the in value price. And our feeling is that in dealing just with these firms that have arguably ancillary relationships and benefits for the State, improves the State's interest in the sale if it goes from Charter back to them. We couldn't argue that that's the case if went to Charter just to somebody else who really doesn't have a relationship with the State. But you should recall the original finding we made that this crude was surplused to instate needs was based on the fact that it would lead to construction of a refinery. Now that that's no longer the case, we can place it with somebody who has a refinery or who supplies products then that enhances the State's interests. So that's why we offered it to only those firms.

Rep. Gardiner: That sort of comes to my second question that we were sort of using the in value price at some kind of measuring stick here that we used for the Alpeteo contract and I guess other times we have used it as a yardstick. I'm wondering if the experience with the Alpeteo contract brings in to question as to whether that how much sense or accuracy that what we are using as an in value price makes the State's trying to sell oil to other people or somebody who contracted trying to market price or not.

\* Commissioner LeResche: It makes every sense from the State's point of view, because we have an obligatory buyer at that price, so that really states in my

view and in the policy and the Administration's view we should never take less than that because we can always get that much from the producers. But as Dudley pointed out partially it does cause a heck of a problem for anyone who wants to buy the stuff and resell it. And in some tight instances for anybody who wants to run it through his refinery. Because the pricing is delayed, because the major producer's sales contract carry a lot more inertia than most crude oil contracts, just watching the in value prices when prices go down theirs stay up, several months beyond the general market going down. When prices go up theirs stay a little lower for a few months. So it is very difficult, and we really acknowledged this from the beginning, for anyone to buy at the best price the producers are getting, sell in a producers market and make money. For resellers the in value price presents a very very great difficulty.

Madam Chairman: Are there any further questions before the members.

Mr. Gardiner: Are there any efforts to renegotiate the contract.

Commissioner LeResche: None whatsoever. Charter did not ask and we certainly did not offer.

Madam Chairman: I want to thank you Zeke and Dudley for coming in and giving us your side of the question. Thank you Commissioner. Are there any further questions?