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Alaska State Legislature

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TRANSCRIPT OF TESTIMONY OF

ALPETCO ATTORNEYS

March 20, 1978

BEFORE THE SPECIAL COMMITTEE ON ROYALTY OIL AND GAS

Committee:

Senators:	Representatives:
Chairman, Mike Colletta	Chairman Bill Miles
Pat Rodey	Charley Parr
Bill Sumner	Chat Chatterton
John Sackett	Joe McKinnon
Kay Poland	Al Osterback

(First Portion of Tape Indiscernible Due to Poor Quality of Tape)

MR. ROGERS:

I believe that's the main management. If you have any questions about any of the individuals I'll try to answer them for you. I think they have various responsibilities. I will have an annual report sent to you.

CHAIRMAN MILES

Okay, I would appreciate that.

CHAIRMAN MILES:

Mr. Rogers can you tell me in the contract where it says that ALPETCO has to process 150,000 barrels a day?

MR. ROGERS:

No, there's no requirement that we have to process 150,000 barrels a day. There is a requirement that we -- the feeling there was that because of the lack of knowledge about the configuration of the plans and because of the concern that once we got the plant in operation we would have what is now planned to be a two and half billion motivation to keep the plant operating, we have no economic interest in expending two and a half billion dollars to have 150,000 barrels a day coming at us. We are concerned that we might want, for reasons of our own, to shut portions of the facility down to add on facilities to shut down to realign the facilities or something like that. We did not want to have a 20 year period of time in which we had an obligation to keep the (indisc.) running. I think Commissioner LeResche was satisfied that if we did sink

AGO 559309

all of the dollars in a minimum of a billion five, that we would have plenty of reason to continue the operation of the facility. Our lenders would certainly not lend us the money, except on the basis of the continued operation of the facility.

CHAIRMAN MILES:

Aside from the 30,000 barrels a day (indisc.), is there a requirement to process anything else in the contractual -- in this contract?

MR. ROGERS:

I think it's implied that if we build a petrochemical facility and put a billion and a half dollars in it, it has got to process something and the current configuration on that is to process 60 to 90,000 barrels of crude oil and fuel oils per day. Only a part of it can go into petrochemicals and the rest for in-state fuels. So to answer your question directly, no there is no requirement --the requirement that we process a certain amount of barrels. There's only a requirement that we continue the operation, but if we follow the criteria of 10.1, excuse me, 10.2, and meet those criteria -- those are the bench marks, so called bench marks -- if we meet the general requirements to construct the facility which is Article 4, the two of those together should satisfy. I think you just have to assume that economic common sense will prevail. A lot of comfort was received by Commissioner LeResche in knowing that if we got a billion and a half financing commitment and if we got 70% take or pay contracts, the rest would all follow and to require a certain minimum production of us, require continued operation, was really an unnecessary thing to do once we passed the point of no return so to speak.

CHAIRMAN MILES:

Representative McKinnon.

MR. McKINNON:

On those same lines, if it turns out that you only -- for some reason or another -- you take 120,000 barrels a day, is the State obligated to supply an additional 30,000 barrels a day? (Indisc.-- simultaneous speech)

MR. ROGERS:

Yes, literally under the contract there is and the principle reason for that is that there may be a period of time in which there is a -- for instance a shutdown of the line. It was suggested during the negotiations that the production delivered be limited to that which paralleled the amount of processing going on in the facility. But we asked that that not be imposed because we are planning a 30 day storage at the site and there will be an amount of storage in great big quotes, in transit so that if the pipeline froze or shut down for an extended period of time, we would have enough storage and enough in process of delivery from Valdez to wherever we're going -- could be even at Valdez, that we would be able to survive

AGO 559310

for that 30 day period. Once everything was turned back on, we would want to (indisc.) as much as we possibly could not only to feed the refinery but to replenish that backlog of the feed stock storage. So we couldn't really tie the production to the -- the deliveries to the production.

MR. McKINNON:

If it did turn out that (indisc.) level of use was 120,000 barrels a day, would the State still be obligated to provide the additional 30,000 barrels per day if ALPETCO, for instance, wanted to take the oil for whatever other purposes they had for it (indisc. -- simultaneous speech)

MR. ROGERS:

Under the pricing formula I think there's no reason why we would. We frankly are having serious concerns whether we'll ever take interim delivery before the petrochemical facility is operating. The pricing under the contract is never going to be below market and can and probably will operate to result in an aggregate price in excess of market and we were told that the brokerage of oil allows for such a narrow margin that there would be no future in (indisc. -- cough). We're in the business of trying to build this petrochemical refinery and it's a very different business that we're going in. I don't think there's much motivation to go into spot sales of 30,000 barrels a day. I think under the contract it's possible.

MR. PRATT:

There's one other -- Mr. Chairman, may I comment?

CHAIRMAN MILES:

Mr. Pratt.

MR. PRATT:

There's one other answer to your question -- it would be no, you don't have 150,000 barrels a day, we wouldn't get any more than 120 if that's all you had.

MR. ROGERS:

Well that's all we had --

MR. PRATT:

-- (indisc. -- simultaneous speech) the answer you were looking for originally but that's another facet of the answer.

AGO 559311

MR. ROGERS:

Well we had 120,000 barrels.

MR. PRATT:

(Indisc.)

MR. ROGERS:

Even if we had other sources or other --

MR. PRATT:

If you only had 120,000 in royalty oil, that's all we get. Am I not correct in that?

MR. ROGERS:

I think technically under the contract we have the right regardless of the present need of the refinery, we have the right to call for up to 150,000 barrels.

MR. PRATT:

But I'm saying if there were only 120,000 (indisc. -- simultaneous speech)

MR. ROGERS:

Yeah, I see, what Henry is saying is that under present circumstances the proposed favored customer clause will never come into effect if the State does not decide to sell any oil cheaper than they're selling to us. 2.4 will not come into operation if there's no in-kind oil available at (indisc.) and if only 120 is coming out at the end of the line, that's all we'll get and to that extent that's correct. And that we're going to have to live with. I'm not answering your question, am I?

MR. McKINNON:

No, you haven't. (Indisc.)

MR. ROGERS:

(Indisc. -- simultaneous speech) We've always heard of that as present design is 150,000 barrels per day. The possibilities of it being scaled down are off in the future and I really can't assist (indisc.-- cough) talking about it presently. If it is scaled down, it results in a change in a section under the contract and a change of intent on our part and literally under the contract we could have 120,000 barrels a day refining capacity and still require 150,000. But in negotiations it was not required because

AGO 559312

everybody felt that there would be no economic motivation on our part to call for that extra 30 unless we needed it for extra storage or something like that.

CHAIRMAN MILES:

Representative Osterback.

MR. OSTERBACK:

Thank you Mr. Chairman. What else would you be -- the question asked there today on your petrochemical plant, you also get material for making nylon rope (indisc.), would there be any chance -- would you be interested in that or would that have to be a separate contract or do you plan on adding to your plant?

MR. ROGERS:

Again, I'm just repeating things that I've heard from my clients. I think the contracts I've written mention in products of that nature that our facility as such is not going to produce end products like that but we're hopeful that we can arrange the purchaser base in a manner that the purchaser might be interested in buying the products out of our facility and next door build an end product use factory. But I do not believe we're going to be doing end product, particularly final finished products, we're (indisc.) building blocks.

MR. OSTERBACK:

But there would be material available for it?

MR. ROGERS:

Yes, hopefully that's what will help -- will further industry in the area and location of the facility.

MR. OSTERBACK:

Well I don't know if anyone's familiar with it here but when you're talking about the bottom fish now -- the nylon rope and polyethylene, the plastic bags which you use on crab buoys -- we're buying them from Norway now at about $50.00 apiece, a 15" bag. By the time you pay $10.75 a pound for gillnet (indisc.) and nylon rope is about the same, you take a big (indisc.) line or crab buoy line, it literally runs into thousands and thousands of dollars just for one boat.

MR. ROGERS:

Mr. Spitz at Chem Systems, I think, was in the ALPETCO story, you can see the different demands for the feed stocks and I think that that economic problem exists all along the West Coast.

AGO 559313

MR. OSTERBACK:

Yes, we're importing most of our stuff. And if the State could go into a deal like this, if (indisc.) follow up on, I think (indisc.) on this contract right here.

MR. ROGERS:

And reduce the consumer's prices. If the volume -- the only thing that might limit it is the potential volume. If the volume is there, it becomes economical, surely someone will come in and do something of that nature.

MR. OSTERBACK:

I imagine the volume (indisc.) now. I don't know how much it would take to (indisc.)

MR. ROGERS:

(Indisc.)

MR. OSTERBACK:

And the price -- you just take nylon -- oh from something like $3.00 a pound to $10.75 in the last three years. You don't know where it's going to stop. (Indisc.) for a drift gillnet (Indisc.) a hundred pounds. And about $360.00 three years ago and now it costs us over a $1000 dollars.

MR. ROGERS:

All your nets are made out of petrochemical products.

MR. OSTERBACK:

Right, nylon and ---

MR. ROGERS:

You'd think there'd be a huge market for that.

MR. OSTERBACK:

Now your rope, there's no more manila rope or (indisc.) rope made any more, it's all nylon or polypropylene and (indisc.) as far as I know and I don't know much about it. But I know if we get into the bottom fish industry, there's a big demand for that type of thing. Because all of that is synthetic and everything.

MR. ROGERS:

Um humh.

MR. OSTERBACK:

AGO 559314

Even your cable is (indisc.).

MR. ROGERS:

(Indisc.)

MR. OSTERBACK:

So much steel and so much polypropylene to make it kind of flexible. So that's what I wanted to know if you guys ever thought of anything like that.

MR. ROGERS:

Well we have thought of it in the context of letting further industry develop, that maybe it's economical for them to do it. It's not part of the present project. We've got our hands full trying to get this facility up.

CHAIRMAN MILES:

Mr. Rogers, under the clause, you know at ALPETCO we asked them if they would take lower priced oil at the same terms and conditions. If the legislature would approve the contract before it, would it thereby be foregoing any options in future contracts -- should you exercise an option to take other (indisc.) in your legal opinion, translated into labor (indisc.)

MR. ROGERS:

First of all, (indisc.) facility as an operation, you can sell your oil -- you can give the oil away until that's the case. The concern stems from us putting in a 2.5 million dollar facility and then the state selling a significant quantity of oil to people it's not presently dealing with. The Tesoro contract is excluded and of course the North Pole is exluded and selling that oil at a subsidy price at a later date in a manner that would destroy our competitive market. We're making a promise that we will build a facility and that we'll service in-state needs and we feel that this will do a lot of good things for the State of Alaska and the (indisc.) for that is just to ask you that if you do decide to sell oil, you're going to sell it all day long at the same (indisc.) price you're selling it to us at. The one area in which that is not true is that the price formula under Article 2.3 is a formula price that figures in not only what you're selling your oil for but the computed transportation costs. In simple terms it means that if there is a sale of Cook Inlet oil at an in-value price, we will probably under 2.3 be able to purchase that oil because it will be at a lower gate price. Fred Boness refers to it as a gate price which is a good term. All 2.3 says is that if the price at the gate of Prudhoe oil is higher than the gate price of the oil from Cook Inlet or wherever, then we have the right of first refusal basically. We have the right to take that oil in place of the Prudhoe oil we're buying and that will allow us the competitive ability to continue operations of our facility.

CHAIRMAN MILES:

What I'm asking is, by approving this contract, let's say you exercise that option that you just laid out (indisc. -- airplane)

AGO 559315

the terms and conditions as it was offered by the state. Does the legislature still have the power to say yea or nay as it does right now on oil and gas sales or would we be getting supplied --

MR. ROGERS:

Yes, it certainly would.

CHAIRMAN MILES:

We would still be able to say --

MR. ROGERS:

You would still have the decision to sell or not sell. All we're saying here is that if you decide to sell, if you did decide to sell, and you decide to sell at a lower adjusted price, then we get the right of first refusal. You're talking about 2.3, aren't you? This is the most favored customer clause. We are not interfering with the legislature's right to approve any contracts, it's just a matter for your concern as to who the purchaser is.

CHAIRMAN MILES:

What would happen if in that case you took oil or determined it was wrong to take oil under another set of facts and the legislature said no?

MR. ROGERS:

Then we would stay where we are. The party at that point in time would be that we would still be drawing oil down under the Prudhoe agreement. There's a six month notification procedure under the Prudhoe agreement and there are some notice requirements -- I'm not familiar with in all of your leases and so nothing would ever happen until the legislature approved or disapproved. If it disapproved then we'd all just be left where we were in the beginning.

CHAIRMAN MILES:

I see. It wouldn't be a court battle that ties up any sale or anything.

MR. ROGERS:

No, sir. We have no right to the oil unless a decision is made to sell it. I don't see on what grounds we could file any suit. We have no -- the legislature's authority is pretty clear. We just want to be the purchaser. We do not want to interfere with any of the procedural aspects of the sale, particularly the legislature's authority to say yea or nay.

CHAIRMAN MILES:

So you don't envision any court fight over it. Did you want to comment on that Elke?

MS. KALLAB:

AGO 559316

Just very quickly. When you say not to destroy the competitive

price, you know, that's provision 2.3. Of course it is possible to have a competitor bid an in-value price, (indisc.-cough) lower transportation costs, you might wind up with a lower price and thereby you become entitled under 2.3. Conversely then, of course, in order for anybody else to purchase that oil, they would have to give a premium to the state, is that correct?

MR. ROGERS:

Yes, all of this assumes a totally imperfect (indisc.) market. If everything's working right there will never ever be any difference, but we know that doesn't always prevent ... The answer to your question is yes. (Indisc. -- loud traffic noise)

MS. KALLAB:

(Indisc.-- loud noise) and to, you know, be fair, you would conceivably ask somebody else to give premiums so that you can continue to pay for in-value.

MR. ROGERS:

If the state was smart they'd sit there and figure out the gate price as one way, and the other way and they'd say okay, we're going to offer this for a premium of "x" dollars and ALPETCO in an exercise of it's economic judgment would say well we'd rather have that oil and it would be one of the rare instances in which the state would be able to get a premium and everybody would walk away happy.

CHAIRMAN MILES:

Representative McKinnon.

MR. McKINNON:

The uppermost question you presented -- if ALPETCO exercises its option, a new contract would have to be presented to the legislature. And the legislature would have to -- and the legislature turns it back. Now you're saying there'd be no court cases involved. The state then went on to once again attempt to dispose of the royalty oil. What would the situation be? Would ALPETCO then still have first option which would have to go back to the legislature?

MR. ROGERS:

Yes, sir. As long as that process, a lower adjusted price, continues ... (interrupted)

MR. McKINNON:

Then theoretically the oil could never be sold unless . . .

AGO 559317

MR. ROGERS:

Well that's where the philosophical rub comes. The question is does -- will the legislature not want the oil to be sold ALPETCO? Will they not be able to find a purchaser that will pay the same price. We have a right of first refusal. It is going to be difficult to give a subsidy price to another competitor. There are obvious ways to get around it,you can sell the oil at the price and then grant them a monitary subsidy if you get into business development and things of that sort. We are worried more about (indis. -- cough) subsidy that would be represented by the lower price.

MR. McKINNON:

The contract requires that the royalty oil be offered under the same terms and conditions. Taking a hypothetical -- say the state decides to release Kachemak Bay. There's a discovery and a substantial amount of royalty oil. And that royalty oil was offered on the condition that it be used for a refinery on the Homer Spit. Now would ALPETCO be obligated to accept that royalty oil under those same terms?

MR. ROGERS:

Would ALPETCO have an option?

MR. McKINNON:

Well if they exercised the option, would they be required to build a refinery on the Homer Spit?

MR. ROGERS:

Oh, yes.

MR. McKINNON:

Okay --

MR. ROGERS:

I would think so.

MR. McKINNON:

Under those conditions then ALPETCO just couldn't exercise its option to take the oil --

MR. ROGERS:

To take the oil and leave it, no sir. Not at all.

CHAIRMAN MILES:

Representative Chatterton.

AGO 559318

MR. CHATTERTON:

Thank you, Mr. Chairman. Let's run this over again a little bit for me. The legislature if there is outside -- whatever you want to call it -- royalty oil, state royalty cil from Cook Inlet or any place. If the only time that the legislature would become involved is a determination as to whether to take that royalty oil in-kind or in-value. Now, if the legislature determines to take it in-kind, there would be no legislative approval be necessary for you to exercise, as I conceive it, for you to exercise the option under 2.3. The legislature's not involved other than they don't approve this contract.

MR. ROGERS:

Pardon my ignorance but aren't all oil and gas contracts subject to legislative approval?

MR. CHATTERTON:

This is a contract right here and the terms of 2.4, I guess, yeah 2.4, I'm sorry, if the legislature approves this contract why other than -- the legislature will never be involved again; except in the determination that the yet to be discovered royalty oil in-value or in-kind. We would have no approval -- we are not in any position to say yea or nay to you.

MR. ROGERS:

I'm totally out of my field of practicing here -- Alaska law. But I don't think that there's a sale of oil under 2.3 until the legislature has approved the contract. I don't --

MR. CHATTERTON:

-- approve of this contract.

MR. ROGERS:

No, approve future sales contracts.

MR. CHATTERTON:

Would you show me that? Where the law is?

MR. ROGERS:

The way the law reads, I don't think --

MR. CHATTERTON:

Present law says you (indisc.) the right to approve any contract for the sale of royalty oil. Any contract.

AGO 559319

MR. ROGERS:

This is only making up to 150-- this is already in the contract that you have.

MR. CHATTERTON:

I understand that, but when somebody elses contract comes along you have the right to approve their contract. But I can't approve their contract because you've got the oil.

MR. ROGERS:

Alright, let me make --

MR. CHATTERTON:

You don't have to answer it now, but you should look into it. I read this 2.4 --

MR. ROGERS:

Let me make sure -- you're on 2.4, we're on 2.3, maybe that's the reason

MR. CHATTERTON:

Well 2.3 is almost the same thing. We're giving you the right of first refusal in both things on any royalty oil.

MR. ROGERS:

I think on 2.4 you have a valid concern. On 2.3, I don't think -- there's certainly is no intention and I don't think the terms put along side the statutory requirement of legislative approval would permit ALPETCO to buy any oil under 2.3 without further legislative approval.

MR. CHATTERTON:

Alright --

MR. ROGERS:

Under 2.4, I think your concern might be expressed by having the in-kind requirement, we have the ability to prevent sales in the future.

MR. CHATTERTON:

I think we do, but I don't know. But I will yield to you on 2.3 and I'm sorry. You're right on 2.3.

CHAIRMAN MILES:

I think Mr. Berry (ph) had a comment.

AGO 559320

MR. BERRY:

Well initially I was having the feeling that you were talking about two different agreements.

MR. CHATTERTON:

I think that's what was happening, I apologize.

MR. BERRY:

I think one way of thinking in 2.4 is that you confuse this contract with having sold 150,000 barrels a day.

MR. CHATTERTON:

(Indisc.)

MR. BERRY:

And insofar as it's necessary to take oil from other leases to make that 150,000 barrels a day that has been sold by this contract and it wouldn't be subject to legislative approval or disapproval.

MR. CHATTERTON:

Correct. And from a completely practical standpoint, we'll always be in this position. I doubt if there's ever more than 150,000 barrels of royalty oil coming from state lands 5 years down the road.

MR. BERRY:

To the extent that that's the case, it has been sold by this contract and it would not end up being before the legislature again.

MR. CHATTERTON:

That's correct. Mr. Chairman.

CHAIRMAN MILES:

Mr. Chatterton.

MR. CHATTERTON:

With your permission, I'd like to (indisc.) Maybe the fastest way for me, rather than asking -- getting around asking questions, is to suggest to you a scenario and have you tell me that this contract won't let me do it. Can we do it that way?

MR. ROGERS:

Sure.

AGO 559321

MR. CHATTERTON:

Okay. My scenario is this and this is despite the language set forth in -- oh whatever it is -- 4.2, I believe. Despite the language set forth there, (indisc.) obligations. My scenario is that I believe that if I were ALPETCO and I was so inclined despite my best good intentions to build a world scale petrochemical plant in Alaska which is what the intentions of both parties are. But then I come to the contract and I say well things aren't going so good and so I say that I'm going to make the necessary expenditures to build a 30,000 barrel a day feed stock products refinery, middle of the barrel products, and so forth and so on, typical Alaska market products, jet fuel, and I'm going to get some letters that say that I can honestly, at the drop of a hat, go and borrow 1.5 billion dollars at any time that I want to, just by picking up the phone. And I go a little further --

MR. ROGERS:

(Indisc.)

MR. CHATTERTON:

Yeah. I have my letter to show that I am financable for the world scale petrochemical plant and I got mad at the end of the 18 months term. At the end of 36 months I have a nice little refinery taking 30,000 barrels a day. At the end of 18 months I'm already exchanging or selling, or something, fuel, my 150,000 barrels a day. At the end of 36 months say, or something like that, I'm running 30,000 of it through my refinery and sending the other 120,000 barrels a day on south and making money doing that and I don't plan to go any further than that. Now would you show me that that doggone guy over there called seller can break this contract? Will you show me --

MR. ROGERS:

Yes, I can show you one -- first the assumption in my mind is it's not feasible economically, -- (indisc.--simultaneous speech)

MR. CHATTERTON:

Are you an attorney, or are you a financial --

MR. ROGERS:

I'm an attorney. (Indisc. -- simultaneous speech)

MR. CHATTERTON:

Let's don't argue that point.

MR. ROGERS:

The question has been asked before and the continual response of our

AGO 559322

people is that you cannot build a fuel refinery for a billion and a half dollars. A fuels refinery --

MR. CHATTERTON:

I don't have to spend any billion and a half dollars.

MR. ROGERS:

In the contract.

MR. CHATTERTON:

Show me in the contract. I don't want the economics. I want you to show me in the contract that I can't --

MR. ROGERS:

10.2 (9) gets to that point.

MR. CHATTERTON:

It doesn't quite. Unless I can't read the English language. But go through that (indisc.) by seller steps. It's on page 31. I guess that's a good place to start. Keep in mind my scenario. I'm going to have a 30,000 barrel a day products refinery and I'm going to have a letter of credit for 1.5 billion dollars and I'm going to be taking 150,000 barrels a day of oil and I'm going to run 30,000 through the refinery and I'm going to ship 120,000 south. I want you to show me the language in this contract that lets the state cancel it.

MR. ROGERS:

At that point.

MR. CHATTERTON:

At any point that the state realizes that I don't plan to build a world scale petrochemical plant.

MR. ROGERS:

But we still have to (indisc.) ourselves in economic reality.

MR. CHATTERTON:

No we don't. I'm looking for contract language that gives the state an oppor--at what point and under what conditions could the state terminate this contract?

MR. ROGERS:

How much have we spent at that point?

AGO 559323

MR. CHATTERTON:

I think we've only spent about 600 million dollars.

MR. ROGERS:

Okay, that's at the 36 months.

MR. CHATTERTON:

At 36 months -- keep in mind that that's not what you have spent, part of that 600 million is what you have spent and the other part is what any political subdivision has spent.

MR. ROGERS:

Right.

MR. CHATTERTON:

It's the sum of the two.

MR. ROGERS:

If you'll make a note, I'll explain how that came into being.

MR. CHATTERTON:

(Indisc.--simultaneous speech)

MR. ROGERS:

To answer your question, the next termination point would be twelve months later, if we had not expended a billion dollars. At that point, by the preparatory language in 10.2, the contract is automatically terminated --no further action of any state official and we're sitting there with a 600 million dollars fuels refinery with no feed stocks.

MR. CHATTERTON:

Okay supposing with my scenario, I got to that point and the state proceeded to terminate. I had my little plant. I'd spent my six hundred million dollars, or my share of the 600 million, and all of this and I didn't plan to go any further and the state comes-- the Commissioner of Natural Resources says on this 48 months "we're canceling your contract". What recourse would I have if I didn't want the contract canceled?

MR. ROGERS:

It's specifically provided that the Commissioner does not have the authority to prevent the termination from occurring. He has certain authority to extend, particularly to allow ALPETCO

AGO 559324

to go to the legislature but he can't stop the termination of the contract.

MR. CHATTERTON:

No. So he says "the contract is terminated". Now ALPETCO says "the hell it is, buddy, I'll see you in the courthouse". Is that a fair scenario.

MR. ROGERS:

I don't understand where we're going with the analogy.

MR. CHATTERTON:

I'm saying that the state can't terminate the contract. I'm asking you how can the state terminate the contract.

MR. BERRY:

Show him where it can terminate it.

MR. ROGERS:

It just says that at the beginning of 10.2, this agreement shall terminate upon the failure of buyer to take each one of those. There is no action required on the part of the state. The contract expires. The state stops delivering the oil. You guys have got the oil. All you do is cut it off and (indisc.).

MR. CHATTERTON:

Then you go to the courthouse and sue us for breach of contract.

UNIDENTIFIED SPEAKER:

On what grounds?

MR. ROGERS:

On the grounds of economic loss. There is no right of action in any court of law. I know the Alaska laws are very similar to all the laws of the other states and there can be plenty of injury but unless there's a wrong, there's no (indisc.) And unless the state had done something wrong or has broken its contract, we have no remedy. Furthermore, I hate to go out on extended examples like this when that's playing economic Russian roulette and our lenders are not going to want to see that.

MR. CHATTERTON:

They haven't loaned you anything yet, to speak of.

AGO 559325

MR. ROGERS:

600 million dollars for a plant -- (indisc. - simultaneous speech)

MR. CHATTERTON:

(indisc.-simultaneous speech) going to get the plant.

MR. ROGERS:

You've got 600 million dollars in the ground. No one is going -- the contract is long because we have made (indisc.- simultaneous speech)

MR. CHATTERTON:

600 million dollars in the ground and you're making a profit and you don't want to go any further.

MR. ROGERS:

I'm saying that the Russian roulette which your example assumes, would not be a rational business decision. No businessman would risk a 600 million dollar plant with no feed stocks to put in it.

MR. CHATTERTON:

That's my point. I say that you will require if you go to court because of the materiality of breach clause on page 42, that if you will go to court and require the state to continue to deliver, I'd dare say the court is going to support.

MR. ROGERS:

No. The materiality -- the breach in that instance would be on our part and our failure to meet our dollar obligation, the materiality clause accepts all of section 10, if you'll note that, number 1. It's right there in the end of the contract somewhere wasn't it?

MR. CHATTERTON:

It's on page 42 at the bottom of it. My point is very simply that the state is suffering no economic loss --

MR. ROGERS:

I was thinking of the reasonableness of approval.

MR. CHATTERTON:

If the state is suffering no economic loss which it would not be, and under the scenario I gave you it wouldn't have its world scale petrochemical plant, so it would be suffering no economic loss and it would still --

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UNIDENTIFIED SPEAKER:

(indisc.) the fine legal line of the contract would still be -- there would be no --

MR. CHATTERTON:

(Indisc. -- simultaneous speech)

MR. ROGERS:

I'm having trouble, frankly, seeing why -- there's a (indisc.) provision at the beginning of 10.2 that says the contract is automatically terminated if you don't spend the next incremental amount of money.

CHAIRMAN MILES:

Mr. Rogers or Mr. Berry.

MR. BERRY:

Could you -- I'm having some difficulty understanding (indisc.) familiar with this type of contract in the construction business but what exactly does commit to expend mean and whether there is any standard for that or any time period to assume to be connected with a commitment to expend a certain sum of money.

MR. ROGERS:

I think the context of the being is a contractual ligatory and enforceable contract which we have entered in an (indisc.) purchase order for that for whatever it is. But many of these components are built over a period of several years and the delivery schedules are not completely within our control and that's what the commitment -- we don't know exactly when we're going to spend it but the binding nature to pay for it is what the commitment is, an obligation to pay for it.

MR. BERRY:

So that it would entail a purchase order or an order for the construction without pinning down in any way the time frame over which the construction would (indisc.).

MR. ROGERS:

Right. The reason we're in all of these dollar things rather than in specifications is that frankly we don't know exactly what the configuration of the plant is and what the time frames will be. Particularly with such a large facility like this, the great variable right now is what the purchaser of the product wants. And we don't know exactly (indisc.) is. There are some

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processes presently that no one knows whether they're economical or efficient now if the new union carbide ethylene processes are efficient as everybody says, that a purchaser will want more ethylene because it reduces the cost of producing ethylene by 30%. We could not stipulate that we will have an x or a y or a z by a certain amount of time because we do not indeed know (a) whether that particular type of unit is going in and (b) what point in time during the construction schedule that particular unit will go in. So we found the benchmark in the one common ground and that is spend enough money to be able to insure that something large and something of a petrochemical nature was being built. It's -- under the present thinking, it's impossible to to spend a billion and a half dollars and build just a fuels refinery without going way over the assured source of crude oil. As I think I mentioned before a 150,000 barrels per day refinery would cost less than 700 million dollars. A billion and a half has to go somewhere and that's into petrochemicals.

CHAIRMAN MILES:

Representative Chatterton.

MR. CHATTERTON:

Thank you, Mr. Chairman. Just to continue. Ed, you have 14.3 on page 42, I believe, in front of you.

MR. ROGERS:

Let me explain one thing that's rather technical and was a request of ours. We asked that the termination provisions in Article 10.2, the benchmarks were not called a default or contract breach but that the state merely had a right to terminate our agreement and be covered for any loss. We're obligated, for instance, to continue accepting deliveries of oil and things of that sort so conceptually 10.2 is not covered as a default or a breach of contract. It is merely a grant -- the reason why it's in Article 10 rather than in Article 14 is that it grants a right of seller independent of breach or anything else, the right to terminate the contract. If you don't do this then the contract ends. The one safety valve to that or the extension period stipulated in 10.2 that permits us to seek an amendment to the contract or get an extra little time if something has delayed us.

MR. CHATTERTON:

Okay. Then it is distinctly your belief that the contract says if within 72 months, I think another six months probably, extends for 12 months, within 84 months if you have not expended or committed to spend one and a half billion dollars why we can cut the oil off -- that we can cut your oil off?

MR. ROGERS:

Exactly.

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MR. CHATTERTON:

You would have no recourse against the State?

MR. ROGERS:

Right. I think also, if we assume your example of -- your example does have credibility in the area of the building. It's my understanding that the fuels portion of the facility will be the first and then the higher processing will be built later. In the event that at any point you feel that we are not committed to a petrochemical facility and probably -- I cannot keep us out the courts, that's the only way to resolve things if everybody's yelling, but I think you have a good action under 4.2 to say you have violated your obligations to build a petrochemical facility. You're just building a fuels refinery and you can see the termination that way. Our great fear, frankly, is that we're pouring so much money into this thing, we're never going to do anything to even imply a breach because with so much money involved I think we're going to do everything we can to exercise caution.

MR. CHATTERTON:

Of course the definitions section of petrochemical facility refers you to the language in 4.2.1.

MR. ROGERS:

Right.

MR. CHATTERTON:

And, you know, if that really says that you -- it has the word petrochemical manufacturing facility in the fourth line of that paragraph. But it sure as heck doesn't define it, does it? Just read that. "Such facility shall include facilities for the manufacture of energy fuels"; that's my 30,000 barrels "aromatics", yeah, it's going to manufacture those because they're going to come off "olefins", it's going to manufacture those, they're going to come off "and petrochemical derivatives"; that's the whole suite of chemicals, it's going to come off. It's not going to be sold as a product. It's going to be dumped into one of these tanker company's ships and sent down south just like it is on any refinery in the State of Alaska now. It hasn't told me a thing that you're going to make any petrochemicals or some of the derivatives.

MR. ROGERS:

The problem that we wrestle with in trying to define anything further in the contract is that we can't define that until we

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know that the producer, the purchaser of the product -- we have been doing this thing chicken and egg for many months now. And a purchaser won't talk to us until we've got a supply and hardly anybody else for that matter, so that we in this paragraph did not want to bind ourselves to any particular configuration.

MR. CHATTERTON:

I agree, you did not.

MR. ROGERS:

We hopefully have, and I think, honestly speaking, that if everybody will keep their copies of our presentational material in which there are described a mammoth, world scale heavily petrochemical refinery, that ALPETCO would look pretty silly in court saying well we complied with them. We had a few olefins and petrochemical derivatives being (indisc.) off this fuels refinery here. The judge is going to say well how about this nice two volume blue brochure you submitted to the state. What is this thing that you submitted here. And I think the description of this has to be rounded out with the context of the facts of the contract. I would not like to be -- I'll join the Alaska side on that.

MR. PRATT:

May I ask a question, Mr. Chairman, strictly from a stupidity point of view?

CHAIRMAN MILES:

They are so used to stupid questions, Mr. Pratt.

MR. PRATT:

Is Tesoro and North Pole presently producing olefins and aromatics?

MR. CHATTERTON:

Sure.

MR. PRATT:

They are.

MR. CHATTERTON:

Well hell yes.

MR. PRATT:

Polypropylene, polyethylene?

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MR. ROGERS:

Not the polys, I don't believe. I think --

MR. CHATTERTON:

(Indisc.--simultaneous speech) we're having an unsemantical understanding here. As a saleable item, they are not, no. As a saleable product, they are not. But keep in mind that's what crude oil is. Now all they are removing from crude oil let's say Tesoro or a Chevron refinery or North Pole, all they're removing from the crude oil is what are called middle of the barrel products, the stove oil, diesel oil, jet fuels. Now that's being removed. Now everything else, all the olefins and all the aromatics and everything else are also being removed from the barrel but they are being shipped south.

UNIDENTIFIED SPEAKER:

(Indisc.)

MR. CHATTERTON:

Yeah. They are being shipped not as separate items, but as a addition----

MR. ROGERS:

(Indisc.--simultaneous speech) the production of that is just what comes off naturally, rather than what's produced and its' a very small amount in relationship to the fuels produced.

MR. CHATTERTON:

No, actually it's very large, about two thirds. Each barrel that goes through one of these refineries in Alaska, well about a third of a barrel stays in Alaska as products and two thirds is shipped south.

MR. ROGERS:

In what form?

MR. CHATTERTON:

In liquid form.

MR. ROGERS:

They're not aromatics or olefins?

MR. CHATTERTON:

Yes, there's aromatics and olefins.

AGO 559331

MR. PRATT:

Are you saying that they're all mixed up together in one barrel?

MR. CHATTERTON:

They are not in into individual products.

MR. ROGERS:

I think that in the context that this language speaks, we're speaking about the production of separated olefins and separated aromatics. It's not -- I think that's what the parties certainly understood and while it's possible in a fuels refinery to draw off certain small amounts of separated -- I don't think the industry considers anything an olefin or an aromatic until it's separated from its generic tie.

MR. CHATTERTON:

I think you're right. I'm paranoid, I admit it. I can't see the language (indisc.--simultaneous speech).

MR. ROGERS:

As John Barbour used to say, I'm not really paranoid, everybody is trying to persecute me.

MR. CHATTERTON:

Thank you, Mr. Chairman.

CHAIRMAN MILES:

In Exhibit B that deals with determining the value, why is it that though some mathematical fluke the figure that comes out the weighted average (indisc.) just happens to be one of the figures that's up there? It just seems unusual that that would be the case?

MR. ROGERS:

Where's this (indisc.)?

CHAIRMAN MILES:

It's (indisc.) B-2.

MR. ROGERS:

By some fluke it's ...

AGO 559332

CHAIRMAN MILES:

(Indisc.) same weighted average price that one of the independent producers -- or one of the individual producers. It just seems

strange that it would come out that way.

MR. ROGERS:

Yes, that is a mathematical fluke. This was taken personally from an actual production report and it was not constructed, it was taken -- it may have been adjusted (indisc.--cough) but this whole thing began from (indisc.--cough) and Mr. Boness created a very lengthy mathematical model of the way that the state believes the pricing should be under its leases which incidentally (indisc.) not agree and there are, as you know, four different prices stipulated in the lease; market and posted prices and the two prices stipulated in here. There is no posted price in the field and because of the way the formula works, the vague reference to market price in the lease and it probably means the weighted average of all producers in the field or something like that. It could also mean market price in comparison with totally different crude oils like Saudi Arabian crudes. No one knows exactly what not standard means so we used the two standards here which are what you see in number 9. The actual value of the oil of each producer, the weighted average of all other producers which is put in a lease to (indisc.) the inefficient or how do I say it nicely, penalize the producer who is giving a brother-in-law price to someone for reasons of his own. He still has to (indisc.-cough) price of all the other producers. It's a way of making sure that there are no bargain prices which yield an unfair royalty price to the state.

CHAIRMAN MILES:

Anybody who's concerned with government (Indisc.) Arlon Tussing made his presentation.

MR. ROGERS:

His (indisc.) theory.

CHAIRMAN MILES:

There seems to be some argument between Mr. Honig and Dr. Tussing on exactly how this figure was arrived at.

MR. ROGERS:

It could be because this gets awfully complex. This is an extremely simplified model because you have 29 producers and a lot of those producers are delivering to multiple delivery points, so the actual price needs to be done on a computer. Once you're familiar with the way it works it becomes very simple and all it means is that if you have a, b, c and d, you just take the weighted average and if the guy's actual price is higher than the weighted average of all of the other producers, then he pays his higher price. If the weighted average

of the other producers was higher than his actual delivery price then it's the other. And that's probably the practical way the formula in the leases are going to work out over the long run anyway. But I think -- I was not here for Mr. Tussing's presentation but I was not aware that he -- I thought his main concern was that by taking that $7.03 we could do something with the oil that would disrupt the market and somehow eventually mess up the ultimate state's value utilization. Henry knows more about this than I do, perhaps he could (indisc.--simultaneous speech).

MR. PRATT: -

Mr. Chairman.

CHAIRMAN MILES:

Mr. Pratt.

MR. PRATT:

Just a comment on it. I think our difference of opinion at the time was Arlon just used three figures. This company's spending 12 something, this one 12 something and this one 11.46. He didn't use the 11.46 price to show how with that difference in there you could (indisc.) down the overall price. We were saying you don't end up with the 11.46, it's that simple. You have to weight the average of the highest with each of the producers as individuals and then weight those to end up with the price. So that the differential between what we would be paying in the highest price paid wouldn't be as great as he reflected it on the board. That's what the difference of opinion was, that he was using a vast disparity in terms of the figures that he marked down. He didn't represent them to be accurate, he said let's just use some figures, but if you look at those kinds of differences you begin to see millions of dollars worth of loss. And we're saying that's not the way it will actually work. The differential will be so small between the actual highest paid and what we'll pay that while we're (indisc.) it won't be the kind of loss you're hypothicating.

MR. ROGERS:

My sister has a PhD in math and I think she got all of the genes when she was born and I can't figure out all of the mathematical models that all of these people (indisc.). We've got into the problems and the economic effect of removing this oil and disposing of it in some way in the interim stage and then the second phase of that is when our oil is removed from the market and processed in the petrochemical facility, there's a call for reverse ratchet theory in which it's almost a certainty that by taking the crude oil out of the market we will increase the in-value receipts of the State of Alaska by removing 150,000 barrels from the market on the West

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Coast or Gulf Coast or wherever it's going and stop deliveries from the most inefficient point. And the in-value calculation under this formula will all go up and we'll all be happy and scratching our bellies.

We got lost in all of the variables when we were talking about this during negotiations and the wild price gyrations that Mr. Tussing thought are possible, are improbable because there are so many different things that are happening. The largest thing in our contract now is that when the reverse flow pipeline is put into effect it was going to reduce transportation costs from California to the Gulf Coast substantially and you're eliminating a whole lot of (indisc.) gyrations. The markets between the Gulf Coast and the West Coast do fluctuate and the earliest in our delivery will begin in 25 months and it's difficult to -- I think Tussing assumed the absolute worst that could possibly happen and that is so improbable that it's not a concern to us. It'll certainly not be motivating our debate.

CHAIRMAN MILES:

The only reason I was concerned was there did seem to be differences of opinion on exactly how this was to be calculated. We had two supposed completely independent figures, not identical.

MR. ROGERS:

That is a mathematical mistatement, not a mistatement, actually in the way his prices are arrived at, I can assure you there's no difference between the Department of Natural Resources and ALPETCO and the Department of Revenue who's been privy to all of our discussions. I think it's a very fair price (indisc.).

CHAIRMAN MILES:

Mr. Rogers, three or four days before the Commissioner indicated that he was going to recommend a contract, the ALPETCO contract. He came out and said nobody was matching what he was (indisc.). Could you (indisc.).

MR. ROGERS:

Commissioner LeResche is a very good administrator. He wrote -- probably the best way to do it would be to look at his last letter to us. That statement was preparatory to sending a letter to each of the bidders saying please change this or your contract was unacceptable and put us in the unenviable position of either accepting or possibly losing the contract to another bidder. We adopted with a few exceptions all the requirements.

CHAIRMAN MILES:

And what were they?

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MR. ROGERS:

I would have to go back and and dig in my notes. If you want to give me a few minutes I can probably leaf through here and tell you what some of the problems were. The numbers were not final until the last few days. We had asked at all times for 90% (indisc.) 90% under 2.3 and 90% under 2.4. And as you can see the results 85 + potential 5% more in Prudhoe, 90% in 2.3 and 70% in 2.4. The Commissioner's concern there was that he have in reserve adequate quantities to serve future in-state needs. Those in-state needs theoretically are not necessary to be spoken to in 2.3. By definition you're selling something that's excess to the state's needs so that was the area where we were allowed to continue our 90%. The point of delivery in our minds was open until the very last, the part of the state for delivery. We always wanted Valdez as the delivery point and that was simply unacceptable to the state. The state indicated that they did not want to be in the oil business (indisc.). The charitable foundation -- I would say there were small changes that were necessary which I cannot remember at this point. The others were potentially (indisc.--poor quality of tape). (Indisc.) just making clear exactly what was to be paid into the charitable foundation, the definition of the net after tax profits. The requirement also was placed in 4.4 and one other place that prevented us from doing what the state is concerned other parties have done with them and that is to enter brother-in-law transactions at unfair prices so we put in a paragraph requiring any transaction between affiliates to be on fair terms. The storage of oil section was nullified and watered down substantially and I don't know if it's wise to speak to it because there's a question legally as to what rights, if any, the state has to storage. The state was very careful to protect itself to insure that they were not warranting in any manner that there was any storage rights. It is unclear what those storage rights were and those were some ending changes.

There were a number of changes to the measurement section but I don't think you need to be concerned with them. They eliminated a lot of standard language that did not apply because fuel practices at Prudhoe were somewhat different than standard fuel practices. A lot of the last minute changes were pulled in some final comments from a number of agencies that had expressed concerns and had read a draft. We were rushing to the end of the negotiations so many of the changes were not -- did not reflect hard bargaining or anything but some last minute comments of other agencies. The price section was pretty much in order before the end. We were agreeable to it. There were some changes to 8.2 that made clear that any costs whatsoever incurred by the state by taking in-value -- by taking in-kind rather than in-value were our problem.

UNIDENTIFIED SPEAKER:

(Indisc.)

AGO 559336

MR. ROGERS:

Yes. 8.2 was revised in every draft and our concern was, of course, in negotiations getting a defined price of some sort to know what we would be walking into in terms of cost. The state, for obvious reasons, did not want to guarantee that a certain price would pertain and that certain costs would or would not be incurred, otherwise they would be unable to represent to everyone that the in-value price would be realized. And in the last stage of the negotiations we yielded on the point and have agreed to pick up any other costs.

MR. CHATTERTON:

(Indisc.)

MR. ROGERS:

The payments and billing section has been in pretty good shape. There were changes to 9.5 which is adjustment to billings to reflect -- we will be buying the oil and paying for it on a month to month basis and there will be some changes necessitated by possible clerical errors, mistaken reports of the producers on which the billings would be rendered, the outcome of the litigation and the state's litigation with the producers and all those were attempted to be taken care of in Article 9.5. I think they have now been done successfully except for the litigation with the producers. We're trying to cut off everything at an early period and stipulate a reasonable period of time.

CHAIRMAN MILES:

Could you go through these a little bit faster.

MR. ROGERS:

Oh sure.

CHAIRMAN MILES:

Because I want to establish what concessions did the state give ALPETCO and time-- (indisc. -- simultaneous speech)

MR. ROGERS:

I think I can answer that pretty simply. The state could not give any concessions. We were not permitted the opportunity at the very end. We were told either put those in or perhaps find the contract unacceptable so we yielded on those points except those--

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CHAIRMAN MILES:

Before we get into that, were we finished with concessions the state controvened in these sessions?

MR. ROGERS:

No.

CHAIRMAN MILES:

Can you finish those.

MR. ROGERS:

I think I've covered most of them. The next big number of changes were a number of technical changes to Article 12.1 that related to the security interest. And most of those changes were initiated by New York counsel.

MR. CHATTERTON:

The State's New York counsel.

MR. ROGERS:

The State's New York counsel. There was a rather wholesale substitution of language done at the very last draft. I believe the second last draft the state had us put in new 25.1, the local hire provisions, were substituted for some other ones that had been contained in a number of drafts. And in the second last -- Exhibit D, the supplemental environmental standards, were added during the last period of time. The referendum was the very final change that was put in and that's in page 51 before I forget it. Our second last draft it was on a Mag Card and it got run through without the clause and some wrong drafts were circulated and I was accused of all sorts of wrong doings.

CHAIRMAN MILES:

You're saying that the state made no concessions at all --

MR. ROGERS:

It's my memory. If you want to call it a concession, we mutually worked out the language on page 4 and 5 with the Prudhoe oil and tried to dovetail the North Pole contract with our contract. The decided reason for reducing us from 90 to 85% was because of the needs of North Pole. They basically said well if they're not taking it, then we, because they've not been taking it under their contract presently. And the answer was yes. And the same as to the provision of the return oil. Let me think

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just a moment. I can review my notes and reply. If I find some more, I will contact your office in the morning and let you know.

CHAIRMAN MILES:

When did the provision for the bottom of tank and the filling.of the line get (indisc.)

MR. ROGERS:

During the arguments about delivery point we were simply unable to agree on delivery point and after a while decided to share concerns and our concern about taking at pump station number 1 was number 1, many of the carriers have lien prohibition. That was the reason why Article 12.1 is such a mess because we needed to make provision for passing the oil down the pipeline and giving the state security but not letting the oil get in a position to be rejected by the carriers because they can refuse oil that has a lien on it, even a state lien. The other concern was that we would have a bunch of oil in the pipeline that is not usable to us until we get to Valdez and it was in the nature of a compromise that we agreed to the principle of pump station number 1 if the state would agree to the pipeline fill. That is not going to be a 100% requirement under present tariff requirements. Many of the carriers provide fill for some reason that I don't quite understand and so it's not going to be a requirement that the state provide 100% of what might be required.

CHAIRMAN MILES:

Was this agreed to last week (indisc.-- no mike near speaker)

MR. ROGERS:

I don't believe so. It was agreed to in San Francisco. When was that, November?

UNIDENTIFIED SPEAKER:

December.

MR. ROGERS:

December.

UNIDENTIFIED SPEAKER:

Yes, December.

CHAIRMAN MILES:

Ms. Kallab.

MS. KALLAB:

(Indisc.--no mike near speaker)

AGO 559339

MR. ROGERS:

As it's turned out, originally it was something very valuable to us. As I mentioned, we wanted pretty large storage. The more we look at it the more difficult it is to see some tangible clear rights. The storage, if it exists, is probably up in Prudhoe Bay. Nobody knows quite what the language in the lease means and the state, with good reason, insured that it has no exposure in the event no storage rights show up. It will be our job to assess whether there are any rights and whether it's worth pursuing any litigation and if there is any litigation, it would be at our cost. It is not regarded -- at the time of the contract execution it was not regarded as a substantial concession.

MS. KALLAB:

I may have missed something here, possibly. Is the storage right at Prudhoe Bay or is it both at Prudhoe Bay and Valdez? Here it says from the (indisc.) and I don't know what the (indisc.) says.

MR. ROGERS:

Well, the clause in this contract speaks to the storage rights under the lease and the answer to your question is that it's very unclear.

MS. KALLAB:

Oh.

MR. ROGERS:

The leases themselves say that storage will be provided by the lessees, if necessary. And the rest of it you've got to write your own scenario. And it's suspected that the point of storage is at Prudhoe Bay and no one knows what reasonably necessary is. I'm not sure where this all ends us up except that I don't think the storage rights are that substantial and because of the strong interest of the state in protecting and making sure that they were not making any warranties of storage, I don't think the state thought they had substantial storage rights. We will find out and get a better fix later on whether those storage rights exist though. It was very important at the beginning and it's one of those things that has become less and less important as we have focused on the lack of clarity in the languages and what the leases probably mean.

CHAIRMAN MILES:

If the option to take lower priced oil is exercised by ALPETCO that scenario (indisc.) What happens to the Prudhoe royalty oil? Do you still own that or does the state get it back?

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MR. ROGERS:

To the extent we're getting less than 150,000 barrels, we get to keep it, of course. But if in exercising the lower price we go over 150, we have to reduce our Prudhoe take and therefore the state will get either in-value or (indisc.) in-kind, free of any restrictions that portion which it gets back.

CHAIRMAN MILES:

So the state would get that back if you take a -- assuming you get up to 150.

MR. ROGERS:

Right.

CHAIRMAN MILES:

The state would get complete control of the oil back.

MR. ROGERS:

Yes.

CHAIRMAN MILES:

Representative Chatterton, do you have any questions?

MR. CHATTERTON:

I have a couple of unrelated questions. One, there's no question in your mind but what for oil other than delivery to pump station 1, point of delivery as covered under paragraph 3.1 is defined as nothing more than an agreement to agree, is that right?

MR. ROGERS:

Say that again.

MR. CHATTERTON:

Okay, any oil outside of the Prudhoe Bay crude being delivered to you at pump station 1 or the LACT meter, to make up your 150,000 barrels a day (indisc.), I think that 3.1 in effect defines point of delivery for such oil, outside oil, extraneous oil or whatever you want to use, is purely an agreement to agree. (Indisc.--no microphone)

AGO 559341

MR. ROGERS:

No, I can't agree with that because that means that we don't have a contract on that then. I think as to any oil outside the Prudhoe Bay oil, the delivery point will be the point of delivery of the royalty oil to the state. Under its leases that means it's probably at the well head -- that is a point of litigation in the producer's litigation. It may mean at the edge of the lease. But wherever the state's taking it, we will take it from.

MR. CHATTERTON:

(Indisc.)

MR. ROGERS:

3.1 just says where's it's going to be. That's a pretty definable place, I would think. And it refers back -- it's the oil that will be sold under 2.3 and 2.4 which we've discussed.

MR. CHATTERTON:

Well down here -- delivery under this article 3.1 be made at such other points of delivery as may be mutually agreed between buyer and sellers.

MR. ROGERS:

Right, if we agree on it -- another place that the state took delivery.

MR. CHATTERTON:

(Indisc.)

MR. ROGERS:

Absent that agreement, we would pick it up wherever the state picks it's oil.

MR. CHATTERTON:

Okay, one other thing, completely unrelated. Do you happen to know whether Barbour Oil or any of Alaska Interstate's, the Alaska Interstate members of the complex, have any subsidies under the entitlements program?

MR. ROGERS:

I would assume that the Pride Refining Company, which is operated by Seatrain Lines, being a domestic refinery, has some. It's between a 35 and 40,000 barrel a day refinery so I'm pretty sure its got some. Alaska Interstate does not have any to my knowledge.

AGO 559342

MR. CHATTERTON:

It does not?

MR. ROGERS:

No.

MR. CHATTERTON:

Thank you. Thank you, Mr. Chairman. Pride Refinery's in Abilene, Texas, Mr. Chairman.

MR. ROGERS:

I'll check and make sure of that.

CHAIRMAN MILES:

Ms. Kallab.

MS. KALLAB:

I'd like to (indisc.) -- question of exportation (indisc.--no microphone)

MR. ROGERS:

Mr. Van Ness's (ph) firm, which has been working on the DOE stuff has advised us on that and given us a pretty clear set of guidelines. If you look at the Energy Reporter, it doesn't take long. There's a definition of products that you can and cannot export. Basically all fuels are prohibited and fuels -- this is -- I'm really not a petrochemical expert so I may be using some wrong terms in the categories but I believe Naptha and Benzine are classified as fuels and are prohibited but the downstream products are perfectly okay for export.

MS. KALLAB:

Would this be available to us? (Indisc.)

MR. ROGERS:

Surely, I have it -- Commissioner LeResche has it. I have a copy at my office that I'll be glad to send you. There's a CCH export Control Reporter that I'm sure is in the Law Library here and it would be in there. If you take someone like Bob Maynard (ph) and sit him down for an hour, he could get it. I will send copies of it to you and if it confuses you, I'll send an expert in and have Mr. Van Ness explain it to you.

AGO 559343

MS. KALLAB:

I have a couple more questions. Has the contract physically been signed between LeResche and (indisc.)

MR. ROGERS:

Yes.

MS. KALLAB:

There are physically signed copies?

MR. ROGERS:

Yes, I could not tell you where they are right now.

MS. KALLAB:

Then under 4.2, or 2.4 rather, what do you consider to be the date of execution (indisc.). What is your definition of that? On the top of page 9, yeah, line 6 or 7, what is --.

MR. ROGERS:

That I must lay at my own door step. That is my language and it was, a concern that there might be commitments made between the date of signing and the effective date of the contract. Of course, if the contract is not approved, it all becomes moot, but if it does, it automatically kicks in the -- as it turns out it's a moot concern. I was concerned that there might be a commitment. As it turns out there is none committed so that there's really nothing to worry about and it was a needless provision, I believe.

MS. KALLAB:

Okay. If you were to re-draft this contract you would (indisc.)

MR. ROGERS:

Yes, Um humh.

MS. KALLAB:

Oh, under section 5.5, subsection 2, (indisc.) the state had to provide ALPETCO with the most recent anticipated production schedule (indisc.) Since you're only getting oil or contracted for royalty oil, what's the interest in the gas?

MR. ROGERS:

I really honestly can't tell you. I can tell you where that provision came from. The language was different there and we were advised that the language was vague and we asked someone from Brown & Root to tell us what they wanted. At the time there was some -- I just honestly -- this language came wholesale from Brown and Root and

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no one has questioned why we're interested in gas and I can't honestly tell you.

MR. CHATTERTON:

(Indisc. -- something about making a guess) They are in the construction business. This is public information.

MR. ROGERS:

That's what it was. Kathy just reminded me that at the time we were getting this information together there was a lot of controversy about the effect of gas production, particularly at Prudhoe Bay, on oil production. And we sort of drug a dragnet to get as much information as we could. There were some alarming newspaper reports anyway that indicated that the more gas you pulled out, the less oil you pulled out and that there were going to be some disasterous reports and this was about the time that that language showed up. I think that was the reason for that.

MS. KALLAB:

You're speaking of the Doscher (ph) report?

MR. ROGERS:

Excuse me.

MS. KALLAB:

Was that the Doscher Doring (ph) report?

MR. ROGERS:

I don't know.

MS. KALLAB:

(Indisc.)

MR. ROGERS:

I don't know the name of it, it must have been.

MR. CHATTERTON:

It strikes me that it probably was but I can't totally recall, myself.

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CHAIRMAN MILES:

Could you explain the supplier-purchaser section for us?

MR. ROGERS:

(Laughter) That came from our Department of Energy wizards in Washington.

CHAIRMAN MILES:

Were they really (indisc.--laughter).

MR. ROGERS:

Compared to them I'm a perfect example of clarity.

CHAIRMAN MILES:

Just kind of translate that --

MR. ROGERS:

Let me translate it through and give you my explanation of what I think it means. The first sentence is a broad one to cover anything we've forgotten that both the state and we will take any action that is necessary to try to get the transactions accomplished. Then begins the language that is necessary to insure compliance with FEA Rules, DOE Rules. In the event that this agreement is terminated, seller and buyer, that's mainly buyer -- we have to agree that we don't mind the state terminating because there is a right on the part of the supplier to insist on a continuation of the supplier-purchaser relationship. Under the rulings that the state has received and ALPETCO has received though, the DOE has affirmed the use of an in-advance waiver of rights to continue the supply relationship. Am I talking in circles yet?

CHAIRMAN MILES:

(Indiscernible--laughter)

MR. ROGERS:

There is a right under the energy regulations -- it's designed to keep in place all of the energy distribution channels that existed in 1973. For that reason, if you have a supply contract the supplier has the right to insist on a continuation of the supply relationship, notwithstanding it's contractual agreement. The state, of course, does not want to enter the contract and be unable to terminate the contract because of Department of Energy insistence. Our standing up and saying, hey, we realize under the contract you've got a right to terminate us, but under

present federal law, you have to continue the supply relationship. So the Department of Energy has said it's perfectly okay number 1 because the Alaska production came on-stream after this frozen period in 1973 and because it's a different market and because we're dealing with the state, which is a different character of party, to waive in advance any rights for us to insist on a continuation of the supply relationship.

CHAIRMAN MILES:

Then does that -- are you saying that if the feds would mandate an interruption, you guys are out-to-lunch or the state's out-to-lunch?

MR. ROGERS:

It says that the state terminates our contract if we fail to meet our 18 month criteria. It means that we cannot stand up and and say, hey, the Department of Energy says you have to continue our oil. Well that's not a theoretical possibility because we can't get our oil until after that. Say we're at the -- this example we used before, we're at the hundred million dollar level going on to 600 million dollar level and the contract was terminated, we cannot cite as a reason to prevent the termination of deliveries, these Department of Energy guidelines. They just don't apply to us. And this language is the language that the Department of Energy says is necessary to give an advance waiver or an advance release to the state. We give you, in order to give up any rights, we have to insist on that. Then to make it even more complicated, if we were selling the oil downstream to some other purchasers, as long as it's crude oil every purchaser and sub-purchaser down the line has the right to insist on a continuation of that supply relationship, so the additional language is designed to require us to pass those same obligations on.

CHAIRMAN MILES:

I'd have to stay up all night to (indisc.)

MR. ROGERS:

I'd disclaim any responsibility for (indisc.-laughter). The first part assumes any general allocation program. The second sentence cites -- says the same thing over again but cites the present program. In order that if there's a -- I'm talking about in 26.6 we have a general sentence and then in the first sentence it talks about any mandatory crude oil allocation program. The next sentence is specifically -- we're talking here and it says the same thing over again about the present federal mandatory petroleum allocation regulations. And then the next sentence is what I talked about --

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these downstream purchasers. And that's in any subsequent contracts we'll get the same agreement. The reason it's so confusing is the repetitiveness of the language, I think. Then the next sentence --

MR. CHATTERTON:

You cascade it down one more layer.

MR. ROGERS:

Yeah. It's cascaded down -- that's a very good description. Then we go from a general -- in that long sentence we're talking in general -- we'll pass on the termination provisions and in that final sentence it says specifically we will have this agreement in the State of Alaska royalty agreement as to any termination. I think after you've read that four or five times you just have to take it on faith that the principle reason it is is to allow a rather free termination of the supplier-purchaser relationship in the Department of Energy relations, without interference of the Department of Energy relations.

MR. CHATTERTON:

That's just your interpretation.

MR. ROGERS:

Yes, and they have been passed on I know by the State of Alaska's DOE counsel in Washington to insure that that's not going to interfere. It has been a constant concern of your people.

MR. CHATTERTON:

Thank you.

CHAIRMAN MILES:

On the Article 12 security clause, I have a couple of questions. What kind of a commitment or what kind of a legally binding document is the letter of credit? You know, I don't understand that insofar as a security measure goes and the second question on that is why doesn't the security apply until the crude gets down to the facility? It doesn't attach while it's in transit, yet it's your oil and so actually although point of delivery is the LACT meter, we're still liable because you're not snapping any security on the thing.

MR. ROGERS:

The letter of credit is merely a letter that will say to the State of Alaska, if these people don't pay then you notify us and we'll fund up to the amount of this letter. It will be from a reputable bank and it's better, in my mind, than the security

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interest that you get from keeping the oil, because it's cash from a good bank. It's an unconditional promise to pay, it's sort of like a check, a blank -- not a blank check but in essence that's what it is. It's a blank check up to the face amount of the letter of credit. Any time that we fail to pay or that you need to go against the security because of some other reason, that's a breach of the contract, you have the right to notify the issuer of that letter of credit that they should pay the State of Alaska a certain amount of money and it will be drawn down. The specific form of the letter of credit, you'll note, is subject to the approval of the Commissioner and so it's got to be an unconditional letter of credit.

MR. OSTERBACK:

It's like a promissory note.

MR. ROGERS:

Yes, sir. And in fact it's a promissory note from a quite reputable payor that a bank issuing a letter of credit treats that on its books as if it had lent the money and it has to by regulation because it's an obligation to pay that money from that bank's standpoint.

CHAIRMAN MILES:

On the other point then --

MR. ROGERS:

The other point is rather complicated and that's part of the compromise that we reached in the pump station number 1. Three or four of the seven tariffs or eight tariffs, say the carrier has a right to reject the oil if that oil has a lien on it. Under 12.1, there is a lien retained in the oil by the seller. And for very good legal reasons that lien should not be given up until the oil has been paid for. Our problem was that we couldn't accept pump station number 1 if we were accepting oil at a point with a lien on it where a carrier might reject it. We don't want the oil with nothing (indisc.) at pump station number 1. So the contorted result was what you see here. The lien is released as to that oil on which tariffs exist prohibiting a lien and the oil would go down the pipeline and then the lien will re-attach and the complexity of that whole paragraph has been designed around and patched around to insure that at no time can we place a lien on the oil while it's going down the 9 days, down the pipeline. It was a way to satisfy our needs and make sure that we could ship the oil down the pipeline and we did as best we could to insure that the state was fully protected. The result is

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that you will have no lien on that oil -- again it's not all the oil, it's just for these four carriers who have lien prohibitions in their tariffs -- while it goes down the line there will be no lien on it but there's a prohibition against our putting any other liens on it and the lien will be attached once it hits Valdez.

CHAIRMAN MILES:

I wish I knew something about lien laws, I guess I'd understand it, but it seems to me reading 12.1 that we have no security until it gets to Valdez and then we can't slap a lien on the products if we have to after because it says no liens will attach to any oil or products produced therefrom, so we don't have -- will you run that through again.

MR. ROGERS:

Yeah --

CHAIRMAN MILES:

(Indisc.--simultaneous speech) gets to the facility, the facility processes it and then we can't slap a lien on it once it goes out.

MR. ROGERS:

Yes, you can. We can't. We can't put any other lien on it. The lien of the seller automatically re-attaches at Valdez. All the oil coming out of the TAPS line will have a seller's lien on it 100%.

CHAIRMAN MILES:

Where does it say that?

MR. ROGERS:

Well at the beginning of 12.1 it says all oil will have a security interest on it from the point of delivery. Then it says notwithstanding the provisions of the above which say the oil lien will attach at pump station number 1, seller agrees that the security interest shall not attach at the time of delivery but instead it will attach when it arrives at Valdez. As to any oil shipped, not all of the oil, but just to any oil shipped under the tariff pertaining to the TAPS, which contains a prohibition against -- that's the whole basic problem. The tariff says if I tender oil that has a lien on it, the carrier can say, we don't want it.

Some of those carriers are also other producers that have oil that they'd like to ship. We don't want to be in a position where they can reject our oil. And that was one of our biggest arguments for accepting the delivery at Valdez and not at pump station number 1.

CHAIRMAN MILES:

I don't think I (indisc.) Let's go on.

MR. ROGERS:

Let me summarize perhaps for you -- where you end up. The state will always have a lien on all of the oil, all of the crude oil, until it's paid for except in one excepted instance and that's as to those -- the pipeline is owned by a number of people in undivided interests, so you've got more than one tariff. If you have a bunch of tariffs and three or four of those say you can't ship any oil down our line if it has another persons lien on it because that might interfere with our own carrier lien. So we have a right to reject that oil. One tariff says it prohibits any oil that goes in the pipeline that has a lien on it. So we just provided that instead of the lien attaching at pump station number 1 at the top, as to those four, the lien will not attach here but will attach at the bottom of the line. And it also says ALPETCO, you can't put any lien on that oil while it's going down the line or grant a lien on it to any other third party without our permission.

CHAIRMAN MILES:

Then doesn't it further say --

MR. ROGERS:

Yeah, just to that portion of the oil.

CHAIRMAN MILES:

What happens after it goes out?

MR. ROGERS:

The lien re-attaches as it goes off and the lien continues at that point as long as it is not paid for, and to the products that are produced from any, and any accounts receivable that are created by the sale of it.

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UNIDENTIFIED PERSON:

(Indisc.)

CHAIRMAN MILES:

So then, where am I, I'm at page 37 about the 6th or 7th line, and the language says no lien shall attach to any oil or products produced therefrom.

MR. ROGERS:

Okay, now that is another exception. We have the right to say over in that storage barrel is a $100,000 worth of crude oil. Here's $100,000, release your lien on that oil and the state is obligated to do so. The state doesn't care because it would rather have the cash payment then it would the crude oil.

CHAIRMAN MILES:

It certainly doesn't seem to say that to me but I won't belabor the point.

MR. ROGERS:

If it makes you feel any better, both of the lawyers working on it will be suprised if this doesn't fox even the best commercial banker. The whole paragraph 12.1 is highly complicated. It has been revised and had the insertion of about 10 lines into it and it is one of the most difficult paragraphs to understand. We have run it over enough that it does what the state and ALPETCO want it to do but it is not easy to understand.

CHAIRMAN MILES:

Thank you. Any questions?

MR. ROGERS:

Do you have a question for me?

MR. PRATT:

I'm worried about Mr. Miles' last question, are you of the opinion that somehow we get the oil into the refinery or the petrochemical complex and thereafter you have no lien on anything?

CHAIRMAN MILES:

Yes, yes, that's my concern and I have to perhaps have another lawyer translate (indisc.)

MR. ROGERS:

It'll take a translation. There are only two instances in which a lien will not exist. From pump station number 1 down to the full

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point of payor. Those two instances are this weird situations along the pipeline as to those carriers that have a lien prohibition. And number 2, as to any time that one of the banks -- the specific reason for the creation of little "ii" in the middle of page 37, was at the instance of our lender. He said he wanted the ability to lend us say 100 million dollars and get some security. And if he was lending a 100 million dollars on a hundred million dollars of our accounts receivable, he wanted to have those accounts receivable available for security for himself. So this just provides that it's just a switch and the state ends up with money rather than security which is good for the state. We have the right to have our bank come in and buy $100,000 worth of receivables by paying the state $100,000 in cash.

MR. PRATT:

You have a lien or a security interest on the accounts receivable of the petrochemical complex unless the bank comes in and says, here, here's a 100 grand, now we want that security interest. In which case your security interest on that 100 grand is gone because you've been paid off.

CHAIRMAN MILES:

I just don't read it that way but --

MR. ROGERS:

Perhaps you're forgetting the general --

CHAIRMAN MILES:

I'm not arguing the point.

MR. ROGERS:

Yes, I understand it so go back to the general -- the only way to keep your mind straight as you go through all the exceptions is to keep in mind the general provision at the very beginning which provides for a blanket lien -- blanket security interest to the state on everything. The crude oil, the products, the accounts receivable and the proceeds and then it says well, notwithstanding that, here are two exceptions. And it's the exceptions that are so horribly complex that they've become almost unworkable --

CHAIRMAN MILES:

It's certainly unreadable.

MR. ROGERS:

I plead guilty on that. I can't blame that on some special counsel either.

CHAIRMAN MILES:

Ms. Kallab.

MS. KALLAB:

(Indisc.) Have you made arrangements to correct some non-substantive mistakes that are in the contract? I just wondered if you had made arrangements with the administration?

MR. ROGERS:

Yes, I believe we have.

MS. KALLAB:

Will we be getting corrected copies of the contract then, because they obviously will have to be executed and signed by you as chief counsel?

MR. ROGERS:

Commissioner LeResche will be back in town tomorrow morning and that was one of the questions and reasons I came up here and probably the best thing to do is when the last unexpurgated final, final version is done, we can circulate it with some notation, perhaps a gold star on it, that will indicate that it's the last copy. We were all very rushed and very exhausted when we got to that point and I'm embarrassed that there were so many --

MS. KALLAB:

It's a minor point, but I just wanted to know.

MR. ROGERS:

If you will let me know after we're done, what it is, I'll make sure that it was one of the corrected things.

CHAIRMAN MILES:

Are there further questions? I have a few but it's 9:30 and we've been working hard enough the last 10 days. Thank you very much. We certainly do appreciate your time.

MR. ROGERS:

I'll be here tomorrow if any of you have some more concerns or if you'd like to go over your questions tomorrow, I'd be glad to stop by your office and answer any of your concerns.
You just get in touch with Henry. I'm available to come back up or talk to you by telephone if you run into anything after I leave town too.

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