SCOMM

28:31

430 L STREET · SUITE 404
ANCHORAGE, ALASKA 99501
(907) 276-1069

KL

MEMORANDUM

To: File

From: Fred Boness FB

Dated: December 7, 1979

Re: Alpetco

On Thursday, December 6, 1979, I met in the morning with Mark Hulsey and Ben Cassler (attorneys for Charter Oil) for about an hour and a half; and in the afternoon with the same two individuals plus Mike Spaan for about 45 minutes. At the morning session, we discussed the submitted take-or-pay contract; and I indicated why I believed it was not truly a take-or-pay contract. I indicated to Mark that there was no obligation to deliver products and hence no obligation on the part of Charter Oil to make even floor payments for price payments. I also indicated that it was unclear what payments were to be made because under 2.01 and 2.02 the switching back and forth between the use of the word "product" and the use of the word "products" was quite confusing.

Mark then explained that their proposed financing plan was to raise $1.5 billion dollars by obtaining $750 million dollars of supplier-type financing and that this financing would be backed up by pledge of the oil purchase contract, the product purchase contract, mortgages, the lease of the land, a security interest in goods, and similar matters. He specifically referred to my memorandum and said the things identified in there would be used as the security for supplier-type financing. He indicated an additional $500 million dollars would be raised by the issuance of bonds by the City of Valdez and that these bonds would be backed up by the full faith and credit of the Charter Company and underwritten by E.F. Hutton. He provided me with a copy of a memorandum written by Kutak Rock & Huie on this subject. The remainder of the funds, in fact $350 million rather than $250 million, would be provided by equity commitments from Charter Oil and the other participants in the Alpetco project.

We then discussed at some length what kinds of information would be required in order to evidence "firm" commitments with respect to this type of financing. I used a very simple example. I said when you go into the bank to borrow money for your house, at the time the bank makes the commitment to provide you with money, they show you the loan document, the Deed of Trust, and all the papers required by the federal truth and lending law. They quote you an interest rate but say it might change a little bit depending on the market and they set aside some money for your loan. Then at closing the definitive documents are basically the same as the documents reviewed earlier except that the interest rate may be a little higher, names and addresses are filled in, and similar matters. I said it seemed to me that most all the paper was in place at the time the commitment was made and that the final closing at which definitive documents are concluded really is only a matter of filling in the blanks. Mark objected that my example was not realistic. He said that in the typically commercial situation, at the time of commitment not all the final documents would be prepared and that the commitment would be much abbreviated. We then discussed at some length whether a bank or banks would really commit $750 million dollars without tying down a large number of details at the time it makes the commitment. Mark indicated that a number of the provisions were standard and usual and even cited my memorandum as indication that standard and usual terms existed. I said that may be so, but that there was nothing standard or usual about a $750 million dollar commitment to a world scale petrochemical plant; and asked him when was the last time a bank has loaned $750 million for such a facility. He said he knew of no such loan which had been made in several years. I suggested that then there was no standard and usual form and that that bank and State would want to see as much precision as possible as early as possible.

We then discussed in some detail the concept of project financing, with which it seems, Mark was really not acquainted. In order to aid them in understanding the concept, I provided them with pages 11, 12 and the first paragraph on page 13 of my memorandum, (citing certain law journal articles). I discussed with them the concept of project financing as presented to the State by Alpetco at the time of contract negotiations and approval by the legislature. I then pointed out to Mark that the financing plan they were advocating was not really a project financing at all and that this posed an additional problem. I indicated that the contract and benchmarks contained therein were based upon

the notion of a project financing and indeed the take-or-pay contract requirement contained in the Alpetco Agreement was at the heart of the project financing. That being so, I pointed out that Alpetco's change in a financing plan raised the possibility that it might comply with the short-term and long-term financing requirements benchmarks in the contract but not the requirement to obtain long-term, take-or-pay contracts. I indicated I did not know how Bob LeResche would want to handle that situation. I suggested that any change from the concepts developed at the time the contract was negotiated would make it more difficult for LeResche to explain to legislators and the public that the benchmark provisions had been complied with even, when, technically, they had not been complied with; but that on the other hand the basic objective of the contract was to sell oil and build a facility in Alaska and that everyone understood that financing was a key to the viability of the project. I said that I thought that if Alpetco presented a very tight and secure financing plan for $1.5 billion dollars, LeResche might be able to conclude that the benchmark requirements were satisfied even if the financing proposal plan no longer hinged upon project financing.

In the afternoon, we rediscussed many of the principles and subjects delinated above. In addition, Mark wanted to make sure that it was my understanding that the Commissioner was going to give notice to the producers on or before January 1, 1980. I indicated that was my understanding and that I thought the Commissioner would do so because if Alpetco did not qualify to take the oil, he would be able to sell it to Tesoro or the producers. Mark was greatly relieved that the Commissioner would take that action because he believes Alpetco might now ask for an extension and attempt to satisfy the financing conditions before June 18, 1980 and request to take the oil on July 17, after compliance. I indicated that it was my understanding that an extension would not be granted costlessly; and that if Alpetco's thinking ran to the possibility of requesting an extension, they should immediately begin discussions with LeResche on such matters as it would be necessary to clarify the terms of an extension. Mark said if the Commissioner wanted to share in the profits of Alpetco's taking of the oil after July 17, then they were not interested requesting an extension and that they would let the deal flounder. I said I could not speak for the Commissioner on that subject. We did not discuss, in any detail at all, whether it would be legal under the contract for the Commissioner to grant the extension and yet deliver oil on July 17. I did indicate

that I knew that LeResche had a problem with providing oil for Tesoro and that he may seek to delay delivery of oil to Alpetco, but that I really had very little information on what kind of terms the Commissioner would be willing to grant in an extension.

Although I indicated to Mark that his explanation of where they were in the financing arrangements was certainly not binding upon them with respect to their ability to maintain that they have complied with the requirements (as I interpreted the requirements) but that as I matched his explanation of where they were in the financing proposal I concluded that Alpetco had not complied with the requirement to obtain a firm financial commitment. He disagreed, although not vigorously, on the grounds that my interpretation of the requirement was not the only interpretation and that I was probably reading too much into the requirements. I agreed more than one interpretation was possible, but indicated that I believe my interpretation was 100% legally defensible based on the record and understanding of the parties as indicated by that record and that, as such, would be defensible in court if it ever came to such. We both, of course, agreed we didn't want it to do so; and that it probably never would.

cc: Robert LeResche

LAW OFFICES OF
PRESTON, THORGRIMSON, ELLIS & HOLMAN
SUITE 404
420 L STREET
ANCHORAGE, ALASKA 99501
AREA CODE 907-276-1969

FREDERICK H. BONESS
JOHN R. MESSENGER

2000 IBM BUILDING
SEATTLE, WASHINGTON 98101
206-623-7580
TELEX THOR-SEA

SUITE 500
1776 G STREET N.W.
WASHINGTON, D.C. 20006
202-628-1700
TELECOPY 202-331-1024

November 13, 1979

Robert E. LeResche
Commissioner, Department of Natural
Resources
Pouch M
Juneau, Alaska 99811

Dear Commissioner LeResche:

Enclosed is a memorandum reviewing certain aspects of the contract between the State of Alaska and Alaska Petrochemical Company. It is submitted pursuant to your request for a legal analysis of the requirements of Articles 10.2 and 2.2.

Although the memorandum itself explains the scope of the analysis we have undertaken therein, I wish to emphasize here what we believe to be the strengths and weaknesses of our analysis. First, it is important to keep in mind that we have undertaken only a legal analysis. Many, and probably most, of the questions and issues which must be answered in December (and at subsequent benchmark dates) are business decisions. Do the expected benefits in terms of tax revenues, employment opportunities, etc., continue to outweigh the costs and risks associated with the project? The answer to this question and its numerous permutations involves principally matters of business judgment and State policy. It is true that once the answer is decided upon, the ability to act in conformity with that decision, depends upon the legal structure of the agreement, but such structure does not really determine the answer.

Second, we have not attempted a comprehensive analysis of the contract since you did not request that. We have focused only on Articles 2.2 and 10.2, and particularly 10.2(3). In order to address adequately these articles, we have found it necessary to consider other terms in the

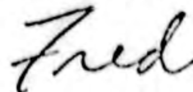
contract; and we have done so. Necessarily, we have also addressed a number of general contract principles relevant to all aspects of the contract. On the other hand, there are several specific areas of the contract we have not addressed. For example, during our review of the files, we were reminded of the extent of concern and controversy surrounding Articles 2.3 and 2.4 of the contract. We have not addressed these articles in any fashion.

Third, our analysis and conclusion are somewhat less precise than we would like them to be. The reason for this is the lack of a specific set of facts. We have used three sources of information in formulating our conclusions. First and foremost we have relied upon the agreement itself. Second, we have reviewed the readily available record of negotiations, public review, and approval of the agreement to amplify the meaning of various contract terms. Finally, we have relied on the custom and common practices in the oil and gas, construction, and commercial and financial industries to provide additional insight into the contract. These sources, however, still leave unanswered a wide range of questions. We believe a review of whatever documents or requests Alpetco submits prior to, or on December 18, may lead to more precise legal conclusions than those expressed here.

We would be happy to meet with you or members of your staff to discuss our conclusions.

Sincerely,

PRESTON, THORGRIMSON, ELLIS,
HOLMAN & FLETCHER

By 
Frederick H. Boness

FHB/sas
Enclosures

LAW OFFICES
PRESTON, THORGRIMSON, ELLIS & HOLMAN
420 L STREET · SUITE 404
ANCHORAGE, ALASKA 99501
(907) 276-1969

MEMORANDUM

TO: Robert E. LeResche, Commissioner, Department of Natural Resources

FROM: Frederick H. Boness FHB.

DATE: November 9, 1979

RE: Legal Analysis of articles 10.2 and 2.2 and Related Provisions of the Agreement between the State of Alaska and Alaska Petrochemical Company

Introduction

This memorandum presents a legal analysis of articles 10.2 and 2.2 and related provisions of the Agreement between the State of Alaska (the State or Seller, hereinafter) and Alaska Petrochemical Company, (Alpetco or Buyer, hereinafter) as amended. We have endeavored to present a comprehensive analysis of these articles. We have relied upon two principal sources of information for our analysis. First, we have, of course, paid close attention to the language of the Agreement itself. In the absence of ambiguity, the language of the Agreement is definitely controlling. Wessells v. State, 562 P.2d 1042 (Ak. 1977) Second, we have reviewed the files relating to the solicitation of proposals to purchase state royalty oil, the negotiation of contracts and the approval of the Alpetco Agreement by the Royalty Board and Legislature. These files provide the additional background and context needed to determine if particular language is ambiguous and, if it is, what the parties intended. (Subsequently, we shall refer to information from the files as "extrinsic evidence"). In addition, we have relied on industry understanding and practice. Generally, where we have turned to industry understanding and practice we have found the information helpful only because it confirms conclusions reached on the basis of our interpretation of the contract and information from the files.

There are limitations on what can be stated in advance of specific actions by Alpetco to comply with the agreement. For example, in addressing the question of what is meant by "written commitments to lend or invest. . ." we have described what the State should expect such commitments to contain in order to assure itself that the commitment is not illusory. However, it is simply not feasible to imagine and evaluate all possible commitment documents which Alpetco might obtain and submit to the State. It is possible that problems not addressed in this memorandum will arise once Alpetco has disclosed what actions it has taken to comply with article 10.2. We strongly recommend that the specific commitments and contracts which Alpetco submits to the State in satisfaction of its obligations under article 10.2 be reviewed and evaluated to determine if they comply with the legal requirements of the Agreement.

Although our focus in this memorandum has been on the legal requirements of articles 2.2 and 10.2(3), it has been necessary to address other related provisions of the Agreement. We have done this in order to present what we believe to be a comprehensive statement of the options available to the State and the legal framework which governs each possible course of action available to the State. This memorandum is divided into the following general catagories: 1) General Legal Principles; 2) The Eighteen Month Benchmark Requirements; 3) Granting or Denying Extensions of Time to Comply with Benchmark Requirements; and 4) Delivery of Royalty Oil Prior to Completion of the Petrochemical Facility.

I. General Legal Principles

In this first section, it is our purpose to review and summarize the basic principles and standards applicable to Alaskan contracts. Although this section might be simplistic for those already familiar with Alaska contract law, we have decided to include this brief discussion because this memorandum may receive wide and diverse readership. Additionally, the discussions which follow this section rely upon the basic principles discussed here. There are no Alaska court decisions (and very few decisions from other jurisdictions) which address any of the specific questions analyzed in this memorandum.

If it were possible to draft contracts which could have only one meaning, and that meaning was crystal clear to anyone who read it, at any time after the contract had been signed, there would be little need for contract law because

There are limitations on what can be stated in advance of specific actions by Alpetco to comply with the agreement. For example, in addressing the question of what is meant by "written commitments to lend or invest. . ." we have described what the State should expect such commitments to contain in order to assure itself that the commitment is not illusory. However, it is simply not feasible to imagine and evaluate all possible commitment documents which Alpetco might obtain and submit to the State. It is possible that problems not addressed in this memorandum will arise once Alpetco has disclosed what actions it has taken to comply with article 10.2. We strongly recommend that the specific commitments and contracts which Alpetco submits to the State in satisfaction of its obligations under article 10.2 be reviewed and evaluated to determine if they comply with the legal requirements of the Agreement.

Although our focus in this memorandum has been on the legal requirements of articles 2.2 and 10.2(3), it has been necessary to address other related provisions of the Agreement. We have done this in order to present what we believe to be a comprehensive statement of the options available to the State and the legal framework which governs each possible course of action available to the State. This memorandum is divided into the following general catagories: 1) General Legal Principles; 2) The Eighteen Month Benchmark Requirements; 3) Granting or Denying Extensions of Time to Comply with Benchmark Requirements; and 4) Delivery of Royalty Oil Prior to Completion of the Petrochemical Facility.

I. General Legal Principles

In this first section, it is our purpose to review and summarize the basic principles and standards applicable to Alaskan contracts. Although this section might be simplistic for those already familiar with Alaska contract law, we have decided to include this brief discussion because this memorandum may receive wide and diverse readership. Additionally, the discussions which follow this section rely upon the basic principles discussed here. There are no Alaska court decisions (and very few decisions from other jurisdictions) which address any of the specific questions analyzed in this memorandum.

If it were possible to draft contracts which could have only one meaning, and that meaning was crystal clear to anyone who read it, at any time after the contract had been signed, there would be little need for contract law because

there would be no basis for disputes between the parties (except possibly, that one party may believe a term "unfair" and wish to avoid the term for that reason). The real world, however, is not so simple. Words are almost always imprecise and efforts to limit this imprecision carry within themselves their own seeds of failure. An imprecise word or sentence is made precise by further explanation, but this explanation may contain its own ambiguities. Furthermore, many contract disputes arise not because the words of a contract are themselves imprecise, but because the parties attached different precise meanings to the words and discover this difference only after the agreement is in effect.

When a dispute arises over the meaning of certain words in a contract and the parties are unable to agree upon a resolution of the dispute the matter is ultimately left to the court to "interpret" the meaning of the contract. Day v. A & G Construction Co., 528 P.2d 440 (1974). Alaska's Supreme Court has concluded that for commercial contracts, a court should interpret a contract by attempting to determine the "reasonable expectation of the parties" which the court has explained to mean "'the sense in which the party using the words should reasonably have apprehended that they would be understood by the other party' and the meaning which the recipient of the communication might reasonably have given to it." Day, supra, at 444-45, Arctic Contractors v. State, 564, P.2d 30 (Ak. 1977).

In many jurisdictions, it used to be that a court would determine what this was simply by reading the language f the contract. If, after doing so, the court decided the language was "clear" or "unambiguous" the court would confirm that clear meaning and go no further. Alaskan courts have rejected this approach. Rather, Alaska's Supreme Court has recognized that even language seemingly "clear" on its face may be ambiguous, or even have a clear meaning other than that which the reader first perceives, when read and understood in the whole context in which a contract is negotiated and agreed upon. Thus, Alaska courts in interpreting a contract first look to extrinsic evidence to determine if the language of the contract is ambiguous. If the court determines the language is not ambiguous, it returns to the contract and states the meaning of the agreement. On the other hand, if the extrinsic evidence indicates ambiguity, then that evidence is used to help resolve the meaning of the contract. Wessells v. State, 562, P.2d 1042, 1044 (Ak. 1977). See also, National Bank of Alaska v. J.B.L. & K. of Alaska, 546 P.2d 579 (Ak. 1976).

The extrinsic evidence to which a court can look in its effort to interpret the meaning of a contract includes the facts and circumstances as they existed at the time the agreement was made by the parties, course of performance, course of dealing, and custom and usage. None of these are necessarily controlling, unless circumstances so indicates; but all may be useful in appropriate circumstances. See A. G. Construction Co. v. Reid Brothers Logging, 547, P.2d 1207 (Ak. 1976); Day v. A. G. Construction Co., supra. In our subsequent analysis, we have relied upon the extrinsic evidence to aid us in our determination of the objective meaning of the agreement.

II. The Eighteen-Month Benchmark Tasks

Perhaps more than any other provision in the Agreement, article 10.2 and especially 10.2(3) must be viewed in the total context of the contract negotiations. There can be no doubt but that both Buyer and Seller regarded this article as crucial. For example, O. Charles Honig testified before the legislature:

> When it gets past the eighteen-month benchmark. . .when we succeed in putting [the financing and other 18-month benchmark requirements] together. . .from then on the likelihood of not going forward is very remote. . .

Commissioner LeResche testifed: "The key benchmark is 18 months."

Before turning directly to a discussion of the specific terms of article 10.2(3) we believe it appropriate to review briefly the major steps and decisions leading up to a final agreement between the State and Alaska Petrochemical Company. As early as 1975 the Department of Natural Resources made a general solicitation of interest of persons who might wish to purchase state-owned royalty oil or gas from Prudhoe Bay. Although some interest was expressed, no agreement was concluded at that time. In the spring of 1977, with oil production expected to begin in June, two companies mounted an intensive effort to purchase royalty oil. One of these companies was Alaska Petroleum Company and the other was Alaska Consolidated Shipping. The former company had been offering to purchase royalty oil since 1975, but had not been able to commit itself sufficiently to construction of an in-state facility to satisfy state officials. Alaska Consolidated Shipping, likewise was not prepared to guarantee construction of an in-state

facility, but rather sought to purchase the oil and use tankers owned by one of its shareholders to transport the oil to markets in the lower 48 states. Each of these companies argued that under federal regulations, the State of Alaska would be prevented from taking its royalty oil in-kind if it did not elect to do so prior to the time at which oil production commenced. In response to this contention, the State administration obtained a ruling from the Federal Energy Agency and a "waiver" from the producers which made it clear that the State would be able to take royalty oil in-kind at a later date. At the same time these two companies sought to purchase oil, the legislature considered adopting legislation which would have required the Commissioner of Natural Resources to take royalty oil in-kind. Although this legislation did not pass, the legislature did express a strong desire that the executive branch sell royalty oil. As part of this expression, AS 28.05.182 was amended to create a presumption in favor of taking royalty oil in-kind.

During the summer of 1977, the Commissioner of Natural Resources made a formal solicitation of persons interested in purchasing royalty oil and constructing a facility in Alaska. That solicitation provided that interested parties should submit their initial proposals to the Commissioner by August 1, 1977 and final proposals by October 15. Part of the solicitation included advising companies of eight policy guidelines which had been adopted by the Royalty Board in May and which would govern, in part, the direction of any future sales of royalty oil. These policies included a statement that the price would not be less than the "in-value" price, and a statement that preference would be given to in-State facilities and those who proposed to build in-State facilities. Ten companies submitted proposals on August 1st.

On September 15, the Commissioner of Natural Resources advised each interested party of the State's view of its August 1, 1977 submission and offered recommendations on how the submission might be changed so that the companies revised submission of October 15 would be more acceptable to the State. Several of the companies chose not to revise their August 1st submission. Some companies withdrew their proposals and others were rejected by the Royalty Board, so that by the end of October, there remained only four competing proposals. During November, December, and January the Commissioner engaged in substantial negotiations with these four companies. Also during that time the Energy Policy Committee of the legislature advised the Commissioner

of its views on what a sales contract ought to achieve. In early December, Committee Chairman, Bill Miles, after holding public hearings, wrote Governor Hammond a letter which contained several very specific suggestions and recommendations. Among the Committee's recommendations were expressions that the "in-value" price be the floor for any sale of royalty taken in-kind and that the provisions contained in many of the October 15 submissions which allowed the price received by the State to drop substantially below that floor were unacceptable. The letter also contained a recommendation that the final contracts should include strong provisions for ensuing that a facility would be built in Alaska. It was suggested that the contract contain penalty clauses for failure to build in Alaska and reasonable termination provisions. The Committe's recommendations were before the Commissioner as he negotiated in December and January.

As negotiations neared an end in early February, the Commissioner of Natural Resources wrote to each company offering a final critique of its proposal and an opportunity to make final changes in its proposal in order to conform to the State's objectives. On February 22, 1978, the Commissioner agreed to a contract with Alaska Petrochemical Company. This agreement was sub mitted to the Royalty Board for consideration, and after hearings approved by the Board. In the legislature, the Agreement was quite controversial. After numerous hearings and debate, the prospect of legislative passage was uncertain. On May 17, 1978, the Commissioner of Natural Resources and Alpetco entered into an amendment to the Agreement which was intended to alleviate certain problems and concerns raised during the course of legislative review. On June 18, 1978, the Agreement, as amended, was approved by the legislature.

It is imminently clear from the policies adopted by the Royalty Board in May and the State Energy Policy Committee recommendations of December 6, 1977, that there were certain basic features which any contract had to contain in order to be acceptable. These included: 1) The price at which the State would sell its oil should be the "in-value" price or higher and reductions below the in-value floor should not be permitted; 2) The purchaser should be clearly bound to construct a facility to use or process the oil in Alaska; clauses which would allow the purchaser to escape this commitment were to be eliminated altogether if possible, and if not, must at least be drafted very narrowly; 3) The contract should include penalties for failure to per-

form; 4) No subsidy should be granted; and 5) The State should sell only a percentage (less than 100%) of its crude, not a specific quantity.

Viewed in this context, it is easy to see that article 10.2 is a direct response to the State's objective of ensuring that the company that purchased the State's royalty oil would also be committed to construction of a facility to use that oil in Alaska.[1/] In the Commissioner's letter of September 15, 1977 to each prospective purchaser, the purchaser was asked to include as part of its commitment to construct a facility a timetable with checkpoints along the way and penalty provisions for failure to meet established checkpoints. Buyer, in its October 15th submission, provided a contract which contained as Buyer's construction obligation a provision which said that Buyer would 1) proceed to construct and complete a petrochemical facility with reasonable diligence, 2) commence detailed engineering design within 30 days of final approval of the Agreement by the legislature, 3) commence construction within a certain number of months (which number was left to be negotiated) after Buyer had begun receiving delivery of royalty oil, and 4) have completed substantially all initial construction relating to the Refinery within a certain number of months (which number was left to be negotiated) after Buyer received first delivery of royalty oil.

The October 15th proposal by Buyer thus did contain a rudimentary timetable as requested by the Commissioner's September 15th letter. However, it is apparent the State's negotiators were not satisfied with this timetable and that article 10.2 evolved as a way to gain the degree of specificity, certainty and commitment required by Seller and yet have sufficient flexibility to meet changing circumstances and conditions likely to be encountered by Buyer. O. Charles Honig stated in testimony before the legislature:

1/ The strength of this concern and the high degree of suspicion that a company would simply purchase State royalty oil and broker it on the Lower 48 spot markets without constructing any facilities in Alaska is amply demonstrated by the transcripts of the legislative hearings. See Transcript of Testimony, March 18, 1978, at 17, 21. Indeed, the May amendments to the Alpetco Agreement appear to be directed at closing "loopholes", real or perceived, which might allow the company to take royalty oil but never build such a facility.

> [One] reason for these benchmarks being what they are is that in negotiating the contract terms, Commissioner LeResche said more than once, do not make the benchmarks too optimistic. Set the benchmarks so that you, in your own feeling, feel they will be obtainable and that we don't have to go back to the Legislature to revise benchmarks. (Transcript of testimony March 18, 1978, at 13)

The extrinsic evidence indicates the timetable of 10.2 was first developed in mid-December during negotiations held in San Francisco.

Article 10.2, and 10.2(3) in particular, were developed out of, and embody Alpetco's plan as it was presented in October and modified (although not significantly) thereafter. The addition of article 10.2 to the agreement did not represent a significant new idea, proposal or approach for either Buyer or Seller; rather it represented only an incorporation into the agreement itself of more of the detail of Buyer's proposal. This action had the effect of creating a stronger linking together of the agreement to buy and sell oil and the agreement to construct a facility in Alaska. Because article 10.2 was based on Buyer's already developed proposal, we can reliably use the Alpetco proposals of August 1 and October 15 to aid us in interpreting Article 10.2(3).

Although Article 10.2(3) contains eight separate requirements, these requirements are not all independent of each other. For example, the requirement to negotiate sale terms with prospective purchasers is partially superseded by the requirement to enter into contracts for 70% of the product output, and both contract requirements are important to (if not determinative of) the requirement to complete plant design and optimization since plant design depends on product output (which of course depends on product purchase contracts). Similarly, the interim financing commitment is integrally related to the requirement to obtain commitments to lend or invest of at least $1.5 billion since the financing plan will have to be arranged as a unit rather than piecemeal. Finally, the contracts for the sale of product are crucially important to obtaining the financing commitments because of Buyer's plan to use "project financing." While the requirements are related, we shall, nevertheless, discuss them individually below because each must be complied with by Buyer.

A. The Ten-Million Dollar Expenditure

We need say relatively little about the benchmark which requires Buyer to expend or commit to expend $10 million in Total Project Costs. Compliance with this requirement involves straightforward accounting matters and not much more. A potentially difficult question might have been raised with respect to which costs incurred prior to the effective date of the agreement were includable. However, a certified audit of expenditures for the period January 1, 1975 to June 18, 1979 was conducted by the accounting firm of Peat, Marwick, Mitchell & Co. and accepted by Seller on September 4, 1979. Thus, there exists a base of at least $4.2 million as of June 18, 1979 upon which Buyer can build its future expenditures in order to satisfy its $10 million obligation. There is another $1.5 million of expenditures which was confirmed but not audited by the accountants.

Where an expenditure has actually been made, it would seem that any possible questions concerning the expenditure should be quite limited. Was the expenditure actually made and for the amount reported? Does the expenditure qualify as a "project cost"? Was it made by a party whose expenditures can be counted towards total project costs? Article 1.13 is important in answering these questions because it defines the limits of "total project costs." It is possible that Buyer may include expenditures which should not be attributable to fulfillment of its commitment under the agreement. However, the language of article 1.13 is broad. Thus, absent dishonesty or fraud, such improper inclusions are likely to be relatively few and we would expect minor if they occur at all.

If Buyer relies upon "commitments" to expend funds rather than actual expenditures, it will be necessary to evaluate the commitment to ensure that it qualifies. In evaluating such commitments to expend, there are several indicia Seller can look to, to determine if the commitment is bona fide. These include: 1) The party with whom the commitment is made, (Is the party reputable and qualified to perform the work called for? Is the party an independent contractor or an affiliate of Buyer?); 2) The timetable for performance and schedule for payment by Buyer; 3) The size of the payment to be made by Buyer in relation to the work called for; (Is it grossly undervalued--suggesting that the contractor might have no damages if the contract is breached. Or is it grossly overvalued, suggesting that the contractor and Buyer have an understanding that if the contract is

terminated Buyer will incur no costs and if it goes forward the contractor receives a premium for the speculative risk undertaken); 4) Any penalty provisions or liquidated damages terms (such terms provide a measure of the degree of commitment Buyer has made to its contractor); and 5) Any termination, default and force majeure terms which allow Buyer to avoid its obligation to make payments. In reviewing these terms and others which may be part of Buyer's "commitment to expend" funds, the State's analysis should not be directed solely toward individual terms and it should not attempt to decide if each term is "good" enough or "strong" enough. Rather the review should be whether any individual term or some group of terms are such that they make the commitment to expend illusory. If that is the case, the "commitment" does not qualify under the agreement.

Finally, if Buyer relies on commitments to expend, the State should take some care to ensure that "double counting" does not occur. This might happen where Buyer or one of its affiliates contracts with a consultant, construction contractor, etc., for work and the consultant or construction contractor in turn subcontracts the work to another consultant or construction contractor. If each reports the expenditure and applies the commitment to the total of expenditures, there would be a double counting of what is really a single expenditure.

B. The Financing and Product Sales Requirements

As noted above, the benchmark requirements relating to contracts for the sale of product output and the financing requirements are part of the same package which Buyer must conclude. We will discuss them together here. The principal documents which describe in greater detail Buyer's plans for financing of its project are its August 1, 1977 submission and its October 15, 1977 submission. In addition, Buyer prepared and distributed an "Update and Restatement" of its October 15 proposal which is dated February 7, 1978 and a summary of its proposal, dated March 15, 1978. These documents also discuss Buyer's financing plan.

In the August 1, 1977 submission, Buyer's financing and marketing plans obviously were still undergoing development. At the time of that proposal, Buyer estimated an initial project cost of $1.5 billion and planned "to procure debt and equity capital requirements through the sale of securities to be managed" by Kuhn Loeb & Co., and E. F. Hutton & Co. The letter from Buyer's financial advisers

addressing Buyers financing plans said nothing more assuring or specific than that the investment bankers were "of the preliminary opinion that the Project can be financed, subject, of course, to economic and monetary conditions existing at the time the financing is undertaken". On the marketing question Buyer did state that it intended "to seek marketing of its products under long-term 'take or pay' contracts."

In its October 15 proposal, Buyer described its plans for marketing in a more detailed, confidential submission. In this document, Buyer reiteiterated its intent to sell products on "long-term 'take or pay' purchase contracts with major chemical companies coinciding with the term of Alpetco's royalty oil purchase contract with the State of Alaska." Buyer indicated that as of October 7, 1977, Buyer had received "expressions of interest for two-thirds of the output of the plant. . ." Finally, Buyer noted that if it was not possible to obtain "acceptable contracts for the sale of substantially all of the project's output. . .," Buyer may approach the project in phases, constructing facilities over a longer period of time.

Buyer's financing plan was also described in greater detail in its October 15 submission. Buyer stated that two important conditions to financing were 1) the availability of crude oil feedstock to the project over the life of the financing and 2) profitable sale of the products over the life of the financing. The first condition Buyer explained could be met by a satisfactory contract to purchase royalty oil and the second by conclusion of long-term "take or pay" contracts with "financially strong purchasers." Additionally, Buyer indicated it would need to assure lenders that completion and operation of the plant would occur as projected and stated that these assurances would be obtained through "stand-by 'open-market' contracts for crude oil supply short-falls" and by "Brown & Root's guarantee of plant start-up."

Buyer indicated that interim construction financing could be arranged through a group of U.S. commercial banks provided that the banks are assured that "the construction loans will be 'taken down' by long-term lenders." In support of this conclusion Buyer presented a letter from Grenville H. Paynter, Senior Vice President of Chemical Bank in which Mr. Paynter expressed his belief that $400 million of interim bank credit could be arranged through a banking group and that Chemical Bank would be willing to lend $100,000,000 itself. On the question of long-term financing

Buyer stated 20 year bonds would be sold to institutional investors and that such bonds would provide for deferred interest and principal amortization until the facility becomes operational. Buyer's letter from Kuhn Loeb and E. F. Hutton was no more definitive than the earlier letter.

Buyer's February 7, 1978 "Update" which was prepared and distributed after Article 10.2 had been agreed to by the parties, but before the total agreement had been accepted by Seller and signed by the parties stated:

> 4. Financing the project. Alpetco and its financial advisors have developed a comprehensive financial plan to provide for all phases of the project, including equity and workable sales contract forms.

and further that Buyer had received:

> 6. Strong expressions of interest by Japanese trading companies and government leaders despite recent Alaskan newspaper stories to the contrary.

In elaborating upon these statements, Buyer stated that the project could be "financed using project financing techniques" and that "equity to support the project can be obtained if necessary." In this report Buyer explained the relationship between the product sales contract and the financing proposal. The long-term contract for the purchase of crude and the "matched" long-term sales contract would "guarantee lenders that monies borrowed to finance the project would be repaid." The product sales contracts, in order to provide assurance to lenders, would have to be "irrevocable and at a minimum provide for debt service (interest payment and principal repayment) even if for some reason the facility does not produce products for delivery to purchasers." Buyer stated such irrevocable sales contracts "are not uncommon."

In a February 3, 1978 report to Commissioner LeResche, Robert Butler of Smith Barney, Harris Upham & Co. confirmed Alpetco's proposed financing as a method used in the industry and stressed the importance of the "hell or high water," "take or pay" contract with the product user as a cornerstone to the financing. The concept of project financing and the importance of the take or pay contract are discussed and emphasized in two law journal articles available at the time. See "Project Financing for Offshore and

Onshore Gas Facilities -- Alternative Methods for Financing from a Legal Viewpoint," M.P. Martin, 28 Inst. O.& G.L. Tax 273 (1977); "Project Financing --Oil and Gas Ventures", J.F. Hunt & H.L. Company, 27 Inst. O.& G.L. & Tax 215 (1977)

With the above information in mind it is easy to see the inter-relationship of Articles 10.2(3)(b),(c), (d) and (e). Furthermore, because of these inter-relationships, it seems likely that Buyer's satisfaction of these requirements will be accomplished almost simultaneously.

Subsection (b) requires Buyer to negotiate sale terms with prospective product purchasers and draft contracts for the sale of products, but it does not require Buyer to conclude final sales agreements. (b) also requires Buyer to delineate product requirements, quantities of products and production ratios. It is possible to satisfy (b) without satisfying requirements (c) or (h). However, with one exception, if Buyer complies with (c) and (h), Buyer will necessarily have complied with (b). It is therefore necessary to address only the exception. In order to avoid reading (b) as wholly redundant with (c) and (h), it seems likely that (b) requires Buyer to negotiate with prospective purchasers of products for the 30% of the products not sold in satisfaction of (c) -- assuming, of course, Buyer concludes contracts for only 70% of its products. Buyer, in certifying satisfaction of (b), should indicate what action it has taken to negotiate such contracts and submit to the State drafts of contracts if hopes to conclude. If Buyer does this, we believe it will have complied with (b) so long as the contracts it submits are reasonable.

Satisfaction of (c) is more demanding, since it requires Buyer to conclude contracts for the sale of at least 70% of the product output of the plant; several uncertainties exist. First, the agreement defines "petrochemical plant" to include off-site facilities such as power supply, water supply, port facilities and administrative buildings. At various times during Sellers public discussion of it proposal, Seller noted the possibility of making excess power available to the loc ' community. It is our conclusion that (c) does not requir uyer to include this as part of its total output. Similarly, we believe that Buyer may not enter into a contract for a sale of water or power and count such contract towards satisfaction of (c). The language of (c) restricts Buyer's obligation to "product output" and we conclude this means the hydrocarbon products produced from the crude oil feedstock and not

ancillary goods and commodities produced principally to support the basic facility. Second, even if we restrict our consideration to hydrocarbons, what is "product output"? It is possible Buyer will use crude as fuel for the plant. If it did so, it is clear that that such crude would not count as "product output." More likely, Buyer will use fuel oil produced from the refinery portion of the plant as fuel. Should this be counted as "product output?" Although it is possible to argue the point either way, we believe the better conclusion is that it should not be included unless the contract to purchase the fuel to run the plant is with an independent, nonaffiliated party and that party must take the fuel if the plant does not use it. This could be the case where Buyer enters into an agreement to sell to a third party fuel oil on a take or pay basis and Buyer in turn agrees to purchase steam or electricity from that third party. In such case, the fuel would actually be plant fuel but the sale would be equivalent to any other take or pay sale. We note there is an incentive for Buyer to undertake a sale to itself of plant fuel as product output if Buyer is having difficulty satisfying (c). This incentive can be understood from the following example: Suppose Buyer will require 20,000 b/d to operate its plant. That leaves 130,000 b/d of products for outside sale. Seventy percent of 130,000 is 91,000. If we assume the fuel requirement is part of product output, then Buyer must conclude contracts for 70% of 150,000 or 105,000 barrels, however, if we net out Buyer's 20,000 barrel sale to itself for fuel, then it must only sell 85,000 of products to others. We believe if Buyer conducts a sale to itself or an affiliate of the plant fuel this sale should be counted in satisfaction of (c) only if it is on terms substantially the same as other sales. On the other hand if, as is likely, Buyer's need for fuel is taken "off the top" Buyer's obligation under (c) should be to sell only 70% of that which it has available for sales to others, not 70% of 150,000 b/d.

A third uncertainty is how the 70% is to be measured. Product output can be measured in terms of weight, volume, value, and perhaps other standards as well. The agreement does not specify the unit of measure and the issue does not appear to have been addressed during negotiation or review of the agreement. It may be that the matter is more theoretical than real, only when Buyers product slate is identified will one be able to judge the significance of this issue. Perhaps more significant then the unit of measure is the period of time over which product output should be measured. It is clear from Buyers submissions that two standards are reasonable and compliance with either

should satisfy the benchmark. One would be for the remaining length of the agreement itself and the other would be for the length of the loans (or bonds). On the other hand, we conclude product sales contracts for 70%, or even, of the product output for a shorter period, such as the first year's production of the plant, would not satisfy (c).

A fourth area of potential difficulty is whether a sales contract is really a contract for the purchase of product output. We would expect that as a minimum such a contract must contain terms relating to price (most likely a formula price of some kind), quantity of product, quality of product, length of the contract, perhaps a commitment by Buyer to provide product from other plants if Buyer's facility is inoperative, and terms establishing the conditions or events which will permit termination or modification of the product sales agreement. It is not necessary that this sales contract be long or complicated (although it may well be). The State should pay particular attention to the provisions, if any, which allow for future termination of the product sales contract, especially as to termination which might occur in the first year or two after the contracts are concluded. The State's right under (c) does not permit the State to dictate the terms of Buyer's product sales contracts, however, if the sales contract is sufficiently open-ended, the State could dispute Buyer's purported satisfaction of (c) on the grounds that 70% of the plant's output over the appropriate period of time, as discussed above, has not occurred.

Article 10.2(3)(d) requires that the Buyer obtain commitments to lend or invest $1.5 billion and article 10.2(3)(e) requires Buyer to obtain interim financing for construction. Satisfaction of (e) is probably easier than (d), however, as a practical matter, it is unlikely that Buyer will be able to comply with (e) unless it has also complied with (d). This is so because interim lenders are unwilling to commit funds until they are absolutely certain that their loans will be "taken out" by the long term lender. See "Current Business Approaches -- Commercial Construction Lending," C.C. Livingston, 13 Real Prop., Probate & Tr. J 791 (Fall, 1978). One indicator that the State can look to in determining if Buyer has complied with its requirement to obtain interim financing is the size of the interim financing commitment. Subsection (e) does not require any particular size commitment but it does require that Buyer obtain interim financing "for the construction." Thus, the amount of financing arranged by Buyer must be sufficient for this purpose. The amount needed will have to be decided upon in

the light of the circumstances as they exist at the time Buyer arranges the financing. A useful guideline, however, is the letter from Chemical Bank to Messrs. Honig and Barbour of October 11, 1977 in which Grenville Paynter advised Alpetco that it was his estimate the project would require $400 million in interim financing. An interim commitment of that size will require a number of investors to participate. Buyer's proposal was that this group would be headed by Chemical Bank. The form of the participation by other investors should be reviewed to be certain that each investor has truly committed funds for interim financing.

In the case of both requirement (d) and (e), a major concern for the State will be that the commitment is indeed a firm commitment. There is no absolute form that the commitment to lend or invest must take in order to satisfy Buyer's obligation. There are, however, certain basic elements which all commitments will contain if they are legitimate. For example, the party promising to loan the funds must have the resources to make the loan and the legal right and corporate authorization to do so. All loan commitments or equity investments should state the amount of the primary loan and also if there are any secondary or contingency funds available to Buyer. The commitment document likely will contain a drawdown schedule for the loan, which schedule, at least in the aggregate, should match Buyer's construction timetable and also the benchmark obligations for expenditures contained in the agreement. The commitment documents will establish an interest rate, term and repayment schedule. Buyer will most likely be required to pay a loan commitment fee. At least some portion of this fee should be payable by Buyer at the time the commitment is entered into. This fee may be refundable at the time the loan is delivered and it may also be a measure of liquidated damages. See "The Broken Commitment: A Modern View of the Mortgage Lenders Remedys" D.C. Draper, 59 Cornell L.R. 418, 427-28 (1974). Whatever arrangement is made, the obligations should be sufficiently onerous to provide a measure of assurance that the lender and borrower are each serious about the loan.

The loans will be secured by assignments of the product purchase contracts, the oil sales contract, leases of land acquired by Buyer, mortgages and/or security interests in materials purchased with loan proceeds and perhaps other forms of security as well. The commitment document should contain a detailed description of the facility, and most likely will be supported by engineering design and cost

estimates and economic analyses of the product markets and an estimate of the economic viability of the project. The lender will reserve to itself the right to have independent engineering and economic analysis conducted prior to disbursement of loan funds and the right to inspect and even to take over construction efforts if the project begins to fall behind schedule or escalates beyond projected costs. Most likely the lender will reserve the right to approve final plans and specifications, hiring of contractors, and perhaps major purchase orders. In a financing of the size required by Buyer, it is likely each of these basic elements will be specified in detail.

Although there will be contingencies such as those discussed above, the commitments required under (d) and (e) are binding contracts between Buyer and Buyer's lenders or investors; they are not expressions of interest by banks or other financial institutions.

C. The Environmental Inpact Assessment.

Subsection (f) requires completion and filing of an Environmental Impact Assessment and (g) requires Buyer to file all material state, local, and federal permit applications. These requirements are neither particularly difficult nor onerous for Buyer to accomplish, and as such if Buyer fails to accomplish these, the failure will indicate lack of commitment by Buyer rather than an insumountable problem. We have not endeavored to enumerate all the material state, local, and federal permits here because this information is more readily available from those agencies which have been meeting with officials from the Department of Natural Resources and Buyer on a regular basis. It should be noted, however, that (g) does not require that Buyer receive all permits, only that Buyer apply for them. The only question which might be raised is whether Buyer's application is so deficient that it really does not constitute an application at all. Such evaluation can be made only after a review of the application requirements and Buyer's application.

Subsection (f) refers to an Environmental Impact Assessment. This requirement is subject to at least two reasonable interpretations. One is that Buyer must prepare a report which documents and evaluates the environmental impact of a proposed facility and submit that report to the State. The other is that Buyer must prepare and file with the appropriate federal agencies the information they will require to prepare an Environmental Impact Statement. We

believe it is this latter interpretation that more nearly represents what the parties' contemplated. We do not believe, however, that Buyer is required to have done more than submit the information to the appropriate federal agencies. For example, (f) does not require that a final EIS be completed or even that a draft EIS be completed since it is the federal agencies rather than the Buyer who control the pace of preparation of those documents.

D. Plant Design

Subsection (h) requires Buyer to complete plant design and optimization necessary to obtain a definitive cost estimate. Compliance with this requirement would seem to be strictly a matter of fact although it may require the opinion of a professional engineering firm to determine if Buyers work satisfies the requirement.

III. Granting or Denying an Extension of Time to Allow Buyer to Satisfy Benchmark Tasks

A. When Should an Extension be Granted or Denied?

Since, the Agreement does not specify a particular procedure either for Buyer to certify to Seller its accomplishment of the tasks specified in the Agreement or for the Seller to grant or deny an extension of time, we rely upon common sense and reasonable practice. It appears that for the 6-month and 12-month benchmarks, Buyer certified its accomplishment of the required tasks as part of its monthly report to the State. See Alpetco's letters of December 14, 1978 (Progress Report No. 6) and June 14 (Progress Report No. 12) and the Commissioner of Natural Resource's letter of September 4, 1979 to Gordon Cain. This procedure seems to be reasonable under the agreement and could be followed for the 18-month benchmark as well. However, we see a possible danger in this approach and, therefore, suggest the State consider a modification of the procedure used by it and Buyer for the past two benchmarks.

Since the 6-month and 12-month benchmarks were relatively easy to accomplish, there was probably little doubt that Buyer would achieve them. But, future benchmarks are much more difficult and accomplishment is less assured. Both the State and Alpetco should be concerned about what happens if Buyer fails to achieve the benchmarks but does not advise the State of this failure until the last minute.

Article 10.2 clearly provides that the Agreement terminates without further action on Seller's part, on

December 18, 1979, unless Buyer has accomplished all the tasks or unless Seller grants a 6-month extension.

It is reasonable to expect that the State will require some time to review Buyer's submissions before it decides whether or not Buyer should be granted an extension. If Buyer's submission and a request for an extension of time is made on December 18, one must ask: What is the status of the Agreement after December 18th and prior to the time the State grants an extension? And, if the Agreement is automatically terminated on December 18, can the State later revive it by granting an extension with retroactive effect? There is no simple, certain answer. We believe it is reasonable to assume the State has the right and power to review Buyer's information, taking a reasonable amount of time to do so, and thereafter grant or deny an extension which would have retroactive effect. It must be noted, however, that both during the negotiations and public review of the agreement there was skepticism about any future administration's willingness to terminate the agreement if the benchmarks were not satisfied. This concern was addressed, in part, by making the agreement terminate automatically rather than by leaving the matter to the State's discretion. With this in mind, it is conceivable that a court would conclude that the automatic termination provision of the agreement is controlling and that the State's power to grant an extension is limited to granting an extension prior to operation of the automatic termination provision. Our recommendation, therefore, is that the more certain and prudent course for both the State and Alpetco is to decide before December 18 whether or not an extension will be granted should the Buyer request one and formally to grant or deny the extension no later than December 18, 1979. To accomplish this, the State may wish to ask Buyer to advise it a month or so in advance of December 18, that Buyer intends to request an extension.

B. For How Long is an Extension Effective and How Many Extensions May be Granted?

Article 10.2(3),(4),(5),(6) and (7) authorize 6-month extensions. Article 10.2(8) authorizes a 9-month extension and Article 10.2(9) authorizes a 12-month extension. In each case, the extension permitted is only for a fixed period of time; that is, 6-, 9- or 12-months. Extensions of either a shorter or longer period of time are not permitted. The extensions are not cumulative and the State may grant only one fixed period extension for each benchmark period.

Article 10.2(10) allows a second, variable period extension for a specific purpose. If the State grants an extension for the 18-month benchmark, the tasks must be accomplished by the 24th month, or the contract automatically terminates (unless Seller grants the second extension authorized under 10.2(10)). At the 24-month benchmark the State may grant a new 6-month extension but only for the task required under the 24-month benchmark not for tasks enumerated under the 18-month benchmark.

The second extension, authorized by article 10.2(10), allows the State to extend any initial extension period for an indeterminate period of time which time elapses on the 90th consecutive day of the legislative session following granting of the extension. In practice, this provision works as follows: If in December of any year Seller grants a 6-month extension, that extension would run until June of the following year. Most likely the legislature would not be in session when that extension expires (June 18th) and certainly the legislature would not be in session for an additional consecutive 90 days after June. Thus, should Seller grant the second extension allowed under the agreement after granting an initial 6-month extension in December, the second extension would keep the agreement in force until the 90th day of the next legislative session (approximately mid-April).

If Seller grants an extension applicable to the 24-, 36-, or 48-month benchmarks, such extension would be granted in June and expire in December. A subsequent extension under 10.2(10) would operate until the 90th day of the legislative session starting in the following January.

An extension granted under 10.2(10) must be for a period which terminates on the 90th day of the next legislative session unless Buyer consents in writing to a shorter extension period.

The consequences of granting an extension under article 10.2(10) are not fully specified in the Agreement. Two plausible interpretations of the effect of granting an article 10.2(10) extension are possible. First, an extension under article 10.2(10) may be like any other extension authorized by article 10.2. Namely, if Buyer during the 10.2(10) extension accomplishes the task for which the extension was granted, then the Agreement remains in force. On the other hand, it seems the better interpretation of the

agreement is that an article 10.2(10) extension is limited to the purpose of "permit[ting] the Commissioner and Alaska State Legislature to consider an amendment or modification of [the] Agreement, particularly of the provisions contained in Article 10.2." Under this interpretation it would not matter that the Buyer accomplishes the task after termination of the initial extension period and prior to termination of the second extension period. The Agreement would, nevertheless, terminate unless the legislature amended the Agreement in a manner which ratified the late compliance. There are two reasons for concluding that this second interpretation is the correct one. First, the language of 10.2(10) states a specific purpose for which the extension is granted, namely to allow consideration of an amendment. Second, 10.2(10) differs markedly from the other extension provisions in that it is for an indeterminate period of time and it does not speak to "attainment of criteria stated" as do each of the extension provisions in articles 10.2(1)-(9). It seems logical that if 10.2(10) was for the purpose of allowing the Buyer to accomplish benchmark tasks the same language that was used repeatedly in articles 10.2(1) through 10.2(9) would have been used.

C. What is the Authority of Seller to Grant or Deny an Extension?

Article 10.1 establishes a 27 year term but makes clear that that term is subject to termination by either party under 10.2 or 10.3. Article 10.2 states that the "Agreement shall terminate" if specified tasks are not accomplished according to the timetable of 10.2 and further provides that the Commissioner "may extend" the time period for attainment of the criteria. This language seems crystal clear with respect to when the contract terminates and what discretionary power the Commissioner has to prevent such termination. Nevertheless, automatic termination is a harsh result, especially where substantial time and money have been invested under the agreement. See, 5 Williston on Contracts § 793 (3ed. Jaeger 1961); c.f. Land Development v. Padgett, 369 P.2d 888 (Ak. 1962). For that reason, the State should expect that a court will look very carefully at such termination to ensure itself that such result was indeed intended by the parties.

It is our conclusion that a review of the agreement and the extrinsic evidence confirms that the parties did intend 1) automatic termination of the agreement, and 2) absolute discretion to the Commissioner in determining

whether or not to grant an extension. The testimony of Buyer's attorney (Mr. Rogers) illustrates this first point well:

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. (emphasis added)

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 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.

With respect to the discretion accorded the Commissioner, article 26.7, governing approvals and consents, is enlightening. That provision imposes a "reasonableness" standard upon each party when making approvals or granting consents called for in the Agreement. We doubt

that the Commissioner's decision to grant or deny an extension is either an "approval" or a "consent" required under the agreement. Nevertheless, article 26.7 expressly exempts from the reasonableness standard the extensions of time called for under article 10.2. The extrinsic evidence indicates that the parties knew, understood and accepted the fact that an extension was solely at the Commissioner's discretion. As a practical matter, including the right to an extension, even if solely at the Commissioner's discretion, represented a concession to Buyer, since Buyer at least would be able to present its case to the Commissioner who could then grant an extension, if he felt it proper to do so. In the absence of such right, automatic termination would result. If an extension was not to be solely at the Commissioner's discretion, only two other alternatives are possible. One would be an automatic extension -- which would be in effect no extension at all, but only a lengthening of the time period for compliance -- and an automatic extension upon satisfaction of certain conditions. There is no indication that either of these types of extensions were contemplated.

D. Does the Agreement Automatically Terminate if the Commissioner Does Not Grant an Extension?

There is one provision in the agreement which might be interpreted to modify or temper the termination provision of 10.2. Article 14.3 provides that "No. . . failure of performance under this Agreement shall be deemed to have occurred under this agreement unless such. . . failure of performance is material or substantial under all the circumstances. . . ." The only guidance as to what constitutes "material or substantial" is the qualifier that one must look to all the circumstances. The "circumstances" presumably include the agreement itself, the understandings and interests of the parties when they negotiated and entered into the agreement, and the events as they exist at the time of the failure of performance. With respect to the agreement itself the language is quite clear. If the tasks are not accomplished by a specific date, the agreement terminates unless an extension is granted. The timetable in the agreement, especially accomplishment of tasks at the 18-month and subsequent benchmark is clearly at the heart of the agreement. (See page 23 above). It could well be concluded from the structure and language of the agreement that any failure to comply with performance required under 10.2 -- even by one day -- is material and thus not excused. The extrinsic evidence supports this view. For example, there are references in the record to the rigid requirement

of 10.2 and the safeguard this term of the agreement provides. (See the testimony of Mr. Rogers quoted above). It must be recalled that many members of the legislature were concerned that there might be some "loophole" that would result in the contract remaining in force even if the Buyer was not satisfying its obligations. Both the Commissioner and Buyer's representatives assured the legislature that was not so.

While it might be that a court would conclude <u>all</u> failures to comply with the benchmarks of article 10.2 constitute material and substantial failures of performance for the reasons discussed above, it cannot be assured that a court will so conclude. As noted above, "circumstances" include events and facts as they are at the time of the failure. What if Buyer failed to comply by only one day? For example, suppose the financing commitment documents were supposed to be signed on December 18, but an airline strike prevented the documents being executed until th 19th or even 20th or 21st. Would the agreement have terminated for failure to satisfy 10.2(3)? Possibly the answer is "yes." On the other hand, a court may conclude that the parties did not intend termination in such event. (Force majeure may also apply to the supposition set forth).

It is not possible to say with absolute certainty what "circumstances" if any, might lead a court to conclude that, (notwithstanding the language of article 10.2,) the agreement did not terminate even though the Buyer did not comply with all the benchmarks. In the light of the contract language and supporting extrinsic evidence, we conclude a court would find failure to comply with the benchmark requirements would be "material and substantial" failure in all but the most extreme cases.

IV. Delivery of Royalty Oil Prior to Completion of the Petrochemical Facility (Article 2.2)

Prior to amendment, article 2.2 of the agreement did not require the passage of any particular period of time before Buyer would be entitled to receive royalty oil from Prudhoe Bay. Rather, article 2.2 required the occurrence of a particular event; that event being, that Buyer "obtain or cause contractually bound third parties to obtain written commitments to lend or invest at least one billion five hundred million [dollars] in the aggregate for payment of Total Project Costs." The extrinsic evidence indicates both Buyer and Seller expected it would take Buyer about 18 months to obtain these commitments, but that each understood

that if Buyer obtained the financial commitment and furnished satisfactory evidence thereof, even one day after the Effective Date, then Buyer would have a right immediately to call for the initiation of deliveries. (See e.g: Questions of Representative Chatterton and Replies by O. Charles Honig in Transcript of Testimony before the Special Committee on Royalty Oil and Gas, March 18, 1978, at pp 7, #10.)

In May, 1978, after the agreement had been presented to the Legislature; hearings were held, and the House voted against approval of the agreement, Alpetco and the Commissioner of Natural Resources entered into certain amendments to the original agreement. One of these amendments modified the original article 2.2 in two ways.

First, the amendment provided that Buyer may not receive royalty oil until at least 25 months after the effective date of the agreement. In effect, the amendment adopted the 18-month period the parties expected it would take Buyer to obtain the financial commitments and made it the minimum time period which must elapse before Buyer may initiate its call for deliveries.[2] It does not, however, grant Buyer an automatic right to receive delivery of royalty oil 25 months after the effective date because the amendment does not change the basic requirement of article 2.2 that Buyer obtain a total of 1.5 billion dollars in commitments before Buyer has a right to receive any royalty oil.

Second, under the amendment to article 2.2, Buyer is not entitled to receive royalty oil until Buyer "has actually expended $100 million in Total Project Costs." This requirement is similar to, but more stringent than, the requirement of article 10.2(4)(a) which states that by the 24th month of the agreement, Buyer must "expend or commit to

---

2/ The 25-month period is arrived at as follows: 18-month period to obtain financing, plus 6-month notice required to change from in-value to in-kind, plus 1 month allowed in the Agreement from time Buyer gives Seller notice, to time Seller must give the lessors notice.

expend or cause contractually bound third parties to expend or commit to expend at least one Hundred Million Dollars in Total Project Costs."

Considering both the original language of article 2.2 and the amendment thereto, three distinct possibilities exist. The first case is where Buyer does not obtain the written financial commitments required by 10.2(3) on or before December 18, 1979, and the agreement is terminated. This case is easy to analyze. Buyer has no right to receive royalty oil because it did not satisfy the requirements of article 2.2 and furthermore, Buyer never will have such right because the agreement is terminated. The second case is where Buyer does not obtain the required financing commitments, but the agreement is extended and during the extension period Buyer obtains the financing commitment. This situation is complicated and not fully addressed by the language of the agreement. Our analysis and conclusion is presented below. The third case is where Buyer does obtain the required financing commitment on (or before) December 18, 1979. This situation should be simple, but the amendment to article 2.2 introduces a complication. Our analysis of this situation follows:

A. Buyer Obtains a Financial Commitment by December 18

Under article 2.2, prior to amendment, Buyer would simply have given notice to Seller who would then give notice to the lessees to deliver royalty in-kind and Buyer would begin purchasing royalty oil 6 months after Seller's notice is delivered by the lessees. However, the amendment complicates this approach. First, under the amendment, Buyer may not receive oil until 25 months after the effective date. This creates a small but easily solved problem. Seller, after receiving notice from Buyer, may either wait the full 30 days permitted under the agreement before giving notice to the lessees, or give notice promptly but make it a 7-month notice. In that way, it will be 25 months after the Effective Date of the agreement before oil is actually received by Buyer.

The second problem is more complicated. Under the amendment, Buyer may not receive the royalty until it has actually expended $100 million. But in order for Buyer to be able to receive royalty oil after the 25th month, Seller must give the lessees notice of taking royalty oil in-kind at least 6 months earlier. The problem, of course, is what happens if Seller gives notice to the lessees to deliver royalty in-kind and Buyer has not satisfied the expenditure requirement by the 25th month?

The problem would not exist, if the amendment to article 2.2 is read to say that Buyer may not ask Seller to give notice to the lessees until Buyer has expended $100 million. Such a reading would mean that Buyer would not receive oil until 6 months after Buyer had expended $100 million. This is contrary to the language of the amendment and also we believe contrary to the expectations of the parties. As best we can discern from the extrinsic evidence, it seems to be that the expectations were that Buyer would obtain financing by the 18th month, Seller would give notice, Buyer would expend $100 million by the 24th month and Buyer would receive royalty oil in the 25th month. We have found no indication in the extrinsic evidence that the difficult position in which Seller is placed was perceived by either Buyer or Seller, or by the Legislature. Additionally, it must be noted that although the Seller is placed in a difficult position, Seller is not without alternatives to protect itself. We conclude that the Seller has an obligation to be prepared to deliver oil to Buyer at the 25th month if Buyer has obtained the financing commitments by the 18th month and expended $100 million by the 25th month. In practical terms, what this means is that if the Buyer does obtain the financing commitment by December 18, 1978, Seller should give notice to the lessees if requested to do so by Buyer unless there is clear evidence that Buyer will not be able to expend $100 million by the 25th month.[3/]

If at the 25th month, Buyer has not satisfied the $100 million expenditure requirement, the Seller can either

---

3/ Seller should ask Buyer to explain its plans for actually expended $100 million by the 25th month. If Buyer does not make a reasonable showing that it will make such expenditures, we believe Seller would not be obliged to give notice to the lessees until such time as Buyer demonstrates a reasonable expectation of meeting the $100 million expenditure requirement.

waive (perhaps)4/ the requirement, sell the oil to Buyer under a separate short-term contract approved by the Royalty Board or sell the oil to another party for a short term until Buyer does satisfy the requirement. None of these options may be particularly desireable but all are permissible under state law. Indeed, if recent past experience is any indication, the major producers may be eager to purchase State royalty oil if Buyer does not have the right to do so under the agreement.

B. The Agreement is Extended

The problem of meshing the Seller's obligations to give notice to the lessees' and Buyer's right to receive royalty oil is readily solved in the situation where Buyer requests an extension of time. Since the Commissioner of Natural Resources has discretion to extend or not extend the agreement, we conclude he may attach conditions to an extension which conditions must be accepted by Buyer if Buyer accepts the extension. We have not undertaken a

---

4/ A significant caveat must be noted to the statement that the Commissioner can waive the expenditure requirement. It is not possible to say with certainty whether or not the Commissioner of Natural Resources has the legal power to waive a condition of the Agreement. As noted by a leading legal commentator, the concept of "waiver" of a contract condition or promise has been confused greatly by the courts. It has no single meaning or application. See In re Oleg Cassini v. Courture Coordinates, 207 F.Supp. 821 (S.D.N.Y. 1969) and Hing Bo Gum v. Nakamura, 549 P2d 471 (Ha. 1976) The courts hve noted that a condition precedent in a contract solely for the benefit of one party can be waived by that party. Whether a waiver has occurred could depend on how it is granted and whether or not the Buyer relied upon the waiver. However, here the matter is even more complicated because "amendments" to the Agreement must be approved by the Royalty Board and Legislature but waivers need not be. Compare article 17 with article 22 of the Agreement. It is possible that an attempted waiver might later be found by a court to be an "amendment" which failed because of lack of Royalty Board and Legislative approvals.

We have not undertaken an analysis of the difference between amendments and waivers and the Commissioner's authority to waive contract conditions and/or promises. This seems beyond the scope of this memorandum, particularly where alternative courses of action are available and involve far less uncertainty.

Sen. Sackett

LAW OFFICES OF
PRESTON, THORGRIMSON, ELLIS & HOLMAN
SUITE 404
420 L STREET
ANCHORAGE, ALASKA 99501
AREA CODE 907-276-1969

FREDERICK H. BONESS
JOHN R. MESSENGER

2000 IBM BUILDING
SEATTLE, WASHINGTON 98101
206-623-7580
TELEX THOR-SEA

SUITE 500
1776 G STREET N.W.
WASHINGTON, D.C. 20006
202-628-1700
TELECOPY 202-331-1024

February 21, 1980

Robert E. LeResche
Commissioner
Department of Natural Resources
Pouch "M"
Juneau, Alaska 99811

Dear Bob:

Enclosed is a written analysis of the financial items submitted by Alpetco in satisfaction of its obligations under the Royalty Crude Oil Contract of February 22, 1978. This analysis commits to writing basically the same comments I offered you following our meetings with representatives of Alpetco, its advisers and partners. Although I note in the enclosed analysis that legal opinions may differ on the question of whether Alpetco has complied, I still conclude, as I earlier did, that your approval of Alpetco's submission would be sustained in court if challenged by a third party.

Since the Governor's decision that Alpetco had satisfied its obligations under Article 10.2(3), and the convening of the legislature, I have seen in newspaper articles and heard in conversations other people's analyses of Alpetco's performance. Some of these comments have been accurate, and indeed, have focussed on the most difficult to judge aspects of the Alpetco submission. Other comments have been so inaccurate that I am mystified about their genesis. I have not attempted to respond directly to these public and private comments in this memorandum because I do not wish the accompanying analysis to be read as an "after-the-fact" defense or rebuttal of the Governor's decision. On the other hand, it must be noted the memorandum does address many (but not all) of the question's being asked and issues being raised at the present time. This is to be expected since the common understanding shared by legislators (and their staffs) and you (and other Administration officials) about the intent of the Alpetco Agreement is, in part, the basis for measuring the adequacy of Alpetco's

compliance with the Agreement of February 22, 1978. For those questions now being raised and not addressed in this memorandum, I would be happy to provide you with comments on the issues to the extent I can in any form or manner you wish.

Sincerely,

PRESTON, THORGRIMSON,
ELLIS & HOLMAN

By
Frederick H. Boness

FHB/sas

Enclosure

LAW OFFICES
PRESTON, THORGRIMSON, ELLIS & HOLMAN
420 L STREET · SUITE 404
ANCHORAGE, ALASKA 99501
(907) 276-1969

MEMORANDUM

To: Robert E. LeResche,
Commissioner
Department of Natural Resources

From: Frederick H. Boness FB

Date: February 21, 1980

Introduction

This memorandum contains a review of the documents submitted by Alpetco on December 13, 26, and thereafter, in satisfaction of the requirements of Article 10.2(3)(d) and (e). As I indicated to you in an earlier memorandum, the "commitment" concept embodied in the benchmark requirement is not defined precisely. It is subject to more than one legal interpretation and the extrinsic evidence available from the record of negotiations and approval of the Agreement by the legislature which can be brought to bear on the matter is, at times, ambiguous. Because the benchmark requirements are subject to more than one interpretation, there is no single set of criteria by which to measure the Alpetco submission. There exist a range of interpretations starting with the most "stringent" and progessing to the most "lenient" interpretation of what is required under the benchmarks. Within that range of interpretation, honest legal opinions may differ, and advocates of opposing points of view will certainly differ. In this memorandum, I have attempted to identify reasons why you might conclude Alpetco has not complied with the benchmark and also those reasons why you might reach the opposite conclusion. The final decision is not easy because the material submitted by Alpetco is neither so persuasive as to demonstrate compliance under even the most stringent interpretation nor so inadequate as to demonstrate noncompliance under all circumstances.

The $1.5 billion Commitment
(Article 10.2(3)(d))

Simplifying somewhat, there are basically two extreme interpretations of the February 22, 1978 Agreement. The first interpretation is that the financial commitment

required by the Agreement must be a contractually binding commitment - which the lenders may not avoid or disaffirm except for limited, specified reasons expressly stated in the commitment; essentially, commitments which assure Alpetco (and the State) that the lenders will deliver funds under all but the most extreme and unexpected circumstances. Such a commitment would assure Alpetco that it will have the funds needed to go forward. Additionally, the thorough review conducted by the lenders before they assume the risk of paying damages, provides additional assurances for others that the Alpetco project is viable and will result in construction of a petrochemical facility in Alaska. The record of negotiations and testimony before the legislature supports implicitly the conclusion that some State officials (and somewhat ambiguously, also some Alpetco representatives) intended that the commitments received by Alpetco would contain such assurances. The record also indicates that both parties recognized that there would be certain "subject to's" in the lender's commitment which, if not satisfied, would result in the final loan not being made. However, the record is not very clear or explicit as to each parties' expectations about the number or breadth of these caveats.

The opposite extreme interpretation of the meaning of the "financing commitment" benchmark is that Alpetco is required to produce statements of commitment from parties who are capable of providing the required $1.5 billion of financing, and that such commitments must be of the same nature and quality as the industry practice generally for projects for which the final loan closing papers are not to be signed for one year into the future. There is some support for this interpretation in the language of the Agreement itself. For example, Article 10.2(5) states that execution of "definitive loan documents relating to the long-term loan of funds" need not occur until the 30-month benchmark. The 12-month time period between the commitment and execution of definitive loan agreements is considerable, and it has been suggested by Alpetco, indicates that the commitment need not be complete or specific with respect to the terms of the ultimate loan. Elsewhere in the expenditure benchmark, there is a specific reference to "contractually bound commitments." It might be argued that when the parties meant contractually binding commitments, they used

express language to that effect and that by not using such language in the financing benchmark, the parties contemplated less than a contractually binding commitment.

As a matter of legal analysis, I believe there is sufficient ambiguity in the record that I would not absolutely rule out a court finding in favor of either extreme interpretation. However, I do believe the evidence in support of the second position to be decidedly weaker than that in support of the first. *

While it might be desirable to focus on each requirement individually and narrowly, I believe it necessary to point out that a correct legal analysis must account for all the relevant facts. To illustrate, let us suppose Alpetco had submitted not a commitment, but a final, signed loan agreement; but that agreement was from a lender who lacked the wherewithal to loan the funds. Surely, if taken narrowly and literally, Alpetco could claim to have satisfied the commitment requirement, yet no reasonable person would feel bound by such gimmickery. Turning the illustration around, I believe it relevant to look at the parties involved in evaluating the commitment both as a practical, business decision (which is probably obvious) and also as a legal matter (which may be less obvious). In the discussion which follows, I have analyzed, individually, each of the three elements of the Alpetco financing plan. These are: 1) a commitment for $600 million of tax exempt financing; 2) a commitment for equity in the amount of $350 million; and 3) a commitment from Thyssen to arrange for an additional $750 million of financing.

The Bonding Commitment

In partial satisfaction of its requirement to secure $1.5 billion of long-term financing, Alpetco has obtained a commitment for $600 million in tax exempt bond financing. The bonding commitment consists of the commitments of the City of Valdez to issue the bonds, and E.F. Hutton to purchase the bonds. According to information submitted by Alpetco, the City of Valdez has passed an ordinance and resolution authorizing the City to commit to issuance of the bonds. In an undated (November) letter, Mayor Bill Walker confirmed the City's commitment to loan or

otherwise provide up to $600,000,000 from the sale of the City's economic development bonds.

Although we are not rendering opinion of bond counsel, it would appear the actions of the City are all correct and proper for the City to issue bonds and lend the proceeds thereof to Alpetco. Earlier we suggested to you our thought that AS 37.10.085 might pose a bar to the City's action. However, the City's bond counsel addressed this question by letter of December 13, 1979 to Mark Lewis expressing his opinion that AS 37.10.085 does not prohibit the City from issuing such bonds. This letter, we believe, ensures that AS 37.10.085 will not later be a bar to issuance of the bonds.

The City's commitment, we believe, probably is not a contractually binding commitment in the sense that Alpetco could sue the City for damages if the City failed to issue the bonds.* On the other hand, short of actually issuing the bonds and lending the money, it is difficult to see what additional steps the City could take to improve the quality of its commitment. That being so, it might be argued that the funds committed by the City should not be counted in partial satisfaction of Alpetco's obligation to obtain $1.5 billion of loans and equity. However, to exclude such funds would be contrary to the intentions of the parties. The fact that some of the funds would be obtained from tax exempt financing was acknowledged and discussed by both parties and is expressly included in the definition of Total Project Costs (Article 1.13).

---

* A plausible legal argument can be made that the City is, in fact, bound by its commitment; especially since the City is only a conduit for the funds and is not itself at risk. However, as a practical matter, even if the argument is meritorious it is of little benefit as prospective purchasers of the bonds are not likely to buy them if the issuing authority is denying their validity in court.

There are two additional matters which must be evaluated in reviewing the bonding commitment. First, the commitment must be applicable to facilities which qualify for tax-exempt financing under Section 103 of the IRS Code. A memorandum submitted by Alpetco describes the applicable facilities and associated amounts as:

1)	Docks & Wharves	$302,500,000
2)	Pollution Control & Sewage and Solid Waste Disposal	$122,000,000
3)	Local Furnishing of Electric Energy	$ 83,000,000
4)	Industrial Park	$ 87,000,000

Without additional information, especially with respect to local furnishing of electricity and the proposed industrial park, it is not possible to determine if all of the proposed facilities will qualify for tax-exempt status. Similarly, without detailed cost estimates it is not possible to determine whether the amounts assumed for these facilities are too high or too low. By comparison with other large industrial projects, we can make the general statement that the amounts do not seem unreasonable. If a concerted effort is made to maximize tax-exempt financing, the items proposed should be in large part achievable.

The second consideration relevant to the bonding commitment is the commitment made by E.F. Hutton. The Hutton commitment is contained in a November 19, 1979 letter and "reaffirmed and revised" in a December 21, 1979 letter. In the first letter, Hutton "confirms its commitment" and in the second it "reaffirms" its commitment "to purchase" bonds from the City. In neither case does Hutton expressly and directly "commit to purchase." It is arguable that Hutton has not committed to purchase because of the ambiguity of the language used. Such argument, however, seems rather technical. It should also be noted that Hutton's commitment is subject to a variety of conditions. Three of these conditions relate to opinions of counsel. These are standard conditions and while we initially raised a question concerning AS 37.10.085, bond counsel for both the City and Hutton have addressed this question satisfactorily.

The requirements concerning delivery of documents also are standard and reasonable, and we believe should not be interpreted as diminishing the Hutton commitment. Likewise, the provisions contained in the penultimate paragraph of the December 21, 1979 letter allowing cancellation of the commitment for specified grounds are reasonable and standard for a commitment letter.

The troublesome aspects of the E.F. Hutton commitment are found in 1) the reservation that Hutton's commitment is subject to receipt from Standard & Poor's of a rating on the bonds sufficient to enable E.F. Hutton to market bonds containing terms substantially as set forth in Exhibit "A", and 2) the requirement that at some future time, Alpetco must agree to "maturity schedules, interest rates, and other terms which are commercially reasonable . . ."

Exhibit "A" contains some general information related to the bonds including coupon denominations and maturity dates, but does not contain agreement on an interest rate or a ceiling rate under which the final interest rate must fall. Failure to specify the interest rate allows considerable latitude to E.F. Hutton to escape its commitment by demanding Alpetco agree to an interest rate too high for Alpetco to accept. It also raises a question whether the commitment is enforceable against Hutton. Most courts are likely to conclude that without specification of an interest rate, the commitment is too indefinate to be binding. See Williston on Contracts, §45 (Jaeger Ed.) On the other hand, the Hutton commitment might be construed to obtain obligations of "good faith" and commercial reasonableness. Cf. Draper, "Tight Money and Possible Substantive Defenses to Enforcement of Future Mortgage Commitments," 50 Notre Dame Lawyer 603 (1975). If such provisions are read into the commitment, the commitment could be construed as enforceable and binding on Hutton.

Judging the Hutton commitment requires attention to the most uncertain aspect of the Agreement of February 22, 1978; namely, the distinction between "commitment" and "definitive documents." It is extremely unlikely an underwriter would bind itself to purchase bonds an entire year in advance of the purchase date. That being so, it is not

surprising that Hutton appears not to have done so. Since the Agreement does not require Alpetco to obtain "definitive documents" until the 30th month, probably the better conclusion is that the commitment required at the 18-month benchmark, in order to be compatible with the 30-month obligation, need not bind the underwriter a year in advance of purchase.

The Equity Commitments

Three hundred and fifty million dollars of the $1.5 billion commitment required under the Agreement is in the form of an equity commitment to the project by the project sponsors. Specifically, Charter Oil (Alaska) has committed $245 million, Alaska Petrochemical Co., $81.9 million, and E.F. Hutton (Alaska) Inc., $23.1 million. In the case of Charter and Hutton, the commitments of the subsidiary corporation are backed up by the parent corporation; and in the case of Alaska Petrochemical Company, the commitment is backed by the commitment of shareholders, Alaska Interstate and Seatrain Lines, Inc. This backing is important because the first line companies are only paper companies; however, the commitments of the parents insures the assets needed to make the commitment meaningful are available.

The commitment letters addressed to "The Alpetco Company" are substantially the same from each company. The operative language is found in the third and fourth paragraphs of the letter. Each joint venturer makes its commitment in consideration of the other joint venturer making a similar commitment. Such commitment is subject to final approval by the joint venturer of the definitive documents relative to the long-term loan of funds and to final execution of those documents. The last paragraph notes that the commitment "is made solely for the purpose of assisting Alpetco in satisfying . . . Article 10.2c(3)(d)" (Sic).

The most significant reason why it might be concluded that these letters do not constitute the commitments required by the Agreement is that the commitment is subject to approval of the final loan documents by the company making the commitment. If the company does not grant approval - which is solely in its power to do or not do -

then the equity commitment never becomes an enforceable obligation against the company making the commitment (i.e. Charter, Alaska Interstate, Seatrain, and E.F. Hutton never have an obligation to the Alpetco Company).

There are also reasons for concluding that the equity letters do constitute the required commitment. For example, it is quite possible that all that is intended by making the commitment subject to that committing company's approval is that it may avoid its commitment if the long-term loan is commercially unreasonable. Or turning the matter around, the committing company must approve the definitive documents and must not thwart the signing of those documents, if the documents are reasonable. In effect, the committing company must act in good faith. A court may well read the commitment letter in this fashion. Nevertheless, some of the uncertainty could be eliminated if the reasonableness requirement had been expressly incorporated into the commitment letter.

The Thyssen Commitment

The Thyssen commitment is contained in a December 7, 1979 letter and December 21, 1979 telex which elaborates upon that letter. By these letters, Thyssen "commit[s] to arrange financing of up to U.S. $750 million." This commitment is subject to 1) Alpetco obtaining another $750 million, 2) final loan documents, and 3) Alpetco achieving the right to receive royalty oil on July 18, 1980. The Thyssen commitment is premised upon an engineering and construction contract between Thyssen, Foster-Wheeler, and Alpetco under which Thyssen agrees to develop a fixed price construction contract and provide a guarantee for completion of the facility. In its telex of December 21, 1979, Thyssen states that there is "a binding commitment on [its] part for the project to the extent and subject to the conditions expressed" in its December 7, 1979 letter. The telex also notes that Thyssen has been involved in other major projects around the world and that the commitment advanced by Thyssen to Alpetco is "substantially stronger than would usually be expected at this stage of the project."

The Thyssen letter can be read on its own to constitute a binding contract on Thyssen to arrange the

financing* for the project subject to certain conditions. This conclusion is bolstered by Thyssen's telex which describes its letter as a binding commitment. It should be noted the "subject to's" in the Thyssen commitment are objective facts outside the control of Thyssen but within the control of Alpetco.

On the other hand, it is possible to argue the Thyssen commitment is insufficient. There are two reasons why this might be so. First, the commitment lacks specificity with respect to relevant financing conditions other than amount. There is no rate of interest, payment schedule, or security terms among others. There is, therefore, considerable leeway for Thyssen to satisfy its commitment in a manner which is unreasonable or unacceptable to Alpetco. This lack of specificity most likely would result in a court concluding the commitment is not enforceable against Thyssen.** Second, Thyssen could avoid its commitment by presenting to Alpetco a fixed price which makes the project economically infeasible.

Interim Financing

As noted in my earlier memorandum to you, the interim financing benchmark is integrally related to the long-term financing commitment. In a conventional financing, in most cases, interim financing falls into place readily once the long-term financing is arranged. With project financing interim financing may pose greater difficulty,

---

* I believe that a commitment "to arrange" is satisfaction of Alpetco's requirement "to obtain" if the commitment is otherwise adequate. It is not surprising to find a lead company willing to take on the obligation to come up with the financing without knowing a year in advance exactly who will provide the funds.

** It is, however, possible a court would conclude that an agreement exists and the terms must be reasonable.

because the risk that the long-term lenders may renege is perhaps greater the magnitude of the interim financing as a proportion of the project is larger. I believe the interim financing is included as a separate benchmark principally because of the proposed "project financing" approach.

Turning to Alpetco's submission, Alpetco initially submitted letters from Chemical Bank and Manufacturers Hanover Trust Company and a memorandum from Kutak, Rock & Huie in satisfaction of the interim financing commitment. The bank letters contain so many conditions which allow the banks to escape the "commitment", one must wonder why Alpetco even submitted them. They amount to nothing more than expressions of interest. On the other hand, the Kutak, Rock & Huie memorandum indicates that the need for interim financing may be minimal because of the possibility of using bond proceeds during construction. Subsequently, Alpetco obtained from Thyssen a letter commiting Thyssen "to arrange interim financing" for up to $150,000,000 if the banks do not provide the funds. The Thyssen commitment is in substantially the same form as the Thyssen equity commitment, and therefore, is of the same quality as that commitment. The strengths and weaknesses of that commitment are therefore essentially the same as those discussed under the equity commitment section.

Conclusion

Because the final arbiter of what a contract means is the court, I have attempted to approach the question of compliance or noncompliance; not in terms of what I think or what others might think, but in terms of what is the probability that an Alaskan court will sustain a particular action. This approach requires an evaluation of both the strengths and weaknesses of each particular decision. It also requires judgment about probabilities, not absolute statements. Using this approach, it is my conclusion that Alpetco has complied with the benchmark requirements, at least if those requirements are interpreted in a light most favorable to Alpetco; and that your approval of Alpetco's submission would be sustained in court if challenged by a third party. I reach this conclusion principally because I believe there is sufficient evidence in the record to support the conclusion that the obligations imposed upon

Alpetco do not require Alpetco to obtain binding, legal commitments, enforceable in a court of law. Less compelling, but a subsidiary basis for this conclusion, I also believe there is a reasonable legal basis for concluding that the commitments are in fact binding financial commitments.

LAZARD FRÈRES & CO.
ONE ROCKEFELLER PLAZA
NEW YORK, N.Y. 10020

CABLE ADDRESS "LAZARD NEW YORK"
TELEPHONE (212) 489-6600

NEW YORK

March 20, 1980

Dr. Robert E. LeResche
Commissioner
Department of Natural Resources
State of Alaska
Pouch "M"
Juneau, Alaska

Dear Commissioner LeResche:

You have asked me to write down the salient points of my several discussions with you of last December regarding the Alpetco project, and specifically how we viewed the documentation and representations made to you by Alpetco, E. F. Hutton Group and Thyssen Rheinstahl Technik in light of the benchmark requirement outlined in Article 10.2(3)(d) of the Agreement for the Sale and Purchase of State Royalty Oil dated February 22, 1978.

At that time we reviewed letters dated December 7, 1979 and December 18, 1979 from Thyssen Rheinstahl Technik to The Alpetco Company, letters dated November 19, 1979 and December 21, 1979 from The E. F. Hutton Group to The Honorable Bill Walker, Mayor, City of Valdez, and letters dated December 13, 1979 to The Alpetco Company from Charter Oil (Alaska), Inc., The Charter Company, Alaska Petrochemical Company, Alaska Interstate Company, Seatrain Lines, Inc., E. F. Hutton (Alaska), Inc. and E. F. Hutton Group, Inc.

It was our opinion at that time that the letters referred to above, taken as a whole, could be considered to be a reasonable financial commitment under the special circumstances of this project.

The special circumstances to which we referred were (a) the size of the project, (b) the additional engineering work which would have to be completed prior to irrevocable commitments from long term lenders, and (c) that major construction on the project itself would not commence for one year.

In addition, we took into consideration

- -- the financial strength and reputation of Thyssen, as well as the experience and reputation of the E. F. Hutton Group, Inc.
- -- statements by the Chairman of the Thyssen Board, Dr. Gshwend, in Seattle on December 13, 1979, attesting

to the assumption by Thyssen of responsibility to complete the financing package;

-- statements made by representatives of the sponsors and senior officials of Thyssen that engineering studies which will require an estimated $25 million to complete have been commenced;

-- acceptance of the requirement that the sponsors must spend $100 million before the State will deliver any royalty oil.

We offered no opinion as to whether or not the statements of Thyssen, the sponsors and the E. F. Hutton Group constitute a binding legal commitment. We did understand that you had discussions with counsel on this matter. From the point of view of a member of the financial community, however, we believed that these oral and written statements were, in a practical sense, as firm as could realistically have been anticipated at the time.

Very truly yours,

Peter A. Lewis

PAL:g

LAW OFFICES OF
PRESTON, THORGRIMSON, ELLIS & HOLMAN
SUITE 404
420 L STREET
ANCHORAGE, ALASKA 99501
AREA CODE 907-276-1969

FREDERICK H. BONESS
JOHN R. MESSENGER

2000 IBM BUILDING
SEATTLE, WASHINGTON 98101
206-623-7580
TELEX THOR-SEA

SUITE 500
1776 G STREET N.W.
WASHINGTON, D.C. 20006
202-628-1700
TELECOPY 202-331-1024

February 21, 1980

Robert E. LeResche
Commissioner
Department of Natural Resources
Pouch "M"
Juneau, Alaska 99811

Dear Bob:

Enclosed is a written analysis of the financial items submitted by Alpetco in satisfaction of its obligations under the Royalty Crude Oil Contract of February 22, 1978. This analysis commits to writing basically the same comments I offered you following our meetings with representatives of Alpetco, its advisers and partners. Although I note in the enclosed analysis that legal opinions may differ on the question of whether Alpetco has complied, I still conclude, as I earlier did, that your approval of Alpetco's submission would be sustained in court if challenged by a third party.

Since the Governor's decision that Alpetco had satisfied its obligations under Article 10.2(3), and the convening of the legislature, I have seen in newspaper articles and heard in conversations other people's analyses of Alpetco's performance. Some of these comments have been accurate, and indeed, have focussed on the most difficult to judge aspects of the Alpetco submission. Other comments have been so inaccurate that I am mystified about their genesis. I have not attempted to respond directly to these public and private comments in this memorandum because I do not wish the accompanying analysis to be read as an "after-the-fact" defense or rebuttal of the Governor's decision. On the other hand, it must be noted the memorandum does address many (but not all) of the question's being asked and issues being raised at the present time. This is to be expected since the common understanding shared by legislators (and their staffs) and you (and other Administration officials) about the intent of the Alpetco Agreement is, in part, the basis for measuring the adequacy of Alpetco's

compliance with the Agreement of February 22, 1978. For those questions now being raised and not addressed in this memorandum, I would be happy to provide you with comments on the issues to the extent I can in any form or manner you wish.

Sincerely,

PRESTON, THORGRIMSON,
ELLIS & HOLMAN

By
Frederick H. Boness

FHB/sas

Enclosure

LAW OFFICES
PRESTON, THORGRIMSON, ELLIS & HOLMAN
420 L STREET · SUITE 404
ANCHORAGE, ALASKA 99501
(907) 276-1969

MEMORANDUM

To: Robert E. LeResche,
Commissioner
Department of Natural Resources

From: Frederick H. Boness FB

Date: February 21, 1980

Introduction

This memorandum contains a review of the documents submitted by Alpetco on December 13, 26, and thereafter, in satisfaction of the requirements of Article 10.2(3)(d) and (e). As I indicated to you in an earlier memorandum, the "commitment" concept embodied in the benchmark requirement is not defined precisely. It is subject to more than one legal interpretation and the extrinsic evidence available from the record of negotiations and approval of the Agreement by the legislature which can be brought to bear on the matter is, at times, ambiguous. Because the benchmark requirements are subject to more than one interpretation, there is no single set of criteria by which to measure the Alpetco submission. There exist a range of interpretations starting with the most "stringent" and progessing to the most "lenient" interpretation of what is required under the benchmarks. Within that range of interpretation, honest legal opinions may differ, and advocates of opposing points of view will certainly differ. In this memorandum, I have attempted to identify reasons why you might conclude Alpetco has not complied with the benchmark and also those reasons why you might reach the opposite conclusion. The final decision is not easy because the material submitted by Alpetco is neither so persuasive as to demonstrate compliance under even the most stringent interpretation nor so inadequate as to demonstrate noncompliance under all circumstances.

The $1.5 billion Commitment (Article 10.2(3)(d))

Simplifying somewhat, there are basically two extreme interpretations of the February 22, 1978 Agreement. The first interpretation is that the financial commitment

---

required by the Agreement must be a contractually binding commitment - which the lenders may not avoid or disaffirm except for limited, specified reasons expressly stated in the commitment; essentially, commitments which assure Alpetco (and the State) that the lenders will deliver funds under all but the most extreme and unexpected circumstances. Such a commitment would assure Alpetco that it will have the funds needed to go forward. Additionally, the thorough review conducted by the lenders before they assume the risk of paying damages, provides additional assurances for others that the Alpetco project is viable and will result in construction of a petrochemical facility in Alaska. The record of negotiations and testimony before the legislature supports implicitly the conclusion that some State officials (and somewhat ambiguously, also some Alpetco representatives) intended that the commitments received by Alpetco would contain such assurances. The record also indicates that both parties recognized that there would be certain "subject to's" in the lender's commitment which, if not satisfied, would result in the final loan not being made. However, the record is not very clear or explicit as to each parties' expectations about the number or breadth of these caveats.

The opposite extreme interpretation of the meaning of the "financing commitment" benchmark is that Alpetco is required to produce statements of commitment from parties who are capable of providing the required $1.5 billion of financing, and that such commitments must be of the same nature and quality as the industry practice generally for projects for which the final loan closing papers are not to be signed for one year into the future. There is some support for this interpretation in the language of the Agreement itself. For example, Article 10.2(5) states that execution of "definitive loan documents relating to the long-term loan of funds" need not occur until the 30-month benchmark. The 12-month time period between the commitment and execution of definitive loan agreements is considerable, and it has been suggested by Alpetco, indicates that the commitment need not be complete or specific with respect to the terms of the ultimate loan. Elsewhere in the expenditure benchmark, there is a specific reference to "contractually bound commitments." It might be argued that when the parties meant contractually binding commitments, they used

express language to that effect and that by not using such language in the financing benchmark, the parties contemplated less than a contractually binding commitment.

As a matter of legal analysis, I believe there is sufficient ambiguity in the record that I would not absolutely rule out a court finding in favor of either extreme interpretation. However, I do believe the evidence in support of the second position to be decidedly weaker than that in support of the first.

While it might be desirable to focus on each requirement individually and narrowly, I believe it necessary to point out that a correct legal analysis must account for all the relevant facts. To illustrate, let us suppose Alpetco had submitted not a commitment, but a final, signed loan agreement; but that agreement was from a lender who lacked the wherewithal to loan the funds. Surely, if taken narrowly and literally, Alpetco could claim to have satisfied the commitment requirement, yet no reasonable person would feel bound by such gimmickery. Turning the illustration around, I believe it relevant to look at the parties involved in evaluating the commitment both as a practical, business decision (which is probably obvious) and also as a legal matter (which may be less obvious). In the discussion which follows, I have analyzed, individually, each of the three elements of the Alpetco financing plan. These are: 1) a commitment for $600 million of tax exempt financing; 2) a commitment for equity in the amount of $350 million; and 3) a commitment from Thyssen to arrange for an additional $750 million of financing.

The Bonding Commitment

In partial satisfaction of its requirement to secure $1.5 billion of long-term financing, Alpetco has obtained a commitment for $600 million in tax exempt bond financing. The bonding commitment consists of the commitments of the City of Valdez to issue the bonds, and E.F. Hutton to purchase the bonds. According to information submitted by Alpetco, the City of Valdez has passed an ordinance and resolution authorizing the City to commit to issuance of the bonds. In an undated (November) letter, Mayor Bill Walker confirmed the City's commitment to loan or

otherwise provide up to $600,000,000 from the sale of the City's economic development bonds.

Although we are not rendering opinion of bond counsel, it would appear the actions of the City are all correct and proper for the City to issue bonds and lend the proceeds thereof to Alpetco. Earlier we suggested to you our thought that AS 37.10.085 might pose a bar to the City's action. However, the City's bond counsel addressed this question by letter of December 13, 1979 to Mark Lewis expressing his opinion that AS 37.10.085 does not prohibit the City from issuing such bonds. This letter, we believe, ensures that AS 37.10.085 will not later be a bar to issuance of the bonds.

The City's commitment, we believe, probably is not a contractually binding commitment in the sense that Alpetco could sue the City for damages if the City failed to issue the bonds.* On the other hand, short of actually issuing the bonds and lending the money, it is difficult to see what additional steps the City could take to improve the quality of its commitment. That being so, it might be argued that the funds committed by the City should not be counted in partial satisfaction of Alpetco's obligation to obtain $1.5 billion of loans and equity. However, to exclude such funds would be contrary to the intentions of the parties. The fact that some of the funds would be obtained from tax exempt financing was acknowledged and discussed by both parties and is expressly included in the definition of Total Project Costs (Article 1.13).

---

* A plausible legal argument can be made that the City is, in fact, bound by its commitment; especially since the City is only a conduit for the funds and is not itself at risk. However, as a practical matter, even if the argument is meritorious it is of little benefit as prospective purchasers of the bonds are not likely to buy them if the issuing authority is denying their validity in court.

There are two additional matters which must be evaluated in reviewing the bonding commitment. First, the commitment must be applicable to facilities which qualify for tax-exempt financing under Section 103 of the IRS Code. A memorandum submitted by Alpetco describes the applicable facilities and associated amounts as:

1)	Docks & Wharves	$302,500,000
2)	Pollution Control & Sewage and Solid Waste Disposal	$122,000,000
3)	Local Furnishing of Electric Energy	$ 83,000,000
4)	Industrial Park	$ 87,000,000

Without additional information, especially with respect to local furnishing of electricity and the proposed industrial park, it is not possible to determine if all of the proposed facilities will qualify for tax exempt status. Similarly, without detailed cost estimates it is not possible to determine whether the amounts assumed for these facilities are too high or too low. By comparison with other large industrial projects, we can make the general statement that the amounts do not seem unreasonable. If a concerted effort is made to maximize tax-exempt financing, the items proposed should be in large part achievable.

The second consideration relevant to the bonding commitment is the commitment made by E.F. Hutton. The Hutton commitment is contained in a November 19, 1979 letter and "reaffirmed and revised" in a December 21, 1979 letter. In the first letter, Hutton "confirms its commitment" and in the second it "reaffirms" its commitment "to purchase" bonds from the City. In neither case does Hutton expressly and directly "commit to purchase." It is arguable that Hutton has not committed to purchase because of the ambiguity of the language used. Such argument, however, seems rather technical. It should also be noted that Hutton's commitment is subject to a variety of conditions. Three of these conditions relate to opinions of counsel. These are standard conditions and while we initially raised a question concerning AS 37.10.085, bond counsel for both the City and Hutton have addressed this question satisfactorily.

The requirements concerning delivery of documents also are standard and reasonable, and we believe should not be interpreted as diminishing the Hutton commitment. Likewise, the provisions contained in the penultimate paragraph of the December 21, 1979 letter allowing cancellation of the commitment for specified grounds are reasonable and standard for a commitment letter.

The troublesome aspects of the E.F. Hutton commitment are found in 1) the reservation that Hutton's commitment is subject to receipt from Standard & Poor's of a rating on the bonds sufficient to enable E.F. Hutton to market bonds containing terms substantially as set forth in Exhibit "A", and 2) the requirement that at some future time, Alpetco must agree to "maturity schedules, interest rates, and other terms which are commercially reasonable . . ."

Exhibit "A" contains some general information related to the bonds including coupon denominations and maturity dates, but does not contain agreement on an interest rate or a ceiling rate under which the final interest rate must fall. Failure to specify the interest rate allows considerable latitude to E.F. Hutton to escape its commitment by demanding Alpetco agree to an interest rate too high for Alpetco to accept. It also raises a question whether the commitment is enforceable against Hutton. Most courts are likely to conclude that without specification of an interest rate, the commitment is too indefinate to be binding. See Williston on Contracts, §45 (Jaeger Ed.) On the other hand, the Hutton commitment might be construed to obtain obligations of "good faith" and commercial reasonableness. Cf. Draper, "Tight Money and Possible Substantive Defenses to Enforcement of Future Mortgage Commitments," 50 Notre Dame Lawyer 603 (1975). If such provisions are read into the commitment, the commitment could be construed as enforceable and binding on Hutton.

Judging the Hutton commitment requires attention to the most uncertain aspect of the Agreement of February 22, 1978; namely, the distinction between "commitment" and "definitive documents." It is extremely unlikely an underwriter would bind itself to purchase bonds an entire year in advance of the purchase date. That being so, it is not

surprising that Hutton appears not to have done so. Since the Agreement does not require Alpetco to obtain "definitive documents" until the 30th month, probably the better conclusion is that the commitment required at the 18-month benchmark, in order to be compatible with the 30-month obligation, need not bind the underwriter a year in advance of purchase.

The Equity Commitments

Three hundred and fifty million dollars of the $1.5 billion commitment required under the Agreement is in the form of an equity commitment to the project by the project sponsors. Specifically, Charter Oil (Alaska) has committed $245 million, Alaska Petrochemical Co., $81.9 million, and E.F. Hutton (Alaska) Inc., $23.1 million. In the case of Charter and Hutton, the commitments of the subsidiary corporation are backed up by the parent corporation; and in the case of Alaska Petrochemical Company, the commitment is backed by the commitment of shareholders, Alaska Interstate and Seatrain Lines, Inc. This backing is important because the first line companies are only paper companies; however, the commitments of the parents insures the assets needed to make the commitment meaningful are available.

The commitment letters addressed to "The Alpetco Company" are substantially the same from each company. The operative language is found in the third and fourth paragraphs of the letter. Each joint venturer makes its commitment in consideration of the other joint venturer making a similar commitment. Such commitment is subject to final approval by the joint venturer of the definitive documents relative to the long-term loan of funds and to final execution of those documents. The last paragraph notes that the commitment "is made solely for the purpose of assisting Alpetco in satisfying . . . Article 10.2c(3)(d)" (Sic).

The most significant reason why it might be concluded that these letters do not constitute the commitments required by the Agreement is that the commitment is subject to approval of the final loan documents by the company making the commitment. If the company does not grant approval - which is solely in its power to do or not do -

then the equity commitment never becomes an enforceable obligation against the company making the commitment (i.e. Charter, Alaska Interstate, Seatrain, and E.F. Hutton never have an obligation to the Alpetco Company).

There are also reasons for concluding that the equity letters do constitute the required commitment. For example, it is quite possible that all that is intended by making the commitment subject to that committing company's approval is that it may avoid its commitment if the long-term loan is commercially unreasonable. Or turning the matter around, the committing company must approve the definitive documents and must not thwart the signing of those documents, if the documents are reasonable. In effect, the committing company must act in good faith. A court may well read the commitment letter in this fashion. Nevertheless, some of the uncertainty could be eliminated if the reasonableness requirement had been expressly incorporated into the commitment letter.

The Thyssen Commitment

The Thyssen commitment is contained in a December 7, 1979 letter and December 21, 1979 telex which elaborates upon that letter. By these letters, Thyssen "commit[s] to arrange financing of up to U.S. $750 million." This commitment is subject to 1) Alpetco obtaining another $750 million, 2) final loan documents, and 3) Alpetco achieving the right to receive royalty oil on July 18, 1980. The Thyssen commitment is premised upon an engineering and construction contract between Thyssen, Foster-Wheeler, and Alpetco under which Thyssen agrees to develop a fixed price construction contract and provide a guarantee for completion of the facility. In its telex of December 21, 1979, Thyssen states that there is "a binding commitment on [its] part for the project to the extent and subject to the conditions expressed" in its December 7, 1979 letter. The telex also notes that Thyssen has been involved in other major projects around the world and that the commitment advanced by Thyssen to Alpetco is "substantially stronger than would usually be expected at this stage of the project."

The Thyssen letter can be read on its own to constitute a binding contract on Thyssen to arrange the

financing* for the project subject to certain conditions. This conclusion is bolstered by Thyssen's telex which describes its letter as a binding commitment. It should be noted the "subject to's" in the Thyssen commitment are objective facts outside the control of Thyssen but within the control of Alpetco.

On the other hand, it is possible to argue the Thyssen commitment is insufficient. There are two reasons why this might be so. First, the commitment lacks specificity with respect to relevant financing conditions other than amount. There is no rate of interest, payment schedule, or security terms among others. There is, therefore, considerable leeway for Thyssen to satisfy its commitment in a manner which is unreasonable or unacceptable to Alpetco. This lack of specificity most likely would result in a court concluding the commitment is not enforceable against Thyssen.** Second, Thyssen could avoid its commitment by presenting to Alpetco a fixed price which makes the project economically infeasible.

Interim Financing

As noted in my earlier memorandum to you, the interim financing benchmark is integrally related to the long-term financing commitment. In a conventional financing, in most cases, interim financing falls into place readily once the long-term financing is arranged. With project financing interim financing may pose greater difficulty,

---

* I believe that a commitment "to arrange" is satisfaction of Alpetco's requirement "to obtain" if the commitment is otherwise adequate. It is not surprising to find a lead company willing to take on the obligation to come up with the financing without knowing a year in advance exactly who will provide the funds.

** It is, however, possible a court would conclude that an agreement exists and the terms must be reasonable.

because the risk that the long-term lenders may renege is perhaps greater the magnitude of the interim financing as a proportion of the project is larger. I believe the interim financing is included as a separate benchmark principally because of the proposed "project financing" approach.

Turning to Alpetco's submission, Alpetco initially submitted letters from Chemical Bank and Manufacturers Hanover Trust Company and a memorandum from Kutak, Rock & Huie in satisfaction of the interim financing commitment. The bank letters contain so many conditions which allow the banks to escape the "commitment", one must wonder why Alpetco even submitted them. They amount to nothing more than expressions of interest. On the other hand, the Kutak, Rock & Huie memorandum indicates that the need for interim financing may be minimal because of the possibility of using bond proceeds during construction. Subsequently, Alpetco obtained from Thyssen a letter commiting Thyssen "to arrange interim financing" for up to $150,000,000 if the banks do not provide the funds. The Thyssen commitment is in substantially the same form as the Thyssen equity commitment, and therefore, is of the same quality as that commitment. The strengths and weaknesses of that commitment are therefore essentially the same as those discussed under the equity commitment section.

Conclusion

Because the final arbiter of what a contract means is the court, I have attempted to approach the question of compliance or noncompliance; not in terms of what I think or what others might think, but in terms of what is the probability that an Alaskan court will sustain a particular action. This approach requires an evaluation of both the strengths and weaknesses of each particular decision. It also requires judgment about probabilities, not absolute statements. Using this approach, it is my conclusion that Alpetco has complied with the benchmark requirements, at least if those requirements are interpreted in a light most favorable to Alpetco; and that your approval of Alpetco's submission would be sustained in court if challenged by a third party. I reach this conclusion principally because I believe there is sufficient evidence in the record to support the conclusion that the obligations imposed upon

Alpetco do not require Alpetco to obtain binding, legal commitments, enforceable in a court of law. Less compelling, but a subsidiary basis for this conclusion, I also believe there is a reasonable legal basis for concluding that the commitments are in fact binding financial commitments.

LAW OFFICES OF
PRESTON, THORGRIMSON, ELLIS & HOLMAN
SUITE 404
420 L STREET
ANCHORAGE, ALASKA 99501
AREA CODE 907-276-1969

FREDERICK H. BONESS
JOHN R. MESSENGER

2000 IBM BUILDING
SEATTLE, WASHINGTON 98101
206-623-7580
TELEX THOR-SEA

SUITE 500
1776 G STREET N. W.
WASHINGTON, D. C. 20006
202-628-1700
TELECOPY 202-331-1024

November 13, 1979

Robert E. LeResche
Commissioner, Department of Natural
  Resources
Pouch M
Juneau, Alaska   99811

Dear Commissioner LeResche:

Enclosed is a memorandum reviewing certain aspects of the contract between the State of Alaska and Alaska Petrochemical Company. It is submitted pursuant to your request for a legal analysis of the requirements of Articles 10.2 and 2.2.

Although the memorandum itself explains the scope of the analysis we have undertaken therein, I wish to emphasize here what we believe to be the strengths and weaknesses of our analysis. First, it is important to keep in mind that we have undertaken only a legal analysis. Many, and probably most, of the questions and issues which must be answered in December (and at subsequent benchmark dates) are business decisions. Do the expected benefits in terms of tax revenues, employment opportunities, etc., continue to outweigh the costs and risks associated with the project? The answer to this question and its numerous permutations involves principally matters of business judgment and State policy. It is true that once the answer is decided upon, the ability to act in conformity with that decision, depends upon the legal structure of the agreement, but such structure does not really determine the answer.

Second, we have not attempted a comprehensive analysis of the contract since you did not request that. We have focused only on Articles 2.2 and 10.2, and particularly 10.2(3). In order to address adequately these articles, we have found it necessary to consider other terms in the

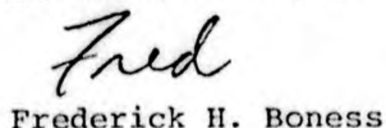
contract; and we have done so. Necessarily, we have also addressed a number of general contract principles relevant to all aspects of the contract. On the other hand, there are several specific areas of the contract we have not addressed. For example, during our review of the files, we were reminded of the extent of concern and controversy surrounding Articles 2.3 and 2.4 of the contract. We have not addressed these articles in any fashion.

Third, our analysis and conclusion are somewhat less precise than we would like them to be. The reason for this is the lack of a specific set of facts. We have used three sources of information in formulating our conclusions. First and foremost we have relied upon the agreement itself. Second, we have reviewed the readily available record of negotiations, public review, and approval of the agreement to amplify the meaning of various contract terms. Finally, we have relied on the custom and common practices in the oil and gas, construction, and commercial and financial industries to provide additional insight into the contract. These sources, however, still leave unanswered a wide range of questions. We believe a review of whatever documents or requests Alpetco submits prior to, or on December 18, may lead to more precise legal conclusions than those expressed here.

We would be happy to meet with you or members of your staff to discuss our conclusions.

Sincerely,

PRESTON, THORGRIMSON, ELLIS,
HOLMAN & FLETCHER



By

Frederick H. Boness

FHB/sas
Enclosures

LAW OFFICES
PRESTON, THORGRIMSON, ELLIS & HOLMAN
420 L STREET · SUITE 404
ANCHORAGE, ALASKA 99501
(907) 276-1969

MEMORANDUM

TO: Robert E. LeResche, Commissioner, Department of Natural Resources

FROM: Frederick H. Boness FHB

DATE: November 9, 1979

RE: Legal Analysis of articles 10.2 and 2.2 and Related Provisions of the Agreement between the State of Alaska and Alaska Petrochemical Company

Introduction

This memorandum presents a legal analysis of articles 10.2 and 2.2 and related provisions of the Agreement between the State of Alaska (the State or Seller, hereinafter) and Alaska Petrochemical Company, (Alpetco or Buyer, hereinafter) as amended. We have endeavored to present a comprehensive analysis of these articles. We have relied upon two principal sources of information for our analysis. First, we have, of course, paid close attention to the language of the Agreement itself. In the absence of ambiguity, the language of the Agreement is definitely controlling. Wessells v. State, 562 P.2d 1042 (Ak. 1977) Second, we have reviewed the files relating to the solicitation of proposals to purchase state royalty oil, the negotiation of contracts and the approval of the Alpetco Agreement by the Royalty Board and Legislature. These files provide the additional background and context needed to determine if particular language is ambiguous and, if it is, what the parties intended. (Subsequently, we shall refer to information from the files as "extrinsic evidence"). In addition, we have relied on industry understanding and practice. Generally, where we have turned to industry understanding and practice we have found the information helpful only because it confirms conclusions reached on the basis of our interpretation of the contract and information from the files.

There are limitations on what can be stated in advance of specific actions by Alpetco to comply with the agreement. For example, in addressing the question of what is meant by "written commitments to lend or invest. . ." we have described what the State should expect such commitments to contain in order to assure itself that the commitment is not illusory. However, it is simply not feasible to imagine and evaluate all possible commitment documents which Alpetco might obtain and submit to the State. It is possible that problems not addressed in this memorandum will arise once Alpetco has disclosed what actions it has taken to comply with article 10.2. We strongly recommend that the specific commitments and contracts which Alpetco submits to the State in satisfaction of its obligations under article 10.2 be reviewed and evaluated to determine if they comply with the legal requirements of the Agreement.

Although our focus in this memorandum has been on the legal requirements of articles 2.2 and 10.2(3), it has been necessary to address other related provisions of the Agreement. We have done this in order to present what we believe to be a comprehensive statement of the options available to the State and the legal framework which governs each possible course of action available to the State. This memorandum is divided into the following general catagories: 1) General Legal Principles; 2) The Eighteen Month Benchmark Requirements; 3) Granting or Denying Extensions of Time to Comply with Benchmark Requirements; and 4) Delivery of Royalty Oil Prior to Completion of the Petrochemical Facility.

I. General Legal Principles

In this first section, it is our purpose to review and summarize the basic principles and standards applicable to Alaskan contracts. Although this section might be simplistic for those already familiar with Alaska contract law, we have decided to include this brief discussion because this memorandum may receive wide and diverse readership. Additionally, the discussions which follow this section rely upon the basic principles discussed here. There are no Alaska court decisions (and very few decisions from other jurisdictions) which address any of the specific questions analyzed in this memorandum.

If it were possible to draft contracts which could have only one meaning, and that meaning was crystal clear to anyone who read it, at any time after the contract had been signed, there would be little need for contract law because

there would be no basis for disputes between the parties (except possibly, that one party may believe a term "unfair" and wish to avoid the term for that reason). The real world, however, is not so simple. Words are almost always imprecise and efforts to limit this imprecision carry within themselves their own seeds of failure. An imprecise word or sentence is made precise by further explanation, but this explanation may contain its own ambiguities. Furthermore, many contract disputes arise not because the words of a contract are themselves imprecise, but because the parties attached different precise meanings to the words and discover this difference only after the agreement is in effect.

When a dispute arises over the meaning of certain words in a contract and the parties are unable to agree upon a resolution of the dispute the matter is ultimately left to the court to "interpret" the meaning of the contract. Day v. A & G Construction Co., 528 P.2d 440 (1974). Alaska's Supreme Court has concluded that for commercial contracts, a court should interpret a contract by attempting to determine the "reasonable expectation of the parties" which the court has explained to mean "'the sense in which the party using the words should reasonably have apprehended that they would be understood by the other party' and the meaning which the recipient of the communication might reasonably have given to it." Day, supra, at 444-45, Arctic Contractors v. State, 564, P.2d 30 (Ak. 1977).

In many jurisdictions, it used to be that a court would determine what this was simply by reading the language of the contract. If, after doing so, the court decided the language was "clear" or "unambiguous" the court would confirm that clear meaning and go no further. Alaskan courts have rejected this approach. Rather, Alaska's Supreme Court has recognized that even language seemingly "clear" on its face may be ambiguous, or even have a clear meaning other than that which the reader first perceives, when read and understood in the whole context in which a contract is negotiated and agreed upon. Thus, Alaska courts in interpreting a contract first look to extrinsic evidence to determine if the language of the contract is ambiguous. If the court determines the language is not ambiguous, it returns to the contract and states the meaning of the agreement. On the other hand, if the extrinsic evidence indicates ambiguity, then that evidence is used to help resolve the meaning of the contract. Wessells v. State, 562, P.2d 1042, 1044 (Ak. 1977). See also, National Bank of Alaska v. J.B.L. & K. of Alaska, 546 P.2d 579 (Ak. 1976).

The extrinsic evidence to which a court can look in its effort to interpret the meaning of a contract includes the facts and circumstances as they existed at the time the agreement was made by the parties, course of performance, course of dealing, and custom and usage. None of these are necessarily controlling, unless circumstances so indicates; but all may be useful in appropriate circumstances. See A. G. Construction Co. v. Reid Brothers Logging, 547, P.2d 1207 (Ak. 1976); Day v. A. G. Construction Co., supra. In our subsequent analysis, we have relied upon the extrinsic evidence to aid us in our determination of the objective meaning of the agreement.

II. The Eighteen-Month Benchmark Tasks

Perhaps more than any other provision in the Agreement, article 10.2 and especially 10.2(3) must be viewed in the total context of the contract negotiations. There can be no doubt but that both Buyer and Seller regarded this article as crucial. For example, O. Charles Honig testified before the legislature:

> When it gets past the eighteen-month benchmark. . .when we succeed in putting [the financing and other 18-month benchmark requirements] together. . .from then on the likelihood of not going forward is very remote. . .

Commissioner LeResche testifed: "The key benchmark is 18 months."

Before turning directly to a discussion of the specific terms of article 10.2(3) we believe it appropriate to review briefly the major steps and decisions leading up to a final agreement between the State and Alaska Petrochemical Company. As early as 1975 the Department of Natural Resources made a general solicitation of interest of persons who might wish to purchase state-owned royalty oil or gas from Prudhoe Bay. Although some interest was expressed, no agreement was concluded at that time. In the spring of 1977, with oil production expected to begin in June, two companies mounted an intensive effort to purchase royalty oil. One of these companies was Alaska Petroleum Company and the other was Alaska Consolidated Shipping. The former company had been offering to purchase royalty oil since 1975, but had not been able to commit itself sufficiently to construction of an in-state facility to satisfy state officials. Alaska Consolidated Shipping, likewise was not prepared to guarantee construction of an in-state

facility, but rather sought to purchase the oil and use tankers owned by one of its shareholders to transport the oil to markets in the lower 48 states. Each of these companies argued that under federal regulations, the State of Alaska would be prevented from taking its royalty oil in-kind if it did not elect to do so prior to the time at which oil production commenced. In response to this contention, the State administration obtained a ruling from the Federal Energy Agency and a "waiver" from the producers which made it clear that the State would be able to take royalty oil in-kind at a later date. At the same time these two companies sought to purchase oil, the legislature considered adopting legislation which would have required the Commissioner of Natural Resources to take royalty oil in-kind. Although this legislation did not pass, the legislature did express a strong desire that the executive branch sell royalty oil. As part of this expression, AS 28.05.182 was amended to create a presumption in favor of taking royalty oil in-kind.

During the summer of 1977, the Commissioner of Natural Resources made a formal solicitation of persons interested in purchasing royalty oil and constructing a facility in Alaska. That solicitation provided that interested parties should submit their initial proposals to the Commissioner by August 1, 1977 and final proposals by October 15. Part of the solicitation included advising companies of eight policy guidelines which had been adopted by the Royalty Board in May and which would govern, in part, the direction of any future sales of royalty oil. These policies included a statement that the price would not be less than the "in-value" price, and a statement that preference would be given to in-State facilities and those who proposed to build in-State facilities. Ten companies submitted proposals on August 1st.

On September 15, the Commissioner of Natural Resources advised each interested party of the State's view of its August 1, 1977 submission and offered recommendations on how the submission might be changed so that the companies revised submission of October 15 would be more acceptable to the State. Several of the companies chose not to revise their August 1st submission. Some companies withdrew their proposals and others were rejected by the Royalty Board, so that by the end of October, there remained only four competing proposals. During November, December, and January the Commissioner engaged in substantial negotiations with these four companies. Also during that time the Energy Policy Committee of the legislature advised the Commissioner

of its views on what a sales contract ought to achieve. In early December, Committee Chairman, Bill Miles, after holding public hearings, wrote Governor Hammond a letter which contained several very specific suggestions and recommendations. Among the Committee's recommendations were expressions that the "in-value" price be the floor for any sale of royalty taken in-kind and that the provisions contained in many of the October 15 submissions which allowed the price received by the State to drop substantially below that floor were unacceptable. The letter also contained a recommendation that the final contracts should include strong provisions for ensuing that a facility would be built in Alaska. It was suggested that the contract contain penalty clauses for failure to build in Alaska and reasonable termination provisions. The Committe's recommendations were before the Commissioner as he negotiated in December and January.

As negotiations neared an end in early February, the Commissioner of Natural Resources wrote to each company offering a final critique of its proposal and an opportunity to make final changes in its proposal in order to conform to the State's objectives. On February 22, 1978, the Commissioner agreed to a contract with Alaska Petrochemical Company. This agreement was sub mitted to the Royalty Board for consideration, and after hearings approved by the Board. In the legislature, the Agreement was quite controversial. After numerous hearings and debate, the prospect of legislative passage was uncertain. On May 17, 1978, the Commissioner of Natural Resources and Alpetco entered into an amendment to the Agreement which was intended to alleviate certain problems and concerns raised during the course of legislative review. On June 18, 1978, the Agreement, as amended, was approved by the legislature.

It is imminently clear from the policies adopted by the Royalty Board in May and the State Energy Policy Committee recommendations of December 6, 1977, that there were certain basic features which any contract had to contain in order to be acceptable. These included: 1) The price at which the State would sell its oil should be the "in-value" price or higher and reductions below the in-value floor should not be permitted; 2) The purchaser should be clearly bound to construct a facility to use or process the oil in Alaska; clauses which would allow the purchaser to escape this commitment were to be eliminated altogether if possible, and if not, must at least be drafted very narrowly; 3) The contract should include penalties for failure to per-

form; 4) No subsidy should be granted; and 5) The State should sell only a percentage (less than 100%) of its crude, not a specific quantity.

Viewed in this context, it is easy to see that article 10.2 is a direct response to the State's objective of ensuring that the company that purchased the State's royalty oil would also be committed to construction of a facility to use that oil in Alaska.1/ In the Commissioner's letter of September 15, 1977 to each prospective purchaser, the purchaser was asked to include as part of its commitment to construct a facility a timetable with checkpoints along the way and penalty provisions for failure to meet established checkpoints. Buyer, in its October 15th submission, provided a contract which contained as Buyer's construction obligation a provision which said that Buyer would 1) proceed to construct and complete a petrochemical facility with reasonable diligence, 2) commence detailed engineering design within 30 days of final approval of the Agreement by the legislature, 3) commence construction within a certain number of months (which number was left to be negotiated) after Buyer had begun receiving delivery of royalty oil, and 4) have completed substantially all initial construction relating to the Refinery within a certain number of months (which number was left to be negotiated) after Buyer received first delivery of royalty oil.

The October 15th proposal by Buyer thus did contain a rudimentary timetable as requested by the Commissioner's September 15th letter. However, it is apparent the State's negotiators were not satisfied with this timetable and that article 10.2 evolved as a way to gain the degree of specificity, certainty and commitment required by Seller and yet have sufficient flexibility to meet changing circumstances and conditions likely to be encountered by Buyer. O. Charles Honig stated in testimony before the legislature:

1/ The strength of this concern and the high degree of suspicion that a company would simply purchase State royalty oil and broker it on the Lower 48 spot markets without constructing any facilities in Alaska is amply demonstrated by the transcripts of the legislative hearings. See Transcript of Testimony, March 18, 1978, at 17, 21. Indeed, the May amendments to the Alpetco Agreement appear to be directed at closing "loopholes", real or perceived, which might allow the company to take royalty oil but never build such a facility.

> [One] reason for these benchmarks being what they are is that in negotiating the contract terms, Commissioner LeResche said more than once, do not make the benchmarks too optimistic. Set the benchmarks so that you, in your own feeling, feel they will be obtainable and that we don't have to go back to the Legislature to revise benchmarks. (Transcript of testimony March 18, 1978, at 13)

The extrinsic evidence indicates the timetable of 10.2 was first developed in mid-December during negotiations held in San Francisco.

Article 10.2, and 10.2(3) in particular, were developed out of, and embody Alpetco's plan as it was presented in October and modified (although not significantly) thereafter. The addition of article 10.2 to the agreement did <u>not</u> represent a significant new idea, proposal or approach for either Buyer or Seller; rather it represented only an incorporation into the agreement itself of more of the detail of Buyer's proposal. This action had the effect of creating a stronger linking together of the agreement to buy and sell oil and the agreement to construct a facility in Alaska. Because article 10.2 was based on Buyer's already developed proposal, we can reliably use the Alpetco proposals of August 1 and October 15 to aid us in interpreting Article 10.2(3).

Although Article 10.2(3) contains eight separate requirements, these requirements are not all independent of each other. For example, the requirement to negotiate sale terms with prospective purchasers is partially superseded by the requirement to enter into contracts for 70% of the product output, and both contract requirements are important to (if not determinative of) the requirement to complete plant design and optimization since plant design depends on product output (which of course depends on product purchase contracts). Similarly, the interim financing commitment is integrally related to the requirement to obtain commitments to lend or invest of at least $1.5 billion since the financing plan will have to be arranged as a unit rather than piecemeal. Finally, the contracts for the sale of product are crucially important to obtaining the financing commitments because of Buyer's plan to use "project financing." While the requirements are related, we shall, nevertheless, discuss them individually below because each must be complied with by Buyer.

A. The Ten-Million Dollar Expenditure

We need say relatively little about the benchmark which requires Buyer to expend or commit to expend $10 million in Total Project Costs. Compliance with this requirement involves straightforward accounting matters and not much more. A potentially difficult question might have been raised with respect to which costs incurred prior to the effective date of the agreement were includable. However, a certified audit of expenditures for the period January 1, 1975 to June 18, 1979 was conducted by the accounting firm of Peat, Marwick, Mitchell & Co. and accepted by Seller on September 4, 1979. Thus, there exists a base of at least $4.2 million as of June 18, 1979 upon which Buyer can build its future expenditures in order to satisfy its $10 million obligation. There is another $1.5 million of expenditures which was confirmed but not audited by the accountants.

Where an expenditure has actually been made, it would seem that any possible questions concerning the expenditure should be quite limited. Was the expenditure actually made and for the amount reported? Does the expenditure qualify as a "project cost"? Was it made by a party whose expenditures can be counted towards total project costs? Article 1.13 is important in answering these questions because it defines the limits of "total project costs." It is possible that Buyer may include expenditures which should not be attributable to fulfillment of its commitment under the agreement. However, the language of article 1.13 is broad. Thus, absent dishonesty or fraud, such improper inclusions are likely to be relatively few and we would expect minor if they occur at all.

?

If Buyer relies upon "commitments" to expend funds rather than actual expenditures, it will be necessary to evaluate the commitment to ensure that it qualifies. In evaluating such commitments to expend, there are several indicia Seller can look to, to determine if the commitment is bona fide. These include: 1) The party with whom the commitment is made, (Is the party reputable and qualified to perform the work called for? Is the party an independent contractor or an affiliate of Buyer?); 2) The timetable for performance and schedule for payment by Buyer; 3) The size of the payment to be made by Buyer in relation to the work called for; (Is it grossly undervalued--suggesting that the contractor might have no damages if the contract is breached. Or is it grossly overvalued, suggesting that the contractor and Buyer have an understanding that if the contract is

terminated Buyer will incur no costs and if it goes forward the contractor receives a premium for the speculative risk undertaken); 4) Any penalty provisions or liquidated damages terms (such terms provide a measure of the degree of commitment Buyer has made to its contractor); and 5) Any termination, default and force majeure terms which allow Buyer to avoid its obligation to make payments. In reviewing these terms and others which may be part of Buyer's "commitment to expend" funds, the State's analysis should not be directed solely toward individual terms and it should not attempt to decide if each term is "good" enough or "strong" enough. Rather the review should be whether any individual term or some group of terms are such that they make the commitment to expend illusory. If that is the case, the "commitment" does not qualify under the agreement.

Finally, if Buyer relies on commitments to expend, the State should take some care to ensure that "double counting" does not occur. This might happen where Buyer or one of its affiliates contracts with a consultant, construction contractor, etc., for work and the consultant or construction contractor in turn subcontracts the work to another consultant or construction contractor. If each reports the expenditure and applies the commitment to the total of expenditures, there would be a double counting of what is really a single expenditure.

B. The Financing and Product Sales Requirements

As noted above, the benchmark requirements relating to contracts for the sale of product output and the financing requirements are part of the same package which Buyer must conclude. We will discuss them together here. The principal documents which describe in greater detail Buyer's plans for financing of its project are its August 1, 1977 submission and its October 15, 1977 submission. In addition, Buyer prepared and distributed an "Update and Restatement" of its October 15 proposal which is dated February 7, 1978 and a summary of its proposal, dated March 15, 1978. These documents also discuss Buyer's financing plan.

In the August 1, 1977 submission, Buyer's financing and marketing plans obviously were still undergoing development. At the time of that proposal, Buyer estimated an initial project cost of $1.5 billion and planned "to procure debt and equity capital requirements through the sale of securities to be managed" by Kuhn Loeb & Co., and E. F. Hutton & Co. The letter from Buyer's financial advisers

addressing Buyers financing plans said nothing more assuring or specific than that the investment bankers were "of the preliminary opinion that the Project can be financed, subject, of course, to economic and monetary conditions existing at the time the financing is undertaken". On the marketing question Buyer did state that it intended "to seek marketing of its products under long-term 'take or pay' contracts."

In its October 15 proposal, Buyer described its plans for marketing in a more detailed, confidential submission. In this document, Buyer reiteiterated its intent to sell products on "long-term 'take or pay' purchase contracts with major chemical companies coinciding with the term of Alpetco's royalty oil purchase contract with the State of Alaska." Buyer indicated that as of October 7, 1977, Buyer had received "expressions of interest for two-thirds of the output of the plant. . ." Finally, Buyer noted that if it was not possible to obtain "acceptable contracts for the sale of substantially all of the project's output. . .," Buyer may approach the project in phases, constructing facilities over a longer period of time.

Buyer's financing plan was also described in greater detail in its October 15 submission. Buyer stated that two important conditions to financing were 1) the availability of crude oil feedstock to the project over the life of the financing and 2) profitable sale of the products over the life of the financing. The first condition Buyer explained could be met by a satisfactory contract to purchase royalty oil and the second by conclusion of long-term "take or pay" contracts with "financially strong purchasers." Additionally, Buyer indicated it would need to assure lenders that completion and operation of the plant would occur as projected and stated that these assurances would be obtained through "stand-by 'open-market' contracts for crude oil supply short-falls" and by "Brown & Root's guarantee of plant start-up."

Buyer indicated that interim construction financing could be arranged through a group of U.S. commercial banks provided that the banks are assured that "the construction loans will be 'taken down' by long-term lenders." In support of this conclusion Buyer presented a letter from Grenville H. Paynter, Senior Vice President of Chemical Bank in which Mr. Paynter expressed his belief that $400 million of interim bank credit could be arranged through a banking group and that Chemical Bank would be willing to lend $100,000,000 itself. On the question of long-term financing

Buyer stated 20 year bonds would be sold to institutional investors and that such bonds would provide for deferred interest and principal amortization until the facility becomes operational. Buyer's letter from Kuhn Loeb and E. F. Hutton was no more definitive than the earlier letter.

Buyer's February 7, 1978 "Update" which was prepared and distributed after Article 10.2 had been agreed to by the parties, but before the total agreement had been accepted by Seller and signed by the parties stated:

> 4. Financing the project. Alpetco and its financial advisors have developed a comprehensive financial plan to provide for all phases of the project, including equity and workable sales contract forms.

and further that Buyer had received:

> 6. Strong expressions of interest by Japanese trading companies and government leaders despite recent Alaskan newspaper stories to the contrary.

In elaborating upon these statements, Buyer stated that the project could be "financed using project financing techniques" and that "equity to support the project can be obtained if nec_ssary." In this report Buyer explained the relationship between the product sales contract and the financing proposal. The long-term contract for the purchase of crude and the "matched" long-term sales contract would "guarantee lenders that monies borrowed to finance the project would be repaid." The product sales contracts, in order to provide assurance to lenders, would have to be "irrevocable and at a minimum provide for debt service (interest payment and principal repayment) even if for some reason the facility does not produce products for delivery to purchasers." Buyer stated such irrevocable sales contracts "are not uncommon."

In a February 3, 1978 report to Commissioner LeResche, Robert Butler of Smith Barney, Harris Upham & Co. confirmed Alpetco's proposed financing as a method used in the industry and stressed the importance of the "hell or high water," "take or pay" contract with the product user as a cornerstone to the financing. The concept of project financing and the importance of the take or pay contract are discussed and emphasized in two law journal articles available at the time. See "Project Financing for Offshore and

Onshore Gas Facilities -- Alternative Methods for Financing from a Legal Viewpoint," M.P. Martin, 28 Inst. O.& G.L. Tax 273 (1977); "Project Financing --Oil and Gas Ventures", J.F. Hunt & H.L. Company, 27 Inst. O.& G.L. & Tax 215 (1977)

With the above information in mind it is easy to see the inter-relationship of Articles 10.2(3)(b),(c), (d) and (e). Furthermore, because of these inter-relationships, it seems likely that Buyer's satisfaction of these requirements will be accomplished almost simultaneously.

Subsection (b) requires Buyer to negotiate sale terms with prospective product purchasers and draft contracts for the sale of products, but it does not require Buyer to conclude final sales agreements. (b) also requires Buyer to delineate product requirements, quantities of products and production ratios. It is possible to satisfy (b) without satisfying requirements (c) or (h). However, with one exception, if Buyer complies with (c) and (h), Buyer will necessarily have complied with (b). It is therefore necessary to address only the exception. In order to avoid reading (b) as wholly redundant with (c) and (h), it seems likely that (b) requires Buyer to negotiate with prospective purchasers of products for the 30% of the products not sold in satisfaction of (c) -- assuming, of course, Buyer concludes contracts for only 70% of its products. Buyer, in certifying satisfaction of (b), should indicate what action it has taken to negotiate such contracts and submit to the State drafts of contracts if hopes to conclude. If Buyer does this, we believe it will have complied with (b) so long as the contracts it submits are reasonable.

Satisfaction of (c) is more demanding, since it requires Buyer to conclude contracts for the sale of at least 70% of the product output of the plant; several uncertainties exist. First, the agreement defines "petrochemical plant" to include off-site facilities such as power supply, water supply, port facilities and administrative buildings. At various times during Sellers public discussion of it proposal, Seller noted the possibility of making excess power available to the local community. It is our conclusion that (c) does not require Buyer to include this as part of its total output. Similarly, we believe that Buyer may not enter into a contract for a sale of water or power and count such contract towards satisfaction of (c). The language of (c) restricts Buyer's obligation to "product output" and we conclude this means the hydrocarbon products produced from the crude oil feedstock and not

ancillary goods and commodities produced principally to support the basic facility. Second, even if we restrict our consideration to hydrocarbons, what is "product output"? It is possible Buyer will use crude as fuel for the plant. If it did so, it is clear that that such crude would not count as "product output." More likely, Buyer will use fuel oil produced from the refinery portion of the plant as fuel. Should this be counted as "product output?" Although it is possible to argue the point either way, we believe the better conclusion is that it should not be included unless the contract to purchase the fuel to run the plant is with an independent, nonaffiliated party and that party must take the fuel if the plant does not use it. This could be the case where Buyer enters into an agreement to sell to a third party fuel oil on a take or pay basis and Buyer in turn agrees to purchase steam or electricity from that third party. In such case, the fuel would actually be plant fuel but the sale would be equivalent to any other take or pay sale. We note there is an incentive for Buyer to undertake a sale to itself of plant fuel as product output if Buyer is having difficulty satisfying (c). This incentive can be understood from the following example: Suppose Buyer will require 20,000 b/d to operate its plant. That leaves 130,000 b/d of products for outside sale. Seventy percent of 130,000 is 91,000. If we assume the fuel requirement is part of product output, then Buyer must conclude contracts for 70% of 150,000 or 105,000 barrels, however, if we net out Buyer's 20,000 barrel sale to itself for fuel, then it must only sell 85,000 of products to others. We believe if Buyer conducts a sale to itself or an affiliate of the plant fuel this sale should be counted in satisfaction of (c) only if it is on terms substantially the same as other sales. On the other hand if, as is likely, Buyer's need for fuel is taken "off the top" Buyer's obligation under (c) should be to sell only 70% of that which it has available for sales to others, not 70% of 150,000 b/d.

A third uncertainty is how the 70% is to be measured. Product output can be measured in terms of weight, volume, value, and perhaps other standards as well. The agreement does not specify the unit of measure and the issue does not appear to have been addressed during negotiation or review of the agreement. It may be that the matter is more theoretical than real, only when Buyers product slate is identified will one be able to judge the significance of this issue. Perhaps more significant then the unit of measure is the period of time over which product output should be measured. It is clear from Buyers submissions that two standards are reasonable and compliance with either

should satisfy the benchmark. One would be for the remaining length of the agreement itself and the other would be for the length of the loans (or bonds). On the other hand, we conclude product sales contracts for 70%, or even, of the product output for a shorter period, such as the first year's production of the plant, would not satisfy (c).

A fourth area of potential difficulty is whether a sales contract is really a contract for the purchase of product output. We would expect that as a minimum such a contract must contain terms relating to price (most likely a formula price of some kind), quantity of product, quality of product, length of the contract, perhaps a commitment by Buyer to provide product from other plants if Buyer's facility is inoperative, and terms establishing the conditions or events which will permit termination or modification of the product sales agreement. It is not necessary that this sales contract be long or complicated (although it may well be). The State should pay particular attention to the provisions, if any, which allow for future termination of the product sales contract, especially as to termination which might occur in the first year or two after the contracts are concluded. The State's right under (c) does not permit the State to dictate the terms of Buyer's product sales contracts, however, if the sales contract is sufficiently open-ended, the State could dispute Buyer's purported satisfaction of (c) on the grounds that 70% of the plant's output over the appropriate period of time, as discussed above, has not occurred.

Article 10.2(3)(d) requires that the Buyer obtain commitments to lend or invest $1.5 billion and article 10.2(3)(e) requires Buyer to obtain interim financing for construction. Satisfaction of (e) is probably easier than (d), however, as a practical matter, it is unlikely that Buyer will be able to comply with (e) unless it has also complied with (d). This is so because interim lenders are unwilling to commit funds until they are absolutely certain that their loans will be "taken out" by the long term lender. See "Current Business Approaches -- Commercial Construction Lending," C.C. Livingston, 13 Real Prop., Probate & Tr. J 791 (Fall, 1978). One indicator that the State can look to in determining if Buyer has complied with its requirement to obtain interim financing is the size of the interim financing commitment. Subsection (e) does not require any particular size commitment but it does require that Buyer obtain interim financing "for the construction." Thus, the amount of financing arranged by Buyer must be sufficient for this purpose. The amount needed will have to be decided upon in

the light of the circumstances as they exist at the time Buyer arranges the financing. A useful guideline, however, is the letter from Chemical Bank to Messrs. Honig and Barbour of October 11, 1977 in which Grenville Paynter advised Alpetco that it was his estimate the project would require $400 million in interim financing. An interim commitment of that size will require a number of investors to participate. Buyer's proposal was that this group would be headed by Chemical Bank. **The form of the participation by other investors should be reviewed to be certain that each investor has truly committed funds for interim financing.**

In the case of both requirement (d) and (e), a major concern for the State will be that the commitment is indeed a firm commitment. There is no absolute form that the commitment to lend or invest must take in order to satisfy Buyer's obligation. There are, however, certain basic elements which all commitments will contain if they are legitimate. For example, the party promising to loan the funds must have the resources to make the loan and the legal right and corporate authorization to do so. All loan commitments or equity investments should state the amount of the primary loan and also if there are any secondary or contingency funds available to Buyer. The commitment document likely will contain a drawdown schedule for the loan, which schedule, at least in the aggregate, should match Buyer's construction timetable and also the benchmark obligations for expenditures contained in the agreement. The commitment documents will establish an interest rate, term and repayment schedule. Buyer will most likely be required to pay a loan commitment fee. At least some portion of this fee should be payable by Buyer at the time the commitment is entered into. This fee may be refundable at the time the loan is delivered and it may also be a measure of liquidated damages. See "The Broken Commitment: A Modern View of the Mortgage Lenders Remedys" D.C. Draper, 59 Cornell L.R. 418, 427-28 (1974). Whatever arrangement is made, the obligations should be sufficiently onerous to provide a measure of assurance that the lender and borrower are each serious about the loan.

The loans will be secured by assignments of the product purchase contracts, the oil sales contract, leases of land acquired by Buyer, mortgages and/or security interests in materials purchased with loan proceeds and perhaps other forms of security as well. The commitment document should contain a detailed description of the facility, and most likely will be supported by engineering design and cost

estimates and economic analyses of the product markets and an estimate of the economic viability of the project. The lender will reserve to itself the right to have independent engineering and economic analysis conducted prior to disbursement of loan funds and the right to inspect and even to take over construction efforts if the project begins to fall behind schedule or escalates beyond projected costs. Most likely the lender will reserve the right to approve final plans and specifications, hiring of contractors, and perhaps major purchase orders. In a financing of the size required by Buyer, it is likely each of these basic elements will be specified in detail.

Although there will be contingencies such as those discussed above, **the commitments required under (d) and (e) are binding contracts between Buyer and Buyer's lenders or investors; they are not expressions of interest by banks or other financial institutions.**

C. The Environmental Inpact Assessment.

Subsection (f) requires completion and filing of an Environmental Impact Assessment and (g) requires Buyer to file all material state, local, and federal permit applications. These requirements are neither particularly difficult nor onerous for Buyer to accomplish, and as such if Buyer fails to accomplish these, the failure will indicate lack of commitment by Buyer rather than an insumountable problem. We have not endeavored to enumerate all the material state, local, and federal permits here because this information is more readily available from those agencies which have been meeting with officials from the Department of Natural Resources and Buyer on a regular basis. It should be noted, however, that (g) does not require that Buyer receive all permits, only that Buyer apply for them. The only question which might be raised is whether Buyer's application is so deficient that it really does not constitute an application at all. Such evaluation can be made only after a review of the application requirements and Buyer's application.

Subsection (f) refers to an Environmental Impact Assessment. This requirement is subject to at least two reasonable interpretations. One is that Buyer must prepare a report which documents and evaluates the environmental impact of a proposed facility and submit that report to the State. The other is that Buyer must prepare and file with the appropriate federal agencies the information they will require to prepare an Environmental Impact Statement. We

believe it is this latter interpretation that more nearly represents what the parties' contemplated. We do not believe, however, that Buyer is required to have done more than submit the information to the appropriate federal agencies. For example, (f) does not require that a final EIS be completed or even that a draft EIS be completed since it is the federal agencies rather than the Buyer who control the pace of preparation of those documents.

D. Plant Design

Subsection (h) requires Buyer to complete plant design and optimization necessary to obtain a definitive cost estimate. Compliance with this requirement would seem to be strictly a matter of fact although it may require the opinion of a professional engineering firm to determine if Buyers work satisfies the requirement.

III. Granting or Denying an Extension of Time to Allow Buyer to Satisfy Benchmark Tasks

A. When Should an Extension be Granted or Denied?

Since, the Agreement does not specify a particular procedure either for Buyer to certify to Seller its accomplishment of the tasks specified in the Agreement or for the Seller to grant or deny an extension of time, we rely upon common sense and reasonable practice. It appears that for the 6-month and 12-month benchmarks, Buyer certified its accomplishment of the required tasks as part of its monthly report to the State. See Alpetco's letters of December 14, 1978 (Progress Report No. 6) and June 14 (Progress Report No. 12) and the Commissioner of Natural Resource's letter of September 4, 1979 to Gordon Cain. This procedure seems to be reasonable under the agreement and could be followed for the 18-month benchmark as well. However, we see a possible danger in this approach and, therefore, suggest the State consider a modification of the procedure used by it and Buyer for the past two benchmarks.

Since the 6-month and 12-month benchmarks were relatively easy to accomplish, there was probably little doubt that Buyer would achieve them. But, future benchmarks are much more difficult and accomplishment is less assured. Both the State and Alpetco should be concerned about what happens if Buyer fails to achieve the benchmarks but does not advise the State of this failure until the last minute.

Article 10.2 clearly provides that the Agreement terminates without further action on Seller's part, on

December 18, 1979, unless Buyer has accomplished all the tasks or unless Seller grants a 6-month extension.

It is reasonable to expect that the State will require some time to review Buyer's submissions before it decides whether or not Buyer should be granted an extension. If Buyer's submission and a request for an extension of time is made on December 18, one must ask: What is the status of the Agreement after December 18th and prior to the time the State grants an extension? And, if the Agreement is automatically terminated on December 18, can the State later revive it by granting an extension with retroactive effect? There is no simple, certain answer. We believe it is reasonable to assume the State has the right and power to review Buyer's information, taking a reasonable amount of time to do so, and thereafter grant or deny an extension which would have retroactive effect. It must be noted, however, that both during the negotiations and public review of the agreement there was skepticism about any future administration's willingness to terminate the agreement if the benchmarks were not satisfied. This concern was addressed, in part, by making the agreement terminate automatically rather than by leaving the matter to the State's discretion. With this in mind, it is conceivable that a court would conclude that the automatic termination provision of the agreement is controlling and that the State's power to grant an extension is limited to granting an extension prior to operation of the automatic termination provision. Our recommendation, therefore, is that the more certain and prudent course for both the State and Alpetco is to decide before December 18 whether or not an extension will be granted should the Buyer request one and formally to grant or deny the extension no later than December 18, 1979. To accomplish this, the State may wish to ask Buyer to advise it a month or so in advance of December 18, that Buyer intends to request an extension.

B. <u>For How Long is an Extension Effective and How Many Extensions May be Granted?</u>

Article 10.2(3),(4),(5),(6) and (7) authorize 6-month extensions. Article 10.2(8) authorizes a 9-month extension and Article 10.2(9) authorizes a 12-month extension. In each case, the extension permitted is only for a fixed period of time; that is, 6-, 9- or 12-months. Extensions of either a shorter or longer period of time are not permitted. The extensions are not cumulative and the State may grant only one fixed period extension for each benchmark period.

Article 10.2(10) allows a second, variable period extension for a specific purpose. If the State grants an extension for the 18-month benchmark, the tasks must be accomplished by the 24th month, or the contract automatically terminates (unless Seller grants the second extension authorized under 10.2(10)). At the 24-month benchmark the State may grant a new 6-month extension but only for the task required under the 24-month benchmark not for tasks enumerated under the 18-month benchmark.

The second extension, authorized by article 10.2(10), allows the State to extend any initial extension period for an indeterminate period of time which time elapses on the 90th consecutive day of the legislative session following granting of the extension. In practice, this provision works as follows: If in December of any year Seller grants a 6-month extension, that extension would run until June of the following year. Most likely the legislature would not be in session when that extension expires (June 18th) and certainly the legislature would not be in session for an additional consecutive 90 days after June. Thus, should Seller grant the second extension allowed under the agreement after granting an initial 6-month extension in December, the second extension wou d keep the agreement in force until the 90th day of the next legislative session (approximately mid-April).

If Seller grants an extension applicable to the 24-, 36-, or 48-month benchmarks, such extension would be granted in June and expire in December. A subsequent extension under 10.2(10) would operate until the 90th day of the legislative session starting in the following January.

An extension granted under 10.2(10) must be for a period which terminates on the 90th day of the next legislative session unless Buyer consents in writing to a shorter extension period.

The consequences of granting an extension under article 10.2(10) are not fully specified in the Agreement. Two plausible interpretations of the effect of granting an article 10.2(10) extension are possible. First, an extension under article 10.2(10) may be like any other extension authorized by article 10.2. Namely, if Buyer during the 10.2(10) extension accomplishes the task for which the extension was granted, then the Agreement remains in force. On the other hand, it seems the better interpretation of the

agreement is that an article 10.2(10) extension is limited to the purpose of "permit[ting] the Commissioner and Alaska State Legislature to consider an amendment or modification of [the] Agreement, particularly of the provisions contained in Article 10.2." Under this interpretation it would not matter that the Buyer accomplishes the task after termination of the initial extension period and prior to termination of the second extension period. The Agreement would, nevertheless, terminate unless the legislature amended the Agreement in a manner which ratified the late compliance. There are two reasons for concluding that this second interpretation is the correct one. First, the language of 10.2(10) states a specific purpose for which the extension is granted, namely to allow consideration of an amendment. Second, 10.2(10) differs markedly from the other extension provisions in that it is for an indeterminate period of time and it does not speak to "attainment of criteria stated" as do each of the extension provisions in articles 10.2(1)-(9). It seems logical that if 10.2(10) was for the purpose of allowing the Buyer to accomplish benchmark tasks the same language that was used repeatedly in articles 10.2(1) through 10.2(9) would have been used.

C. What is the Authority of Seller to Grant or Deny an Extension?

Article 10.1 establishes a 27 year term but makes clear that that term is subject to termination by either party under 10.2 or 10.3. Article 10.2 states that the "Agreement shall terminate" if specified tasks are not accomplished according to the timetable of 10.2 and further provides that the Commissioner "may extend" the time period for attainment of the criteria. This language seems crystal clear with respect to when the contract terminates and what discretionary power the Commissioner has to prevent such termination. Nevertheless, automatic termination is a harsh result, especially where substantial time and money have been invested under the agreement. See, 5 Williston on Contracts § 793 (3ed. Jaeger 1961); c.f. Land Development v. Padgett, 369 P.2d 888 (Ak. 1962). For that reason, the State should expect that a court will look very carefully at such termination to ensure itself that such result was indeed intended by the parties.

It is our conclusion that a review of the agreement and the extrinsic evidence confirms that the parties did intend 1) automatic termination of the agreement, and 2) absolute discretion to the Commissioner in determining

whether or not to grant an extension. The testimony of Buyer's attorney (Mr. Rogers) illustrates this first point well:

> 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. (emphasis added)
>
> 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". Wha 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 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.

With respect to the discretion accorded the Commissioner, article 26.7, governing approvals and consents, is enlightening. That provision imposes a "reasonableness" standard upon each party when making approvals or granting consents called for in the Agreement. We doubt

that the Commissioner's decision to grant or deny an extension is either an "approval" or a "consent" required under the agreement. Nevertheless, article 26.7 expressly exempts from the reasonableness standard the extensions of time called for under article 10.2. The extrinsic evidence indicates that the parties knew, understood and accepted the fact that an extension was solely at the Commissioner's discretion. As a practical matter, including the right to an extension, even if solely at the Commissioner's discretion, represented a concession to Buyer, since Buyer at least would be able to present its case to the Commissioner who could then grant an extension, if he felt it proper to do so. In the absence of such right, automatic termination would result. If an extension was not to be solely at the Commissioner's discretion, only two other alternatives are possible. One would be an automatic extension -- which would be in effect no extension at all, but only a lengthening of the time period for compliance -- and an automatic extension upon satisfaction of certain conditions. There is no indication that either of these types of extensions were contemplated.

D. Does the Agreement Automatically Terminate if the Commissioner Does Not Grant an Extension?

There is one provision in the agreement which might be interpreted to modify or temper the termination provision of 10.2. Article 14.3 provides that "No. . . failure of performance under this Agreement shall be deemed to have occurred under this agreement unless such. . . failure of performance is material or substantial under all the circumstances. . . ." The only guidance as to what constitutes "material or substantial" is the qualifier that one must look to all the circumstances. The "circumstances" presumably include the agreement itself, the understandings and interests of the parties when they negotiated and entered into the agreement, and the events as they exist at the time of the failure of performance. With respect to the agreement itself the language is quite clear. If the tasks are not accomplished by a specific date, the agreement terminates unless an extension is granted. The timetable in the agreement, especially accomplishment of tasks at the 18-month and subsequent benchmark is clearly at the heart of the agreement. (See page 23 above). It could well be concluded from the structure and language of the agreement that any failure to comply with performance required under 10.2 -- even by one day -- is material and thus not excused. The extrinsic evidence supports this view. For example, there are references in the record to the rigid requirement

of 10.2 and the safeguard this term of the agreement provides. (See the testimony of Mr. Rogers quoted above). It must be recalled that many members of the legislature were concerned that there might be some "loophole" that would result in the contract remaining in force even if the Buyer was not satisfying its obligations. Both the Commissioner and Buyer's representatives assured the legislature that was not so.

While it might be that a court would conclude all failures to comply with the benchmarks of article 10.2 constitute material and substantial failures of performance for the reasons discussed above, it cannot be assured that a court will so conclude. As noted above, "circumstances" include events and facts as they are at the time of the failure. What if Buyer failed to comply by only one day? For example, suppose the financing commitment documents were supposed to be signed on December 18, but an airline strike prevented the documents being executed until th 19th or even 20th or 21st. Would the agreement have terminated for failure to satisfy 10.2(3)? Possibly the answer is "yes." On the other hand, a court may conclude that the parties did not intend termination in such event. (Force majeure may also apply to the supposition set forth).

It is not possible to say with absolute certainty what "circumstances" if any, might lead a court to conclude that, (notwithstanding the language of article 10.2,) the agreement did not terminate even though the Buyer did not comply with all the benchmarks. In the light of the contract language and supporting extrinsic evidence, we conclude a court would find failure to comply with the benchmark requirements would be "material and substantial" failure in all but the most extreme cases.

IV. Delivery of Royalty Oil Prior to Completion of the Petrochemical Facility (Article 2.2)

Prior to amendment, article 2.2 of the agreement did not require the passage of any particular period of time before Buyer would be entitled to receive royalty oil from Prudhoe Bay. Rather, article 2.2 required the occurrence of a particular event; that event being, that Buyer "obtain or cause contractually bound third parties to obtain written commitments to lend or invest at least one billion five hundred million [dollars] in the aggregate for payment of Total Project Costs." The extrinsic evidence indicates both Buyer and Seller expected it would take Buyer about 18 months to obtain these commitments, but that each understood

that if Buyer obtained the financial commitment and furnished satisfactory evidence thereof, even one day after the Effective Date, then Buyer would have a right immediately to call for the initiation of deliveries. (See e.g: Questions of Representative Chatterton and Replies by O. Charles Honig in Transcript of Testimony before the Special Committee on Royalty Oil and Gas, March 18, 1978, at pp 7, #10.)

In May, 1978, after the agreement had been presented to the Legislature; hearings were held, and the House voted against approval of the agreement, Alpetco and the Commissioner of Natural Resources entered into certain amendments to the original agreement. One of these amendments modified the original article 2.2 in two ways.

First, the amendment provided that Buyer may not receive royalty oil until at least 25 months after the effective date of the agreement. In effect, the amendment adopted the 18-month period the parties expected it would take Buyer to obtain the financial commitments and made it the minimum time period which must elapse before Buyer may initiate its call for deliveries.2/ It does not, however, grant Buyer an automatic right to receive delivery of royalty oil 25 months after the effective date because the amendment does not change the basic requirement of article 2.2 that Buyer obtain a total of 1.5 billion dollars in commitments before Buyer has a right to receive any royalty oil.

Second, under the amendment to article 2.2, Buyer is not entitled to receive royalty oil until Buyer "has actually expended $100 million in Total Project Costs." This requirement is similar to, but more stringent than, the requirement of article 10.2(4)(a) which states that by the 24th month of the agreement, Buyer must "expend or commit to

---

2/ The 25-month period is arrived at as follows: 18-month period to obtain financing, plus 6-month notice required to change from in-value to in-kind, plus 1 month allowed in the Agreement from time Buyer gives Seller notice, to time Seller must give the lessors notice.

expend or cause contractually bound third parties to expend or commit to expend at least one Hundred Million Dollars in Total Project Costs."

Considering both the original language of article 2.2 and the amendment thereto, three distinct possibilities exist. The first case is where Buyer does not obtain the written financial commitments required by 10.2(3) on or before December 18, 1979, and the agreement is terminated. This case is easy to analyze. Buyer has no right to receive royalty oil because it did not satisfy the requirements of article 2.2 and furthermore, Buyer never will have such right because the agreement is terminated. The second case is where Buyer does not obtain the required financing commitments, but the agreement is extended and during the extension period Buyer obtains the financing commitment. This situation is complicated and not fully addressed by the language of the agreement. Our analysis and conclusion is presented below. The third case is where Buyer does obtain the required financing commitment on (or before) December 18, 1979. This situation should be simple, but the amendment to article 2.2 introduces a complication. Our analysis of this situation follows:

A. Buyer Obtains a Financial Commitment by December 18

Under article 2.2, prior to amendment, Buyer would simply have given notice to Seller who would then give notice to the lessees to deliver royalty in-kind and Buyer would begin purchasing royalty oil 6 months after Seller's notice is delivered by the lessees. However, the amendment complicates this approach. First, under the amendment, Buyer may not receive oil until 25 months after the effective date. This creates a small but easily solved problem. Seller, after receiving notice from Buyer, may either wait the full 30 days permitted under the agreement before giving notice to the lessees, or give notice promptly but make it a 7-month notice. In that way, it will be 25 months after the Effective Date of the agreement before oil is actually received by Buyer.

The second problem is more complicated. Under the amendment, Buyer may not receive the royalty until it has actually expended $100 million. But in order for Buyer to be able to receive royalty oil after the 25th month, Seller must give the lessees notice of taking royalty oil in-kind at least 6 months earlier. The problem, of course, is what happens if Seller gives notice to the lessees to deliver royalty in-kind and Buyer has not satisfied the expenditure requirement by the 25th month?

The problem would not exist, if the amendment to article 2.2 is read to say that Buyer may not ask Seller to give notice to the lessees until Buyer has expended $100 million. Such a reading would mean that Buyer would not receive oil until 6 months after Buyer had expended $100 million. This is contrary to the language of the amendment and also we believe contrary to the expectations of the parties. As best we can discern from the extrinsic evidence, it seems to be that the expectations were that Buyer would obtain financing by the 18th month, Seller would give notice, Buyer would expend $100 million by the 24th month and Buyer would receive royalty oil in the 25th month. We have found no indication in the extrinsic evidence that the difficult position in which Seller is placed was perceived by either Buyer or Seller, or by the Legislature. Additionally, it must be noted that although the Seller is placed in a difficult position, Seller is not without alternatives to protect itself. We conclude that the Seller has an obligation to be prepared to deliver oil to Buyer at the 25th month if Buyer has obtained the financing commitments by the 18th month and expended $100 million by the 25th month. In practical terms, what this means is that if the Buyer does obtain the financing commitment by December 18, 1978, Seller should give notice to the lessees if requested to do so by Buyer unless there is clear evidence that Buyer will not be able to expend $100 million by the 25th month.3/

If at the 25th month, Buyer has not satisfied the $100 million expenditure requirement, the Seller can either

---

3/ Seller should ask Buyer to explain its plans for actually expended $100 million by the 25th month. If Buyer does not make a reasonable showing that it will make such expenditures, we believe Seller would not be obliged to give notice to the lessees until such time as Buyer demonstrates a reasonable expectation of meeting the $100 million expenditure requirement.

waive (perhaps)4/ the requirement, sell the oil to Buyer under a separate short-term contract approved by the Royalty Board or sell the oil to another party for a short term until Buyer does satisfy the requirement. None of these options may be particularly desireable but all are permissible under state law. Indeed, if recent past experience is any indication, the major producers may be eager to purchase State royalty oil if Buyer does not have the right to do so under the agreement.

B. The Agreement is Extended

The problem of meshing the Seller's obligations to give notice to the lessees' and Buyer's right to receive royalty oil is readily solved in the situation where Buyer requests an extension of time. Since the Commissioner of Natural Resources has discretion to extend or not extend the agreement, we conclude he may attach conditions to an extension which conditions must be accepted by Buyer if Buyer accepts the extension. We have not undertaken a

---

4/ A significant caveat must be noted to the statement that the Commissioner can waive the expenditure requirement. It is not possible to say with certainty whether or not the Commissioner of Natural Resources has the legal power to waive a condition of the Agreement. As noted by a leading legal commentator, the concept of "waiver" of a contract condition or promise has been confused greatly by the courts. It has no single meaning or application. See In re Oleg Cassini v. Co ture Coordinates, 207 F.Supp. 821 (S.D.N.Y. 1969) and Hing Bo Gum v. Nakamura, 549 P2d 471 (Ha. 1976) The courts hve noted that a condition precedent in a contract solely for the benefit of one party can be waived by that party. Whether a waiver has occurred could depend on how it is granted and whether or not the Buyer relied upon the waiver. However, here the matter is even more complicated because "amendments" to the Agreement must be approved by the Royalty Board and Legislature but waivers need not be. Compare article 17 with article 22 of the Agreement. It is possible that an attempted waiver might later be found by a court to be an "amendment" which failed because of lack of Royalty Board and Legislative approvals.

We have not undertaken an analysis of the difference between amendments and waivers and the Commissioner's authority to waive contract conditions and/or promises. This seems beyond the scope of this memorandum, particularly where alternative courses of action are available and involve far less uncertainty.

thorough analysis of the limits on the Commissioner's power to impose conditions. We are confident that where the conditions seek to clarify ambiguous matters, such conditions are defensible. On the other hand, we can imagine extreme conditions being imposed which, even though accepted by Buyer, might later be held by a court to constitute ineffective amendments to the agreement, or voided by the court on the grounds of economic duress. See Totem Marine Tug & Barge v. Alyeska Pipeline Service Co., 584 P.2d 15 (Ak. 1978). We therefore advise judicious use of the imposition of corditions as part of the granting of an extension.

We suggest any extension granted Buyer should seek to clarify Buyer's right to royalty oil by establishing that Seller shall not be obligated to give notice to the lessees until 1) Buyer has obtained the financing commitment; and 2) expended $100 million. This modification is more harsh than the original terms of the agreement, but justifiable since Buyer's failure to meet the benchmark may be regarded by the Commissioner as a basis for extreme caution in the delivery of royalty oil to Buyer.