

STANDING COMMITTEE REPORT NO. 15-49

RE: C.B. NO. 15-80/R&D

SUBJECT: APPROVING THE GUARANTY BY THE FEDERATED STATES
OF MICRONESIA OF A LOAN AGREEMENT BETWEEN THE
FEDERATED STATES OF MICRONESIA PETROLEUM
CORPORATION AND THE BANK OF GUAM.

NOVEMBER 21, 2007

The Honorable Isaac V. Figir
Speaker, Fifteenth Congress
Federated States of Micronesia
Third Special Session, 2007

Dear Mr. Speaker:

Your committee on Resources and Development, to which was referred
Congressional Bill No. 15-80, entitled:

"A BILL FOR AN ACT TO AUTHORIZE THE PRESIDENT OF THE FEDERATED
STATES OF MICRONESIA TO EXECUTE A FULL FAITH AND CREDIT GUARANTY
AS SECURITY FOR A LOAN AGREEMENT BETWEEN THE FSM PETROLEUM
CORPORATION AND THE BANK OF GUAM.",

begs leave to report as follows:

The intent and purpose of the bill are expressed in Paragraph 1:

"The newly created FSM Petroleum Corporation (FSMPC) is in
the process of consummating a transaction with Mobil Oil
Micronesia, Inc. (MOMI) to purchase MOMI's fuel facilities
located within the FSM and to enter into a new fuel supply
agreement with MOMI and is in need of a commercial loan in
order to complete these deals and begin its operations.
FSMPC has negotiated a loan with the Bank of Guam (BOG) in
the amount of approximately \$10,000,000. BOG requires FSMPC
to secure from the President a "full faith and credit
guaranty," the essence of which is that the National
Government will agree to become jointly and severally liable
for FSMPC's payment obligations under the loan and consent
to waive its sovereign immunity for the transaction. A
limited waiver of sovereign immunity is codified at 6
F.S.M.C. § 702. However, pursuant to 27 F.S.M.C. § 251 (as
enacted by Public Law No. 15-08), the National Government
will not assume the debts of FSMPC in the absence of a law
expressly authorizing such assumption."

DISCUSSION:

On September 11, 2007 C.B. 15-39 was signed by the President and
became PL 15-08. That law created the new FSM Petroleum Corporation

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that was given the power to purchase and take over management and operation of the fuel storage and distribution facilities within the Federated States of Micronesia and enter into fuel supply agreements. Subsequently Congress adopted C.R. No. 15-39 by which it gave its approval to the terms of the asset purchase agreement with Mobile Oil Micronesia, establishing the purchase price for the assets and also approving the five year fuel supply agreement necessary to put the Petroleum Corporation in business.

Throughout the approval processes for the bills and resolutions referred to, it was consistently represented that any financing to implement the purchase agreements and to fund the initial operating needs of the new corporation would require a guaranty by the FSM National Government.

Negotiations with the Bank of Guam were initiated by the FSM Fuel Task Force and concluded by representatives of the FSM Petroleum Corporation. Those negotiations have resulted in a loan agreement providing for three separate loans. One is evidenced by a Promissory Note in the amount of \$5,200,000 and the other two are "Line of Credit Facilities" or "Master Line of Credit Notes" in amounts of up to \$4,300,000 and \$240,000 respectively. The Note is to be used to finance the asset purchase from Mobile Oil Micronesia. The larger line of credit is intended for initial fuel inventory purchases and operating capital. The smaller line is intended for payment of initial insurance costs for the new business. The total amount to be guaranteed by the National Government is up to \$9,740,000, depending on draw against the lines of credit.

THE GUARANTY:

The reason for the Bill appears in the recitations on page 1 of the Guaranty:

"* * *, Lender is unwilling to make such loans to Borrower unless Lender receives the Full Faith and Credit Guarantee of the Guarantor (FSM) covering the liabilities and obligations of Borrower described below."

The essence of the Guaranty is aptly stated in Presidential Communication 15-106. If approved, the National Government will be agreeing to become jointly and severally liable for the obligations of the Petroleum Corporation to the Bank and will be consenting to a waiver of its sovereign immunity. That means that if there is a

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breach of a term or condition of the loan or a failure to make a required payment, the Bank could legally pursue payment for all of the obligations from the National Government without first pursuing remedies against the Corporation. Paragraph 4 specifically states, "This is a guaranty of payment and not of collection."

Most of the terms of the Guaranty are typical of such undertakings and include statements of waivers of various potential defenses to an action on the Guaranty. It further consents to various actions by the Bank in relation to the indebtedness. The guaranty continues until the indebtedness of the Corporation is fully paid and released, including periods of renewal or extension.

Paragraph 7 purports to be an assignment and pledge by the National Government of all indebtedness at any time owed to it by the Petroleum Corporation.

The Committee notes the Guaranty draft presented does not contain language confirming a right of subrogation in the FSM National Government in the event it is called upon to satisfy the debt of the Corporation to the Bank of Guam due to breach or default. This matter is discussed later in this Report.

PUBLIC HEARING:

A public hearing on C.B. No. 15-80 was held on Saturday, November 17, 2007 commencing at 10:00 a.m. at the Committee Hearing Room. Senator Dion G. Neth, Chairman of the Standing Committee on Resources and Development chaired the meeting. Other committee members present were Senators Peter Sitan, Paliknoa Welly, Joe N. Suka and Joseph J. Urusemal and Vice Chairman Satiro Paul. Also in attendance was Speaker Isaac V. Figir. Peter Christian, Chairman of the Interim Board of Directors of the FSM Petroleum Corporation, Maderson Ramon, Director of the Division of Energy of the Department of Resources and Development, Loretha Barnett, Assistant Attorney General with the Department of Justice, Jared Morris, energy advisor to the corporation and Noel Pascua and Secretary Finley Perman of the Department of Finance were present by invitation.

After welcoming remarks, Chairman Neth invited Mr. Christian to address the Committee on the financing arrangements of the Corporation and specifically the requested Guaranty by the National Government. Following a brief statement by Board Chairman Christian concerning the

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need for the guaranty, Chairman Neth invited questions by the
Committee members.

Floor Leader Suka started the discussion by asking for an update
concerning where the Corporation is in the process of commencing
operations. Chairman Christian stated that for the Corporation to
commence operations, it needs the money that will be provided by the
loans from the Bank of Guam. He stated that the Corporation faces a
few remaining challenges but expressed his confidence the Corporation
could begin operations very shortly after completion of the
requirements for the financing. He outlined the planned phased
takeover of Mobile Oil Micronesia facilities and operations to be
completed before the end of the calendar year.

Chairman Neth clarified the sequence as (1) approval of the Guarantee,
(2) receipt of loan proceeds and (3) sequential payment for and
takeover of facility operations in the various states.

Senator Welly stated his understanding that the loan commitment of the
Bank required participation by all of the States of the FSM. Maderson
Ramon was asked to respond and stated that the Bank of Guam did have
two primary conditions to its loan commitment. First is the "full
faith and credit guarantee" of the National Government and the second
was a four state operation.

When asked by Senator Sitan whether a refusal by any one state to
participate in the Corporation would lessen the amount of the loans
from the Bank, Chairman Christian responded that it would not. He
stated that participation by any particular state would was not a
requirement for the acquisition of the MOMI assets in that state and
that the corporation would be purchasing the assets of MOMI in
Pohnpei, Chuuk and Yap regardless of the failure or refusal of any one
of them to participate in the management of the Corporation.

The discussion moved to the Bill, itself. Floor Leader questioned the
underlined wording on page two of the document marked C.D.1 and asked
for an explanation. Assistant Attorney General Barnett stated that
the waiver of sovereign immunity language was wording that was being
required by the Bank of Guam and that it had been erroneously omitted
from the original draft of the Bill introduced as C.B. 15-80. The
underlined language of C.D.1 was simply to correct that omission.
During further discussion concerning the waiver, she stated the Bank
was requiring that language in an abundance of caution in order to
insure that sovereign immunity would not be claimed by the FSM in the

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event it were necessary to make a legal claim on the Guaranty. She stated her belief that the Title 6 of the FSM Code already provided for such a waiver and that the language required by the Bank would not alter existing law.

Several members expressed concern with the fact the Bill referred to a loan "in the amount of approximately \$10,000,000" rather than the specific amount of \$9,740,000 spelled out in the Guaranty document. It was concluded the two documents should use the same amount and that they should be harmonized by a C.D.1 revision to C.B. No. 15-80.

Further discussions centered on the rights of the FSM in the event it were ever required to satisfy the indebtedness of the Corporation pursuant to the Guaranty. Assistant Attorney General Barnett stated she has already requested that the Bank include a provision for "subrogation" into the Guarantee to the effect that, if the FSM makes payment on the Guaranty in satisfaction of all obligations of the Borrower, the FSM shall be subrogated to all rights of the Bank arising under its notes, loan agreements and security agreements, etc. and the Bank will do whatever is necessary to enable the FSM to exercise those rights and shall do nothing after loss to prejudice them. She explained that a "subrogation" would effectively give to the FSM all of the rights against the Corporation provided to the Bank by the loan agreement, pledge and security agreements.

In response to questions from Chairman Neth, Secretary Perman confirmed that moneys guaranteed by the National Government do not show on national audit reports as liabilities unless or until it becomes liable under a Guaranty. Legal Council T. Lam Dang added that facts creating an imminent potential for liability pursuant to a guaranty must be reported in connection with the audit process.

CONCLUSION:

Your Committee observes that the Nation has been working toward a competitive fuel supply arrangement for its citizens since 1994. The determination was made that ownership or control of the fuel distribution facilities located in each of the States and a unified negotiation for future fuel supplies would promote that goal.

The Fifteenth Congress has acted to create the FSM Petroleum Corporation to acquire the assets from Mobil Oil Micronesia and has already approved the asset purchase agreement and a five-year fuel supply agreement between MOMI and the Corporation. Those approvals

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were made with full awareness that the financing necessary to implement them would require a guaranty by the National Government. That fact is emphasized by the Bank's recitation in the Guaranty, itself, that the Bank is unwilling to make the necessary loans without the "Full Faith and Credit Guaranty" of the National Government.

RECOMMENDATION:

Your Committee on Resources and Development recommends adoption of C.B. No. 15-80, C.D.1 as requested by the President in his Presidential Communication No. 15-106.

Respectfully submitted,

/s/ Dion G. Neth
Dion G. Neth, chairman

/s/ Setiro Paul
Setiro Paul, vice chairman

Resio S. Moses, member

/s/ Peter Sitan
Peter Sitan, member

/s/ Joe N. Suka
Joe N. Suka, member

/s/ Joseph J. Urusemal
Joseph J. Urusemal, member

/s/ Paliknoa K. Welly
Paliknoa K. Welly, member