

STANDING COMMITTEE REPORT NO. 15-42

RE: C.R. NO. 15-39/R&D

SUBJECT: APPROVING THE TERMS OF SUPPLY AND PURCHASE AGREEMENTS
WITH MOBIL OIL MICRONESIA, INC (MOMI).

SEPTEMBER 25, 2007

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

Dear Mr. Speaker:

Your committee on Resources and Development, to which was referred Presidential Communication No. 15-61 and Congressional Resolution No. 15-39, entitled:

"A RESOLUTION TO APPROVE THE TERMS OF SUPPLY AND PURCHASE
AGREEMENTS WITH MOBILE OIL MICRONESIA, INC (MOMI).",

begs leave to report as follows:

The intent and purpose of the resolution are expressed in its title.

Presidential Communication No. 15-61 explains that C.R. No. 15-39 is intended to approve agreements that were negotiated by the Fuel Task Force for the benefit of the Federated States of Micronesia Petroleum Corporation. It acknowledges the terms of the contracts may appear one sided but cites the comments of the environmental advisor to the Task Force, Miles Wilkinson, and the Pacific Islands Forum Secretariat energy advisor, Jared Morris, for the proposition the Agreements are favorable to the FSM.

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BACKGROUND:

In the mid-1990's the Economic Policy Implementation Council (EPIC) charged the Fuel Task Force (FTF) with coordinating the negotiation of national fuel supply agreements. Beginning in 2005 following EPIC Resolution 2005-1-01 the FTF was also directed to explore the possibility of acquiring ownership of fuel terminals and distribution facilities in Yap, Chuuk and Pohnpei. Kosrae opted out of the common contracting arrangement in 1995.

The Micronesia Fuel Task Force began acquisition discussions with MOMI in 2005. In mid-2006 an "in principle" agreement with MOMI was reached which facilitated the beginning of more detailed negotiations. An initial offer was received from MOMI in March, 2007 at which time a petroleum industry consultant was identified and retained by the FTF for assistance in the valuation of the assets and the offer.

Further negotiations resulted in a firm agreement as to the purchase price of the assets and the duration of a new fuel supply agreement in March, 2007. By that time, an extension of the old arrangement, which originally expired on June 30, 2007, had been agreed upon giving the FSM until September 30, 2007 to complete the transaction for the assets and implement the new 5-year fuel supply agreement.

DISCUSSION:

Your Committee notes that on September 11, 2007 C.B. No. 15-39 was signed by the President becoming Public Law No. 15-08. That law created a new public corporation capable of purchasing and taking over management of the fuel storage and distribution facilities within the Federated States of Micronesia. The law did not, of itself, result in ownership of the assets by the Corporation or an agreement for a continued flow of fuel to the various States.

This Committee conducted public hearings in each of the four States and a final public hearing with the FSM Fuel Task Force prior to submitting its S.C.R. No. 15-23 relating to the establishment of the shared legal entity. Throughout that process it was emphasized that the background negotiations between the MOMI and the Task Force were based on an "four States" participation requirement by the Seller and that any purchase-sale agreement for the assets was irrevocably tied to a fuel supply agreement for all four of the States.

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C.R. No. 15-39 is a Resolution by which the Congress of the FSM would give its approval to the terms of the supply and purchase agreements with MOMI that would put the FSM Petroleum Corporation in business. As emphasized by your Committee during its hearing process on the Corporation Bill, however, it continues to be a requirement of the Seller that the Agreements and the undertakings of the Agreements be ratified and approved by all four of the States as well.

SALE AND PURCHASE AGREEMENT

This agreement is between MOMI and the FSMPC **AND** the Governments of the FSM, Chuuk, Pohnpei and Yap for the sale and purchase of the fuel facilities in Chuuk, Pohnpei and Yap. However, this Agreement at Section 2(a) is made subject to a contemporaneous Supply Agreement, which must also be joined in and guaranteed by the State of Kosrae.

The purchase price in the Agreement is \$4,900,000 for the assets in all three of the States.

The word "novation" or "novate" as used in the context of the agreement refers to agreements relieving MOMI from liability for leases or agreements relating to the facilities being purchased.

Paragraph 3(d) prohibits any transfer, assignment, sublease or other parting with the possession of the Land or Assets without the prior written consent of MOMI for a period of 5 years but does seem to allow for "divestment" to one or all of the State Governments during that period provided the obligations under the FSA are guaranteed by the transferee.

Paragraph 7 is the RELEASE and INDEMNIFICATION language whereby the Corporation, FSM, Chuuk, Yap and Pohnpei essentially agree to excuse Mobile from any and all liability it might otherwise face as a result the occupation or use of the Land or Assets or any breach of the Agreement or of any Environmental Law or Order. Subparagraph (c) acknowledges that the Corporation, the national government and each of the States relating to facilities located therein assume and are solely responsible for all Environmental Liabilities relating to or arising out of prior use of the Land or the Assets, whether known or later discovered, including remediation activities as may be required by laws, regulations or orders of any of the Governments.

The Agreement is contingent upon Mobil obtaining approval from landlords to the assignment and novation from Mobil to the Corporation. This primarily relates to the current lease for the

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land on which the Pohnpei facilities are located. It is also contingent upon the Corporation obtaining at least \$5 million in financing.

The Agreement is governed by the laws of the FSM.

FUEL SUPPLY AGREEMENT

The Corporation agrees to buy all of its requirements of Diesel, Jet A-1 and Mogas exclusively from Mobil Oil Guam for a period of 5 years after "Commencement Date."

The Corporation agrees to a "Minimum Annual Quantity" which may be adjusted annually by not more than 10% of the previous years volumes. The minimum volumes for each State are set out Page 5.

The pricing for product is set pursuant to a complex formula set out commencing at Schedule 1, Paragraph 6 of the Agreement.

All five FSM Governments guarantee the performance of the contract by the Corporation although each State's guarantee only applies in respect to the obligations with respect to that State. The terms of the Guarantees appear beginning at Page 42, Paragraph 22 and include a duty to pay costs Seller may incur in collecting payments or enforcing the Agreement. Each State "guarantees" the minimum volumes for itself only while the National Government is exposed to joint and several liability for the obligations of the Corporation in all States.

This contract is governed and interpreted pursuant to the laws of Singapore.

PUBLIC HEARING:

A public hearing on the proposed agreements was held on Monday, September 24, 2007 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 K. Welly, Joe N. Suka and Joseph J. Urusemal. Also in attendance were Senators Roosevelt D. Kansou and Dohsis Halbert. The Chairman of the FSM Fuel Task Force (FTF), Peter M. Christian, FTF member and Director of the Division of Energy of the Department of Resources and Development, Maderson Ramon, Deputy Attorney General Loretha Barnett and Jimmy Pascua representing the Department of Finance were present by invitation.

After welcoming remarks, Chairman Neth invited Mr. Christian to address the Committee on the terms of the contracts.

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Mr. Christian began his comments by stating that the President has already asked for appointments to the interim board from the State Governors and that the Board should be ready to move forward within a very short time. He confirmed that the Corporation would not be able to move forward with the agreements without the adoption of C.R. No. 15-39 by Congress. He acknowledged that the contracts required similar resolutions from each of the four States and that none of the States have yet acted on them.

In response to a question from Senator Urusemal concerning deadline dates in the contracts that have already passed, Assistant Attorney Barnett stated there is an "implied" extension from the fact that MOBILE has not withdrawn them and continues to work with the Fuel Corporation representatives toward completion.

Following a general discussion about the obligations that would accrue to the National Government as a result of C.R. No. 15-39, it was stated that the contracts being approved have the effect of waiving enforcement the FSM Environmental Law against MOMI for past contamination and of guaranteeing the financial obligations of the Fuel Supply Agreement. It was confirmed that any financing agreement negotiated by the Corporation would not be guaranteed by this particular Resolution and that if an FSM guarantee were to be a requirement of such a financing agreement, future action by Congress will be required.

During discussion of the Fuel Supply Agreement it was also confirmed that the risk of loss from an environmental incident during shipment of fuel supplies from Guam to the States would be with the Corporation and not MOMI. Mr. Maderson Ramon stated that the financing for the start up of the new Corporation includes approximately \$240,000 for an initial insurance package that would provide coverage for such contingencies. Members of the Committee commented that adequate insurance to cover any potential environmental catastrophe should be an essential business expense of the Corporation.

Mr. Christian concluded his remarks by stating his vision that the Federated States of Micronesia and each of the States will be looking at a very different negotiating position five years from now than it had during the initial negotiations. He expressed his confidence that the Corporation will be successful not only in satisfying its obligations, but also in controlling the price of fuel.

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Mr. Christian asked that C.R. No. 15-39 as introduced be amended in the form of C.R. 15-39, C.D.1 to improve the wording without changing its legal effect.

CONCLUSION:

Your Committee recognizes that by adoption of the two Contracts, the National Government not only will be waiving its right to enforce its environmental laws against MOMI in relation to contamination at the fuel distribution sites in three of its States but will also be exposing itself to potential financial liability in the event the operation of those facilities by the FSM Petroleum Corporation proves unsuccessful.

C.R. No. 15-23 granted Congressional "approval in principle" to a Memorandum of Understanding between MOMI and the FTF dated June 28, 2007 "providing that all environmental risk shall shift from MOMI to the FSM upon acquisition." That Resolution further confirmed "the FSM shall be authorized to guarantee the performance of the Corporation" with reference to the proposed 5 year fuel supply agreement (FSA)." In S.C.R. No. 15-18 this Committee considered those issues in a report adopted by Congress prior to the adoption of C.R. No. 15-23.

The Fuel Supply and the Sale and Purchase Agreements appear to be consistent with the representations that have been made to your Committee during its hearing process. While the Committee may have hoped for more favorable terms, it appreciates the challenges faced by the Fuel Task Force during its negotiations with MOMI and gives credence to the President's recommendation of the Agreements.

In S.C.R. No. 15-23, this Committee stated that the Bill creating the shared Petroleum Corporation was only a "next step" in assuring future energy supplies for the nation and would by no means be the culmination of the process. Approval of the Agreements by Congress is another "next step." Mindful of the "completion" deadlines that have been imposed on the Corporation to assure an uninterrupted supply of fuel from MOMI to each of the States and that approvals must be obtained from each of the four States before the Contracts are completed, early action by Congress is important.

The Committee also wishes to stress its recommendation that the Corporation place a high priority on securing and maintaining an insurance package adequate to provide full coverage for all contingencies including environmental catastrophe.

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RECOMMENDATION:

Your Committee on Resources and Development recommends adoption of Resolution C.R. No. 15-39, C.D.1 as requested by the President in his Presidential Communication No. 15-61.

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

Joseph J. Urusemal, member

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