Alaska Industrial Development and Export Authority
BOARD MEETING MINUTES
April 1, 2011
Anchorage and Juneau, Alaska; Ayacucho, Peru;
Taiwan; and Tucson, Arizona

1. CALL TO ORDER

Acting Chairman Mike Felix called the meeting of the Alaska Industrial Development and Export Authority to order on April 01, 2011 at 9:05 a.m. A quorum was established.

2. ROLL CALL: BOARD

Members present in Anchorage: Acting Chair Mike Felix (Public Member); Susan Bell (Commissioner, Department of Commerce, Community, and Economic Development); Jerry Burnett (Deputy Commissioner, Department of Revenue); Hugh Short (Public Member).
Member participating from Arizona: Gary Wilken (Public Member).
Member participating from Peru: Robert Sheldon (Public Member).
Member participating from Taiwan: Ron Arvin (Public Member).

3. AGENDA APPROVAL

Acting Chair Mr. Felix added an item to the agenda. Item 6A will be added to include Executive Session to discuss client/attorney privileged issues. Item 6B will be Resolution No. G11-07. The agenda was approved as amended.

4. ROLL CALL: STAFF, PUBLIC

Staff present in Anchorage: Ted Leonard (Executive Director); James Hemsath (Deputy Director-Development Finance); Chris Anderson (Deputy Director-Commercial Finance); Mark Davis (Economic Development Officer); Karl Reiche (Project Development Manager); (Karsten Rodvik (External Affairs Project Manager); Chris Rutz (Procurement Manager); Sandy Burrows (Administrative Assistant); and Sherrie Siverson (Executive Assistant).

Others present in Anchorage: Brian Bjorkquist (Department of Law); Dennis Fenerty (Groh Eggers); Mark Gardiner and Pat Clancy (Western Financial Group); Jim Watt (Buccaneer Alaska); Steve Sutherlin (Strategic Action Associates and Escopeta Oil); Tim Bradner, (Alaska Journal of Commerce); Russell Bell (Alaska Telecom); and Kyle Parker (Crowell & Moring).

Others attending via conference call: Eric Lidji (Petroleum News); Scott Bernstein (Buccaneer Resources); and Curtis Burton and Mark Landt (Buccaneer Alaska).

Listen to the full audio recording of the 04/01/2011 meeting at http://www.aidea.org/boardmin.html

5. PUBLIC COMMENTS

Steve Sutherlin, Strategic Action Associates and Escopeta Oil

Mr. Sutherlin, spoke on behalf of Escopeta Oil. They are currently transporting a jack-up rig to Cook Inlet with the intent to make it available to companies that are interested in using it to drill for oil or gas. They intend to take advantage of Senate Bill 309, which was designed to bring a jack-up rig to Cook Inlet to stimulate private investment. Mr. Sutherlin expressed his belief that the board has a tremendous responsibility in considering this issue and feels they should look at Escopeta making a private investment in bringing a jack-up rig to explore Cook Inlet. He stated that their interest pre-dates any tax incentives that were offered by the Legislature.

Mr. Felix asked several questions and confirmed that this jack-up rig is being transported from another U. S. port by a ship with a foreign flag. He asked if the ship has a Jones Act waiver. Mr. Sutherlin produced the Jones Act waiver that was issued in June 27, 2006. In response to Mr. Felix's question if the waiver was for this particular rig, Mr. Sutherlin replied that it is for the TAI AN KOU, a foreign-owned and foreign-flag vessel. Mr. Sutherlin stated that they have 100% confidence that Escopeta will be moving a jack-up rig into the Cook Inlet that is fully capable of drilling there. The equipment is on the way.

6. NEW BUSINESS

6A. EXECUTIVE SESSION

Motion: Mr. Short moved to go into executive session to discuss attorney/client privileged information regarding the deal points with the Buccaneer Alaska project. Seconded by Deputy Commissioner Burnett.

EXECUTIVE SESSION – 9:22 a.m.

The board reconvened its regular meeting at 10:28 a.m. Roll call was taken and a quorum was established.

6B. Resolution No. G11-07, Approval of acquisition by the Authority of an interest in an oil and gas Rig for use primarily in Cook Inlet Alaska and other Alaska waters.

Mr. Leonard briefed the board on Resolution No. G11-07. The request is for $30 million to help finance, acquire and modify a rig to be brought up to Cook Inlet. This resolution would give the Executive Director authorization to execute a Joint Ownership Agreement.

Mark Gardiner, from Western Financial Group, discussed the finance plan which reflects the final Joint Ownership Agreement that has been agreed to by the parties on the other side. Mr. Gardiner reviewed the structure of the transaction. The project sponsors, Buccaneer and Ezion, will form an LLC under the name Kenai Offshore Ventures (KOV) which will enter into a joint ownership agreement with AIDEA to acquire, modify, transport and mobilize the rig. The agreement is $30 million from AIDEA and $5 million from Buccaneer/Ezion and $50 million from a term loan with a senior lender. That loan is guaranteed to the lender by Ezion but AIDEA's interest is subordinate to that loan. Mr. Gardner stated the term loan, as it has been approved by the bank for Ezion, includes the potential to go up to $56 million, rather than just $50 and in that case, AIDEA's participation would go down to $24 million. AIDEA's participation is limited to 30 million. Mr. Short asked what the driver is behind $56 or $50 million. Mr. Gardiner replied that it depends upon the third party bank appraisal for the modified rig whether it goes from $50 to $56.

Mr. Leonard stated the condition precedents have a $50 million minimum. Mr. Felix asked if the appraisal is lower than that, will Ezion have a decision at that point whether or not to fund the loan? Mr. Gardiner stated if the loan is not funded the project capital contribution would be dispersed pro rata, with the bank, KOV and AIDEA. Ezion has agreed to loan the project, $3.3 million, for purposes of prefunding start-up period interest. That provides the portion of the first year's debt service and that has the effect of offsetting the project's obligation to the bank. AIDEA's interest is as a preferred owner with a dividend and the KOV ownership is a common ownership. There are a series of rights that go with preferred ownership that are outlined in the agreement beyond just receiving a dividend. The plan is that AIDEA's ownership interest would be repurchased by KOV or potentially by third parties over five to six years. During the time that the ownership interest is held by AIDEA, the project is obligated to pay AIDEA an 8% dividend for the outstanding ownership interest balance and in the event a dividend is not paid, or a portion of a dividend is not paid in a year that remains an obligation to be paid to AIDEA. It doesn't compound the principles. The principle is always calculated on original ownership interest as retired but it does remain an obligation for that dividend to be paid at some point. Mr. Felix stated that it accumulates as a dividend payment but it doesn't accrue and if there is a default in liquidation, it becomes AIDEA's amount.

Mr. Gardiner stated that any unpaid dividend would be part of what is due in full. Buccaneer commits to paying for use of the rig to drill four wells, to a bare boat charter for the rig, and to repurchasing $3 million of AIDEA's ownership upon the receipt of any ACES or other Senate Bill 309 credits for rig mobilization. There is an early payment provision that if the rig arrives and earns those credits out of that first amount of credits then $3 million is paid to buy down AIDEA's ownership.

Mr. Hemsath replied to the question asked by Mr. Felix whether Senate Bill 309 applies to everybody who comes or just the first to arrive. He explained that Senate Bill 309, as it is currently written, is for the first rig that arrives in Cook Inlet whose drill bit reaches Pre-Tertiary depths, about 12,000 feet. The starting point is when they start drilling but they have to reach depth and if they do and are number one, then they get the first credit. The second party that comes in, using the same rig, gets the second credit. Third party comes in using the same rig, gets the third credit. Mr. Gardiner noted that there is a table in the report that shows the effect of two rigs so that we can see how the ACES and Senate Bill 309 works. The ACES applies for any rig.

Mr. Hemsath stated that the ACES credit applies to those costs in excess of what SB 309 covers so when you see an ACES number on the SB 309 those costs are in excess of $25 million dollars. Mr. Leonard said that the bottom line to this table is that there is a substantial credit for any well that is drilled. Sixty-five percent of exploratory costs will be reimbursed. He noted the interesting fact that with SB 309, if the well is a producing well then some of those credits will be recaptured by the State. Mr. Hemsath added that at the point that the well produces revenue it basically pays back the SB 309 credit to some level.

Mr. Gardiner continued his presentation stating that once the rig is in operation, the JOA controls the flow of funds in this order:

- first to a limited amount of KOV expenses;
- to the operating expenses of the rig manager;
- the payment on the senior debt;
- transaction cost, which is one-time only in the first year;
- the Ezion loan repayment, which is the payment of the $3.3 million;
- then AIDEA payments to a reserve account that is to the benefit of AIDEA;
- distribution to the other owners.

In the event of a default or liquidation of the rig, Buccaneer is obligated to pledge any ACES credit receivables up to $7 million and in the event of liquidation, AIDEA has the right to acquire the term loan from the senior lender in its entirety and AIDEA has approval rights on any changes to the term loan. It protects AIDEA to make sure the rig is sold for the highest amount to recover AIDEA's ownership interest. KOV has the option to acquire all or part of AIDEA's ownership interest at par plus accrued dividends until December 31, 2013. This provides an incentive for them to recapitalize the rig. It will have accomplished AIDEA's economic development objective at that point of having the rig brought to Alaska and drilling wells and it will allow AIDEA to fund other projects.

Mr. Felix asked what happens after December 31, 2013. Mr. Gardiner stated they no longer have that interest to buy it at par. Mr. Felix added they can still buy it or make a proposal to buy it but it is negotiated at that point. Mr. Gardiner stated there are mutual rights of first refusal on third party offers to buy the interest so if KOV had an offer from someone to buy their interest, AIDEA has the right of first refusal to step into the shoes of the potential purchaser and likewise for a potential purchaser of AIDEA's interest. Mr. Felix then asked if AIDEA also has rights in approving new owners. Mr. Gardiner replied at one point AIDEA did have bilateral approval of new owners. The right of first refusal went into the agreement in place of that.

In the event of a default or liquidation Buccaneer would provide AIDEA with an overriding royalty interest (ORRI) on 3.5% of their worldwide holdings. That would become a lien on those holdings in the event of a failure to pay any dividends or principal repurchase payments. It becomes a lien at the point any payment is not made to AIDEA in a timely manner. Mr. Felix asked where the preponderance of their worldwide holdings exists. Mr. Gardiner replied Texas.

Mr. Short inquired what the estimated collateral value of 3.5% of their holdings is today. Mr. Gardiner stated that it is a hard question to answer because of the nature of valuing prospective revenues. They have Alaska holdings above $30 million but their confidence in those estimates was not high enough that one could actually liquidate for that value. Mr. Felix asked if it is the total value, not the 3.5% value. Mr. Gardiner replied that it was the ORRI value.

Mr. Short asked how one could perfect that lien and what would the liquidation process be at that point. Mr. Fenerty stated they have engaged Texas oil and gas council to assist them in documenting the lien against the ORRI. It is what is called a "springing lien" because it will only arrive in the event that KOV doesn't make its payments of dividend or repurchase of any year. If that event would occur in year one, AIDEA would take the 3.5% ORRIs. In year two or immediately following the failure to make payments to AIDEA, there is a process for taking a lien against an overriding royalty interest. Mr. Leonard noted that the lien will cover the difference between the $30 million plus dividend minus what was recovered in the default, so an estimate of ten to fifteen million dollars.

Mr. Leonard asked Mr. Fenerty if AIDEA can sell their leases if there is an ORRI on them. Mr. Fenerty indicated that before AIDEA takes the lien, KOV is free to deal with it as they see fit. Once AIDEA takes the lien they would only be able to sell subject to the lien. Mr. Short inquired why AIDEA wouldn't take the lien up front to be in a position so where they are not selling leases and moving assets out of this company into another company. Mr. Fenerty replied that it is a springing lien that is always risky because of changing circumstances between the day you are promised it and the day you take it. That is a negotiated risk but in the agreement one of the conditions precedent provides the documentation of the interest and overriding royalty interest. The reason AIDEA wouldn't have the lien right away is because it could be a barrier for KOV to receive financing for drilling wells.

Mr. Gardiner reviewed the draft JOA that includes 15 conditions precedent to closing. Only if all of the precedent conditions are met will AIDEA fund and go forward. He highlighted some which are listed in the report. These precedents are at AIDEA's sole discretion for approval. Mr. Fenerty stated they put both the conditions precedent and the conditions subsequent in the resolution that staff is asking the board to approve.

Mr. Gardiner then reviewed the five conditions subsequent which are important to protecting AIDEA's interest but which are not possible to be done before the deal closes. In the case of conditions subsequent not being met, the remedy is AIDEA's ability to declare default. Mr. Felix asked if the board gets another opportunity to approve this after conditions subsequent. Mr. Gardiner replied no. If a condition subsequent is not met to AIDEA's satisfaction, then the agreement provides that AIDEA could declare a default.

Mr. Wilken inquired whether the pro forma and all of the financials are based upon not receiving credits out of legislation. Mr. Gardiner reviewed that the pro forma are based on the rental for the rig from a rig operator which receives revenue from the working interest party that owns the resource and is paying for the drilling. The working interest party's position is improved by the state incentives. They are not part of the financial pro forma for the rig ownership.

Mr. Felix asked if permits are part of conditions subsequent or conditions precedent. Mr. Gardiner replied that they are subsequent. Mr. Wilken asked, just as a general discussion, what is the status of permits if any are having problems.

Mr. Gardiner said there is a permit plan for the project that has been developed by Buccaneer and their consultants specializing in that area and AIDEA has engaged specialty council who is monitoring that process and advising AIDEA about that. AIDEA's understanding, at this point, is that all of the applications that should have been made, have been made and that those processes for the permits are proceeding as expected. The specialist has characterized the permit situation as "tight but achievable". There are permits which could be full stop, as with any project of this type. There is not an expectation that this will happen but that risk exists and in that circumstance that would mean that a condition subsequent was not met and that AIDEA would have the right under the agreements to declare a default. How the other parties might respond to that is unknown but if there was a high probability that permits would be received, ultimately, they were just delayed. There is some reasonable likelihood that KOV and its participants would fund to carry through. If that did not appear to be likely, then AIDEA's right to declare default would have the effect of stopping the project and, most likely, ultimately moving or liquidating the rig.

Mr. Bjorkquist added a comment that was made in the executive session that AIDEA will have the discretion whether to declare a default or not. It is not an automatic trigger so AIDEA will be able to evaluate the situation after any of the conditions subsequent are not met, and decide what to do at that point. Mr. Fenerty said the offshore Chinese bank, OCBC, is also attuned to this issue. If permits should not occur, AIDEA will be in significant negotiations with the bank. An agreement also could be reached to continue so long as Ezion will be the required party to make the extra contributions to the bank.

Mr. Gardiner continued his presentation with the process and timelines. If the board were to approve the JOA today, AIDEA would be immediately moving into a very intense period of checking off conditions precedent with the expectation that those need to be done in order to meet the schedule by late this month. If all of those are achieved then the closing would happen late in April. The rig would be purchased and on its way to the shipyard in Singapore to be refitted and upgraded and then be would be transported to Cook Inlet with the expectation of drilling beginning in mid-August. Mr. Felix asked if the permitting process is the main support for this schedule. Mr. Gardiner replied that first is getting the entire financing plan and business agreements together. There is the JOA, which is negotiated but then all the subsequent guarantees and other agreements that need to be completed, the details on the purchase agreement, the requirements on the bank loans are in concordance to the JOA, and then it's doing the rig and the permitting which run parallel. His partner, Pat Clancy and Mr. Hemsath went to Singapore to do due diligence and at that same time visited the shipyard that will be doing the work on the rig. They have received a high level of confidence in the players involved and are not afraid of these timelines on that basis.

Mr. Felix asked what would be the biggest risk factor to getting everything done for the drilling season for 2011. Mr. Gardiner responded with the permits.

Mr. Short asked to hear from Buccaneer as to who the operators are going to be. He asked if they had any concerns with regard to actually getting the company out there and getting the rig going because of the aggressive timeline. Mr. Curtis Burton stated he is in direct contact with the rig operator they are working with. He is in discussion to get some people on the rig in question. They don't believe this will be an issue. Mr. Short asked who the operator is, and if it is an Alaskan company. Mr. Burton answered that it is an international drilling contractor that is well recognized in the industry but he was not at liberty to divulge their name at the moment. Once the letter of intent is signed next week this information will be released to the board.

Mr. Gardiner continued with the financial part of the presentation. Under the $50 million dollar loan scenario, the total is $85 million with $35 million in owner capital and a $50 million loan. The report also listed a $56 million dollar loan scenario which would be used if the rig appraisal value, post renovations, came in higher than expected.

Mr. Gardiner continued to provide context, stating besides the rig project Buccaneer and Ezion also are committing substantial resources to the actual drilling and have committed to drill four wells with this rig. Buccaneer has agreed to exclusive use of this rig for any drilling they do in Alaska. Mr. Arvin commented that he read that it was only in Alaska for a year, and questioned if that was right. Mr. Gardiner replied that the expectation is that the rig would be in Alaska for at least five or six years necessary to pay AIDEA's interest, and there are identified prospects that actually require that it stays in Alaska as long as AIDEA is an owner. Mr. Fenerty added that the exclusive use remains an obligation of Buccaneer for so long as we remain a co-owner.

AIDEA's experts have provided information that demonstrates there is a market for resources from Cook Inlet for drilling beyond the commitments that KOV has made to use the rig so there is an economic base for the project.

Mr. Gardiner reviewed the projected JOA cash flow. Mr. Short asked about the $21,900,000 in annual rig rental revenue, how that number came about and if it is a realistic number. Mr. Gardiner replied it is based on the day rate of $60,000 a day times 365 days. Mr. Gardiner said the assessment of the experts was that the day rate was in a reasonable range.

Mr. Short asked if they will mark up the price based upon whenever they can get in the market. Mr. Fenerty replied that they understand the market is in excess of $100,000 a day but our number is fixed, their number is what the market will bear. Mr. Leonard added that the lease on the Bareboat Charter to the operating company is a guaranteed yearly lease.

Mr. Felix asked about the assumption of how many drill days per year and if the rate that is outside of those is pro forma. Mr. Gardiner replied that those influence the probability of the operating company and are not part of this pro forma. Mr. Short confirmed then if for some reason, the rig sits for an excessive amount of time not rented out and the $21,900,000 is not able to be paid would that then trigger the default which would trigger everything else.

Mr. Gardiner reviewed the suitability of the project stating it is in a targeted region, in a targeted industry, it meets other criteria necessary for AIDEA participation. He reviewed job creation and noted that the expectation is that this will create the seed for a skill base in the community that doesn't exist now. This is beyond the jobs; it is creating the skill base in that industry in the area.

Mr. Gardiner then reviewed the risk table. The JOA was structured to mitigate all of the risks.

Deputy Commissioner Burnett asked Mr. Leonard if he is confident that this is a good deal and in the best interest of AIDEA. Mr. Leonard replied yes. He thinks Cook Inlet is a very important aspect of south central and will provide a stable supply of gas coming into the economy.

Most of the board members commented on how uncomfortable they were with this project at the beginning but now, from much education and hard work from the staff and Buccaneer, they feel ready to move on this project. They thanked the staff for their many hours of tremendous work to help the board come to this point.

MOTION: Deputy Commissioner Burnett moved to adopt Resolution No. G11-07. Seconded by Commissioner Bell.

The question was called. A roll call vote was taken and the motion passed unanimously with Mr. Felix, Mr. Wilken, Commissioner Bell, Mr. Short, Mr. Sheldon, Mr. Arvin and Deputy Commissioner Butcher voting yea.

7. DIRECTOR COMMENTS

Mr. Leonard thanked the board for their patience as they moved through this process. He thanked the staff, the financial advisors, the lawyers, and the assistant AG for working ten to twelve hours a day on this deal, especially during the last two or three weeks.

The next meeting is April 20, 2011**.**

8. BOARD COMMENTS

Commissioner Bell commented that as the board is thinking about the calendar and timing, there are elements of our strategic planning discussion that need to resume. Mr. Leonard stated that the parts of the strategic plan on financial capacity, metric and items that did not get covered in February, will be a part of the agenda of a regular meeting that .Mr. Felix and Mr. Leonard are looking into.

Mr. Short shared information on a summit June 19-21 in Girdwood called the Arctic Imperative Summit. He passed this information to Mr. Leonard to see if AIDEA could be a sponsor of this event. He noted that there is a list of possible and confirmed speakers. Topics include Race to the Resources, Infrastructure needed in the Arctic in Alaska, Arctic Science and Research and Development. Mr. Short thinks AIDEA should play a role in the development of these types of things when they talk about strategic planning. He encouraged Mr. Leonard to take a look at this and perhaps get something to the board regarding sponsorship. He hopes some of the board members will be able to attend.

Mr. Wilken thanked Mr. Leonard for the piece on the Seafood Processing Waste. He would like to add another meeting to hear updates from that project and also cover things lingering from the February work session. He noted that the board will need to talk about a chairman to replace Mr. Felix. He thanked Mr. Felix for his leadership today.

Mr. Arvin thanked Mr. Leonard and his staff for putting together information on this Buccaneer Jack-Up project.

Mr. Felix stated that the board does need to talk about his replacement as he will be retiring from the board soon. He noted that he is in a very small group of executives that report directly to the chairman of AT&T and who do the integration of things that AT&T buys. AT&T just announced the $39 billion acquisition of T-Mobile. His time schedule has been difficult but he is grateful that they got through this process and thanked everyone for being coachable in how to manage a board and how to get something as big and unwieldy as this through. He thanked everyone for their patience and staff and outside counsel for all of the hard work and stated he appreciated all of the hard work that everyone put into this. He wanted the record to show that they finished 20 minutes early and got this thing done.

9. ADJOURNMENT

There being no further business of the Board, the meeting was adjourned at 11:40 a.m.

Ted Leonard, Executive Director/Secretary
Alaska Industrial Development and Export Authority