



Alaska Pipeline Company
A SUBSIDIARY OF SEMCO ENERGY, INC.
P.O. Box 190288
401 E. International Airport Rd.
Anchorage, Alaska 99519

February 11, 2019

Via Email and Certified Mail

Scott Pinsonnault
Chief Operating Officer
Furie Operating Alaska, LLC
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Anchorage, AK 99503
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Furie Operating Alaska, LLC
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Chief Financial Officer
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Energy Capital Partners Mezzanine
Opportunities Fund A, LP (Collateral Agent)
Attn: Andy Singer
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Courtesy Copy To:
Energy Capital Partners Mezzanine
Opportunities Fund A, LP (Collateral Agent)
Attn: Jennifer Gray
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Re: Default Notice under Gas Supply Agreement between Furie and Alaska Pipeline Company

Dear Mr. Pinsonnault:

Alaska Pipeline Company (“APC”) hereby declares Furie Operating Alaska, LLC (“Furie”) in default under Section 13.4(ii) of the Gas Supply Agreement dated February 26, 2016 (“GSA”) between the parties for the reasons set forth below. This constitutes a Formal Notice under Section 13.5 of the GSA. This Formal Notice is concurrently being provided to Energy Capital Partners Mezzanine Opportunities Fund A, LP (“ECP”), Furie’s lender, pursuant to Section 3(b) of the Consent to Collateral Assignment dated February 26, 2016. Under Section 13.5 of the GSA, the parties have 20 days from delivery of this



Formal Notice of default to meet in order to attempt to work out an acceptable arrangement (as more fully described in Section 13.5); if an acceptable arrangement cannot be worked out during the 20 day period, the GSA is terminated. APC reserves all rights and remedies under the GSA.¹

Background:

Furie has had a difficult time meeting required milestones under the GSA from the time the ink was dry on the GSA. These failures relate to lack of funding and, thus, “creditworthiness” issues under Section 12.2 of the GSA, and failures to drill required wells and demonstrate reserve levels and production capability to meet the GSA. APC has been very accommodating to Furie over the past 3 years when APC has had the ability to terminate the GSA at several junctures. To provide Furie with every opportunity to prove that it could meet the Gas requirements under the GSA, the parties entered into the following Amendment and letter agreement:

1. Amendment to Gas Sales Agreement dated September 13, 2017 (“Amendment”) that lowered the Gas Sales Price to be paid by APC under the GSA due to Furie’s failure to meet certain Conditions Precedent set forth in Section 13.3(b) of the GSA. The Amendment also extended the deadline for Furie to submit its Reserves Report and Engineer’s Opinion Letter contemplated in Sections 2.10(e) of the GSA to October 31, 2018.
2. Letter Agreement dated December 5, 2017 (and executed by Furie on December 11, 2017) that allowed Furie, among other things, until April 1, 2018 to close on the financing commitment by ECP that APC had received prior to November 30, 2017, but which was rejected as non-compliant with the proof of capital raise requirements under the Agreement.

In spite of the extensions to accommodate Furie’s drilling of additional wells, and to provide Reserve Reports, Engineering Reports, and a Contingency Plan (all due by October 31, 2018), Furie has been unable to provide the Reports and Plan, and has continued to have operational trouble with wells and production. For instance, from the first day of gas deliveries under the GSA, Furie has been supplementing its delivery of Gas to APC by purchasing third party Gas and drawing Gas out of CINGSA storage. While this alone did not place Furie in default, it demonstrated that Furie was not capable of producing sufficient quantities of Gas to meet the GSA requirements.

Then, on January 17, 2019, Furie requested a delayed delivery for more than a half of its Firm Gas quantity while it mitigates hydrate issues at its facility. APC agreed to defer the delivery of the requested volumes requiring Furie to return these volumes by March 31, 2019. APC acquiesced to this delay, but has been required to buy Cover Gas under Section 2.9 of the GSA for both the one-half delayed delivery Gas and the *Force Majeure* Event described below.

Section 2.10 provides the obligation of Furie to provide all required quantities of Gas after the Start Date (April 1, 2018) has occurred. Once Furie started delivering Gas under the GSA, it undertook the absolute obligation to supply all required quantities of Gas. The only remedy for APC is to seek Cover under Section 2.9; the only remedy for Seller, is to collect money for Gas delivered (all has been paid). Section 2.10 contains important language:

¹ All capitalized terms used herein are defined in the GSA, unless otherwise specified.



“Seller agrees to provide to Buyer adequate Gas to satisfy its obligations under this Agreement, subject to Seller's Existing Commitments. In all situations which curtail the volumes of Gas available for delivery by Seller after the Start Date (including due to a *Force Majeure* Event), the Existing Commitments shall have first priority over Buyer to any Gas Seller has available, including priority to any Gas still being processed by Seller at Sellers Facilities; provided, however, all of Buyer's remedies under this Agreement are preserved, including the right to cover under Section 2.9.” (Emphasis added)

This language defines the following Seller obligations: (a) supply adequate Gas to meet the obligations under the GSA, (b) if sufficient Gas is not delivered to meet these obligations (including a *Force Majeure* situation), Buyer is entitled to Cover under Section 2.9. APC reserves all rights and remedies, including the right to Cover under Section 2.9.

***Force Majeure* Event:**

On January 23, 2019, Furie notified APC of an alleged *Force Majeure* Event, citing Sections 11.1(b)(i) (“Acts of God”) and 11.1(b)(iv) (“the freezing of a well or line of pipe”). Section 11.1(d)(i) requires that a party claiming excuse based on *Force Majeure* notify the other party of the event “within a reasonable time” by Formal Notice and that the notice provide “reasonably full particulars.” Furie has failed to fulfill either requisite. First, Furie failed to notify APC of the event within a reasonable time because the well freeze-up occurred on January 5, 2019, more than two weeks before Furie provided APC with Formal Notice.

Second, Furie failed to provide reasonably full particulars in its Formal Notice because APC was not provided with sufficient factual basis to conclude that the event was in fact a *Force Majeure*. Pursuant to Section 11.1(b), an event may only be declared a *Force Majeure* Event “if the event is not attributable to the gross negligence or willful misconduct of the affected Party.” To date, Furie has not provided any evidence that the well freeze-up did not occur due to Furie’s gross negligence or willful misconduct (such as failing to install dehydration units as recommended).

Until and unless APC receives such confirmation and has the opportunity to review data from the days prior to the January 5 well freeze-up, and has information necessary to investigate any design defects and how they arose, APC does not accept that this event qualifies as a *Force Majeure* Event and reserves all rights and remedies, including Cover under Section 2.9.

Default:

Pursuant to Section 13.4(ii) of the GSA, APC declares Furie in default of its Gas delivery obligations, which includes Furie’s failure to provide the required reports listed below that give APC assurance that Furie has the reserves and production capability to perform under its delivery obligations of Section 2.10. Despite repeated demands by APC,² Furie has ignored its reporting obligations under Section 2.10(e) to demonstrate the sufficiency of Furie’s Available Gas Reserves and production capability as required under the APC by failing to (a) deliver a Reserve Report due by October 31, 2018; (b) deliver an Engineer’s Report due by October 31, 2018, and deliver a Contingency Plan due by October 31, 2018.

² See emails dated November 13, 2018 and January 14, 2019 from APC to Furie attached as Exhibit A.



These Reports and the Plan are material contract terms meant to confirm the reliability of Furie's reserves and Furie's ability to deliver the promised quantities of Gas APC is relying upon in order to ensure a supply for its customers at the promised prices. Verification that Furie has sufficient reserves and can reliably deliver the Gas under the GSA is the fundamental reason for the reporting structure required by the GSA. The reports allow for APC to take actions, such as termination and mitigation, to protect its customers.

In addition to the reporting requirements, Furie has a continuing obligation under the GSA to demonstrate creditworthiness at all times during the Term under Section 12.2. Furie's failure to provide critical reports with information about reserves and production capacity, coupled with the demonstrated inability to produce sufficient quantities of Gas over the past several months, leads APC to question Furie's ability to produce Gas to satisfy Existing Commitments (Homer Electric) and the APC commitments. This concern extends to Furie's ability to continue paying for supplemental Gas from third parties to meet its delivery obligations to APC. As stated in Section 12.2 of the GSA, "[a]ny failure by each Party to maintain creditworthiness, *as determined by the other Party in its sole reasonable discretion*, represents a breach of this Agreement." (emphasis added) APC demands proof of Furie's creditworthiness supported by evidence that Furie has the ability to either (a) produce Gas at rates sufficient to meet its commitments under the GSA, or (b) pay for sufficient Gas from third parties to meet its obligations. The amount of production and needed Cover will only be apparent when and if Furie can produce the Reports it is in default of providing. Pursuant to Section 12.2, APC requests financial information from Furie (including such things as a current balance sheet, line of credit or other availability to borrow funds, and financial projections that include capital expenditures) to demonstrate creditworthiness that APC can review in its "sole reasonable discretion." APC requests that this information be provided within 10 calendar days of the date of this letter. If Furie cannot provide sufficient information within the required time frame, APC will consider Furie's failure to fulfill its obligation under Section 12.2 as a separate breach, distinct from its breach under Section 2.10(e).

Process under Section 13.5(a):

Under Section 13.5(a) of the GSA, with the declaration of default by APC, the parties are required to meet within 20 days of the Formal Notice of default in order to see if there is some satisfactory accommodation that can be reached. There is no obligation to reach such an accommodation. Should the parties not come to agreement, then the termination becomes effective on the 20th day. Moreover, under Section 3(b)(ii) of the Consent to Collateral Agreement between APC, Furie and ECP, ECP has 15 days to elect whether to undertake a cure, and then 45 days to implement that cure.

Reservation of Cover Damages and Letter of Credit Draw:

Under Section 2.9, APC can claim as damages against Furie, generally described as the difference between the price of Gas to be supplied by Furie and the cost of APC obtaining any quantity of Gas Furie fails to supply. APC is collecting and retaining all records to quantify its Cover damage claim, including for the period covered by the alleged *Force Majeure* Event subject to an acceptance that this is a legitimate *Force Majeure* assertion. Assuming Furie is unable to prove the facts underlying the alleged *Force Majeure* Event, APC has also attached an invoice for Cover damages for the month of January as **Exhibit B**.



Under Section 12.1 of the GSA, Furie was required to provide a \$6 million letter of credit to protect APC from any inability of Furie to pay its Cover damages. While the time for APC to draw on the letter of credit is not ripe since required notice and cure timeframes have not occurred yet, APC intends to draw on the letter of credit to protect itself, if needed.

Conclusion:

Based on a default under Section 13.4(ii) of the GSA, and the procedures set out in Section 13.5(a), the parties must meet within 20 days to discuss whether there is any ability to cure or any accommodation that is acceptable to APC to avoid termination. APC will make itself available throughout the 20-day period to accomplish this required meeting. If a consensual resolution cannot be obtained, APC will terminate the GSA and seek all appropriate damages.

Sincerely,



John Sims
President
Alaska Pipeline Company

