December 11, 2014
Alaska Department of Natural Resources
State Pipeline Coordinator’s Office

Analysis of Transfer of Interest Request for
the Badami Oil Pipeline Right-of-Way Lease, ADL 415472, and
the Badami Utility Pipeline Right-of-Way Lease, ADL 415965,
from Savant Alaska, LLC (a partial interest owner of Nutaaq Pipeline, LLC)
to Miller Energy Resources, Inc.

I. Nature of the Request:

The Badami pipeline right-of-way leases, ADL 415472 and ADL 415965 (referred to herein as “Badami Pipeline Leases”), are currently held by Nutaaq Pipeline LLC, a conglomerate of Savant Alaska, LLC and Badami Pipeline Holding Company, LLC. In a letter dated June 20, 2014, Savant Alaska, LLC and Nutaaq Pipeline LLC request that the Department of Natural Resources (DNR) approve a transfer of Savant Alaska, LLC’s indirect interests in the Badami Pipeline Leases to Miller Energy Resources, Inc. (Miller). Savant Alaska, LLC will be merged with Miller Energy Colorado 2014-1, LLC, a subsidiary of Miller. Savant Alaska, LLC will retain its name and responsibilities as operator of the Badami Pipeline Leases.

In order to transfer control of a lessee’s interest in a right-of-way lease, the DNR Commissioner is required, pursuant to Alaska Statute (AS) 38.35.120, to consider if the transferee is fit, willing, and able to perform the transportation or other acts proposed in a manner that will reasonably protect the lives, property, and general welfare of the people of Alaska. The authority to authorize a transfer of interest in an AS 38.35 Right-of-Way Lease as described in AS 38.35.120(a)(09) has been delegated to the State Pipeline Coordinator (SPC) via Department Order 003 “Delegations of Authority”.

II. Background:

Badami Pipelines
The Badami Pipeline Leases were entered into and made effective between the State of Alaska and BP Transportation Alaska, Inc. (BPTA) on December 15, 1997. BPTA had been operating the pipelines through its contract operator, BP Exploration Alaska, Inc. (BPXA).

Savant Alaska, LLC (Savant) has been working with BPXA since 2008, when the two companies began to develop plans to restart the Badami Unit after a period of inactivity. On January 7, 2012, BPXA transferred the Badami Unit to Savant and ASRC Exploration, LLC; since that time Savant has been providing operator services to the Badami Pipelines.

On April 25, 2013, BPTA and Nutaaq Pipeline LLC (Nutaaq) submitted a transfer of interest to the DNR State Pipeline Coordinator’s Office (SPCO), which was approved by the DNR Commissioner on December 24, 2013. Nutaaq is owned by Savant, which holds a 67.5% interest, and Badami Pipeline Holding, LLC, which holds the remaining 32.5% interest. Badami Pipeline Holding, LLC is a wholly-owned subsidiary of ASRC
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Exploration, LLC, which in turn is a wholly-owned subsidiary of Arctic Slope Regional Corporation (ASRC).

Badami Pipeline Right-of-Way Leases
The two existing Badami Pipeline Leases have been written in accordance with AS 38.35 and include all covenants required under AS 38.35.120. The Badami Pipeline Leases are written in a manner intended to mitigate potential conflicts with existing uses and specific protections of the public and private property interests. These leases contain environmental mitigation stipulations and require the implementation of an approved surveillance and monitoring program and an approved quality assurance program. These programs specify how the lessee will implement mitigation measures and administer programs to prevent potential significant adverse environmental impacts and damages to fish and wildlife, as described in the lease. The leases also address protection of interests of individuals living in the general area and continued public access upon the leaseholds.

Financial Assurances
The Badami Pipeline Leases require, via AS 38.35.120(a)(14), that the lessee (Nutaaq) will procure and furnish liability and property damage insurance from a company licensed to do business in the state or furnish other security or undertaking upon the terms and conditions the Commissioner considers necessary if the Commissioner finds that the net assets of the lessee are insufficient to protect the public from damage for which the lessee may be liable arising out of the construction of operation of the pipeline.

Prior to the transfer of the Badami Pipeline Leases from BPTA to Nutaaq, the leases were covered by BP Corporation North America’s (BP North America) parent guaranties stating that BP North America “unconditionally guaranties to the State full performance, fulfillment, and satisfaction of all duties, obligations, and liabilities of BPTA arising under or pursuant to the Lease.”; this was required via Section 11 of the Badami Pipeline Leases. On October 14, 2013, BPTA submitted a request for partial release of these BP North America parent guaranties for the Badami Pipeline Leases. The request was to release BP North America of any liability arising from the operation of the pipelines. After review and consideration, a partial release of the BP North America guaranties was approved by the Commissioner on January 31, 2014 via the “Analysis of Request for Partial Release of BP Corporation North America Guaranty.” Currently, BP North America unconditionally guaranties full performance of all lease obligations, and satisfaction of all duties, obligations, and liabilities relating to termination obligations of the pipelines as they existed as of the transfer date, February 6, 2014, from BPTA to Nutaaq and for any improvements associated with the Piggable Wye Project for the Point Thomson Export Pipeline (ADL 418975).

As agreed to in the transfer from BPTA to Savant and ASRC: unconditional guaranties for the Badami Pipeline Leases from Savant (67.5% interest owner of Nutaaq) and Arctic Slope Regional Corporation (32.5% interest owner of Nutaaq through fully-owned Badami Pipeline Holding, LLC) corresponding with the interest of each party in Nutaaq, have been submitted to the SPCO.
Nutaaq is also required to maintain insurance coverage intended to mitigate shortfalls in the size and the joint risk associated with Savant as the current guarantor. The Nutaaq insurance coverage addresses AS 38.35.100 criteria:

**Spill Risk Insurance** – Nutaaq is currently covered by an $85 million insurance policy with a $1 million deductible for each incident. However, the insurance carrier has the responsibility to collect the deductible; in the event that the lessee is unable to pay the deductible, the carrier will still be liable to make incident related payments.

The policy covers the following expenses:

- **Remediation Expenses** – exclusively for remediation of pollutants that are on or under a covered property, provided the remediation expenses arise from Onsite Pollution
- **Emergency Response** – emergency response expenses as a result of pollution incident and incurred in response to an imminent and substantial threat to human health or environment
- **Third-Party Claims** – bodily injury or property damage
- **Transportation** – bodily injury, property damage, or remediation claims which arise from transportation
- **Waste Disposal Activities** – bodily injury, property damage or remediation from a pollution incident resulting from waste disposal
- **Business Interruption** – insured’s business interruption expenses.

**Other Insurance** – Nutaaq is also covered by the general liability, excess liability, and pipeline property coverage to include 3rd party bodily injury and property damage over and in excess of that covered by the risk spill insurance.

**Proposed Guarantor and Transferee**

The proposed guarantor, Miller Energy Resources, Inc. (Miller), is a publicly-traded corporation headquartered in Huntsville, Tennessee, specializing in oil and gas exploration, production and drilling. It is the owner/operator of several oil and natural gas wells in the state of Tennessee, with more than 54,500 acres of lease holdings and 600 wells. Miller has invested considerably in the Cook Inlet area with a 2009 acquisition of Alaskan-based assets from Pacific Energy Resources. Its Alaskan-based assets include West McArthur River Unit, Osprey Platform, Kustatan Production Facility, West Foreland natural gas field, Three Mile Creek field (30% interest), the North Fork Unit, and Susitna Basin assets through its subsidiary Cook Inlet Energy.

**III. Administrative Record:**

The following documents constitute the administrative record for this analysis:

- The Badami Sales Oil Pipeline Lease and associated case file; and
- The Badami Utility Pipeline Lease and associated case file.
IV. Proposed Transfer:

The transfer request proposes that Miller will acquire all of the membership interest in Savant when Miller’s subsidiary, Miller Energy Colorado 2014-1, LLC, merges into Savant. Upon completion of the merger, Savant will be the surviving entity, and through its ownership of Savant, Miller will have an indirect interest of 67.5% in Nutaaq, the lessee.

Upon completion of the pending transfer, no management changes are anticipated in the operation of the Badami pipelines; Savant has been providing operator services for the Badami pipelines, and will continue these services after the merger with Miller Energy Colorado 2014-1, LLC. Savant will be the surviving entity in the merger.

The requested transfer of interest does not include changes in the use or propose additional use of the Badami pipeline leases. According to the application, Miller Energy Resources, Inc. has accepted and agreed to be bound by the terms and conditions of the Badami pipeline leases.

V. Technical Review:

DNR staff reviewed the technical condition of both the Badami gas and oil pipelines for the analysis of the BPTA to Nutaaq transfer of ownership request in late 2013. For the review in 2013, staff developed a list of eight technical questions and data requests to assess the condition of the pipelines. BP produced documentation that successfully answered all of those questions. DNR staff has evaluated developments and inspections of the pipelines conducted during the interim and found no significant changes during the past year. The pipelines remain in relatively good condition and, in general, Savant continued with previous maintenance practices.

The review by the SPCO was intended to assess the condition of the pipelines for continued operations under current programs and conditions; this was not intended to be a full engineering analysis. The review did not reveal any significant deficiencies, corrosion problems, settling or other issues that would require a new owner to perform major maintenance or assume inordinate risk. It did reveal that the buried stream crossings were likely the greatest operating risk; however, this part of the original construction is a design that BPTA has successfully managed and operated since the beginning of Badami production.1 The DNR, Pipeline Hazardous Materials Safety Administration (PHMSA), and other government agencies have monitored these crossings since the beginning of production and have seen no significant problems develop during nearly 15 years of operations.

BPXA’s Technical Authority for Pipelines produced a short condition report on the Badami pipelines. Among other conclusions, he stated, “[b]ased on the information review, the Badami Oil and Gas Pipelines are fit for continued service.” He also stated, “[t]he pipelines have been maintained and are in good condition.”2

1 Memo, Louis Kozisek, PE, to Allison Iversen, BP to Savant Transfer, November 26, 2013.
2 Correspondence, Glen Pomeroy to Don Turner, Subject: Badami Oil and Gas Pipeline Status, November 8, 2013.
VI. Financial Review:

The request that the SPCO received from Savant Alaska, LLC and Badami Pipeline Holding Company, LLC for the transfer of the Badami Pipeline Leases is part of a larger transfer of the Badami Unit and associated infrastructure. The majority of the authorizations and assets being transferred are managed by the State of Alaska Division of Oil and Gas (DOG) and were completed and approved on November 26, 2014. The financial review below was requested by SPCO and provided by commercial analyst within DOG in support of the Badami pipeline Leases. Due to the nature of the language and financial assurance requirements contained in AS 38.35, the transfer of the AS 38.35 Badami pipeline leases is conducted separately from the Badami Unit and associated authorizations. This analysis assesses the financial standing of the companies involved in the transfer as required by AS 38.35.120.

Miller and Savant entered a merger agreement, effective May 1, 2014, in which Miller will acquire 100 percent of the ownership interest in Savant, a company that currently operates the Badami Unit and holds rights to a certain group of oil and gas leases, permits, rights-of-way (two of which are the Badami pipeline leases issued via AS 38.35) and easements that extend to areas outside the Badami Unit. As a result of this merger agreement, and subject to the corresponding regulatory approvals, Savant will become a wholly-owned subsidiary of Miller. Following this, Savant shall remain the operator of the Badami Unit and the working interest owner of all corresponding oil and gas leases subject to this transfer of assets. In this way, only the ownership of Savant changes, with no other alterations to the operations, personnel and policies of procedures of Savant.

Miller Acquisition of Savant

To evaluate Savant and Miller’s ability to perform obligations required by the Badami pipeline leases, DNR used the parties’ most recent financial statements to calculate their Altman Z-Scores (Z-Score) and equity values and to obtain an indication on the likelihood that each of the companies will experience financial distress in the short term. Following that approach, DNR evaluated key parameters such as the following ratios: working capital to total assets, retained earnings to total assets, Earnings Before Interest & Tax (EBIT) to total
assets, book (or market) value of equity to book (or market) value of total liabilities, and sales to total assets.

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014 (for the period ending in April)</th>
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<tbody>
<tr>
<td><strong>Miller (in US$ M)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Assets:</td>
<td>509,081</td>
<td>536,389</td>
<td>575,405</td>
<td>766,822</td>
</tr>
<tr>
<td>Current Assets:</td>
<td>8,304</td>
<td>14,603</td>
<td>30,564</td>
<td>71,236</td>
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<tr>
<td>Current Liabilities:</td>
<td>15,986</td>
<td>43,181</td>
<td>26,309</td>
<td>74,914</td>
</tr>
<tr>
<td>Working Capital</td>
<td>-7,682</td>
<td>-28,578</td>
<td>4,255</td>
<td>33,528</td>
</tr>
<tr>
<td>Depreciation</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shares on April 30</td>
<td>39,880,251</td>
<td>41,086,751</td>
<td>43,444,694</td>
<td>45,756,697</td>
</tr>
<tr>
<td>Share price on April 30</td>
<td>5.77</td>
<td>5.43</td>
<td>3.80</td>
<td>4.82</td>
</tr>
<tr>
<td>Working Capital / Total Assets</td>
<td>-1.51%</td>
<td>-5.33%</td>
<td>0.74%</td>
<td>0.48%</td>
</tr>
<tr>
<td>Retained Earnings:</td>
<td>245,725</td>
<td>226,188</td>
<td>200,693</td>
<td>158,926</td>
</tr>
<tr>
<td>Retained Earnings / Total Assets</td>
<td>48.27%</td>
<td>42.17%</td>
<td>34.88%</td>
<td>20.73%</td>
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<tr>
<td>EBIT:</td>
<td>-14,592</td>
<td>-25,085</td>
<td>-32,349</td>
<td>-10,693</td>
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<tr>
<td>EBIT / Total Assets</td>
<td>-2.87%</td>
<td>-4.68%</td>
<td>-5.62%</td>
<td>-1.39%</td>
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<td>Total Equity:</td>
<td>$230,109</td>
<td>$223,101</td>
<td>$165,090</td>
<td>$220,547</td>
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<tr>
<td>Total Liabilities:</td>
<td>$214,339</td>
<td>$236,566</td>
<td>$255,288</td>
<td>$416,303</td>
</tr>
<tr>
<td>Total Equity / Total Liabilities</td>
<td>107.36%</td>
<td>94.31%</td>
<td>64.57%</td>
<td>52.98%</td>
</tr>
<tr>
<td>Revenue:</td>
<td>22,842</td>
<td>35,402</td>
<td>34,801</td>
<td>70,558</td>
</tr>
<tr>
<td>Revenue / Total Assets</td>
<td>4.49%</td>
<td>6.60%</td>
<td>6.05%</td>
<td>9.20%</td>
</tr>
</tbody>
</table>

The table above shows that, for the past four years, Miller has had a significantly small share of working capital with respect to its current assets. Also, its EBIT has been consistently negative for this period. Lastly, Miller’s equity has been representing a progressively smaller share of its liabilities. These outcomes, in combination with its value of equity, contributed to placing Miller’s Z-Score into the “Distress” Zone for the past three years, making it a candidate for being unable to fulfill its Badami pipeline lease commitments in the future.

In the case of Savant, DNR has available information for the past two years; given the confidential nature of this information submitted under AS 38.05.035(a)(8)(D), DNR can only report that for the past two years Savant’s financials have the capability of producing a relatively higher Z-Score than for the case of Miller. However, it is important to note that, due to the estimated levels on the DR&R costs, Savant’s relatively smaller equity value can still place the company in the risk of falling into the “Distress” Zone, making it also a potential candidate subject to financial distress.

Based on the DOG analysis and as a result of both Savant’s and Miller’s current prediction in terms of their financial ability to perform the obligations under the Badami Pipeline Leases the SPC’s decision is to require that Miller Energy Resources, Inc. provide an irrevocable, parental, unconditional guaranty covering Savant’s obligations under the AS 38.35 Badami Pipeline Leases, proportional to their ownership interest. Additionally, the lessee will continue the required insurance coverage.
VII. Fit, Willing and Able Analysis of Transfer Request:

In accordance with the leases and AS 38.35.120(a)(9), as delegated, the SPC is required to consider the protection of the public interest, including whether the proposed transferee, Miller, is fit, willing, and able to perform the transportation or other acts proposed in a manner that will reasonably protect the lives, property, and general welfare of the people of Alaska.

Miller, as guarantor and transferee, has agreed to accept the terms of the leases without modification to the existing stipulations or terms. Miller has agreed to ensure that Savant continues to assume all of the responsibilities for implementing plans and programs to continue operations of these pipeline leases in accordance with the lease agreements.

The SPC has considered Miller's and Savant's operational histories in the oil and gas industry as part of this analysis. As discussed in the background and technical sections, Savant and Miller each have experience in exploration, production and transportation of resources, with Savant having more experience on Alaska's North Slope. Savant personnel have been contracted to perform operational duties on the Badami pipelines since January 2012.

The requested transfer of interest does not include changes in the current use or additional use of the Badami pipeline rights-of-way. According to the application, Savant will continue to operate the Badami pipelines, with "no change of the management, personnel, equipment...or operating policies and procedures of Nutaaq" anticipated. The SPCO has been conducting surveillance and monitoring of Nutaaq's maintenance, surveillance, and quality programs that ensure conformance with the lease requirements and will continue with the newly-merged Savant/Miller operators.

Based on the cumulative information from lease compliance reports and the technical review of the pipeline integrity and infrastructure, DNR asserts that the pipelines are fit for transfer. Based on the technical review of Miller as an owner it is determined that Miller is fit to own the operator of these Badami pipelines.

Financial Assurances Required

As discussed in the background section of this document, as part of the transfer of the Badami pipelines from BPTA to Nutaaq, Nutaaq was required to provide unconditional guaranties from its owners Savant Alaska, LLC and Arctic Slope Regional Corporation corresponding with the interest of each party in Nutaaq. Additionally, BP Corporation North America retained DR&R obligations for the pipelines as they existed as of the date of transfer from BPTA to Nutaaq and for any improvements associated with the Piggable Wye for the Point Thomson Export Pipeline (ADL 418975).

Upon completion of this transfer the current guaranty from Savant Alaska, LLC for Nutaaq will remain. The SPC requires that Miller Energy Resources, Inc. provide an unconditional guaranty to cover Savant's duties and obligations under the Badami Pipeline Leases.
The Miller guaranty provides limited value due to the company’s financial standing therefore, the SPC will continue to require that the lessee continues to carry insurance coverage at the current level. The insurance carried by Nutaaq is currently an $85 million insurance policy with a $1 million deductible for each incident, as discussed in the background section of this document. Nutaaq will also be required to be covered by the general liability, excess liability, and pipeline property coverage to include third party bodily injury and property damage over and in excess of that covered by the risk spill insurance. The SPCO must be listed as additional insured on the policies.

If the Commissioner determines at any time that the guaranty of Miller Energy Resources, Inc., or any guaranty affiliated with the Badami Pipeline Leases, is insufficient to guaranty performance of Nutaaq’s duties, obligations, and liabilities under the Badami pipeline leases, the Commissioner may require Nutaaq to procure and furnish additional liability and property damage insurance or other financial assurance package, as the Commissioner determines necessary. If and when another pipeline connects to the Badami pipelines, including, but not limited to, the Point Thomson Export Pipeline, the Commissioner will re-examine Nutaaq’s financial assurance requirements.

VII. Authority:

The authority to authorize a transfer of interest in an AS 38.35 Right-of-Way Lease as described in AS 38.35.120(a)(09) has been delegated to the State Pipeline Coordinator via Department Order 003 “Delegations of Authority”.

IV. Conclusion:

The requirements for the transfer of interest have been met and the applicable statutes have been satisfied. Therefore, the transfer of Savant’s interest in the Badami Pipeline Leases, ADL 415472 and ADL 415965, Badami Pipeline Leases to Miller Energy Resources, Inc. is approved.

Ray Jakubczak
State Pipeline Coordinator,
Department of Natural Resources