

December 28, 2011
Alaska Department of Natural Resources
State Pipeline Coordinator's Office (SPCO)

Analysis of Transfer of Interest
Right-of-Way Lease for the Kenai Kachemak Pipeline, ADL 228162
GUT, LLC to Hilcorp Alaska, LLC

I. Nature of Request:

AS 38.35.120 requires the Commissioner of the Department of Natural Resources ("Commissioner") to include in each lease, among other conditions, the requirement that the lessee:

not transfer, assign, or dispose of in any manner, directly or indirectly, or by transfer of control of the carrier corporation, its interest in a right-of-way lease, or any rights under the lease or any pipeline subject to the lease to any person...except to the extent that the commissioner, after consideration of the public interest (including whether the proposed 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), authorizes; the commissioner shall not unreasonably withhold consent to the transfer, assignment, or disposal.

Pursuant to an Asset Sale and Purchase Agreement dated July 19, 2011, Union Oil Company of California ("Union") has agreed to sell as a package all of Union's Cook Inlet exploration, production and pipeline assets to Hilcorp Alaska, LLC ("Hilcorp"). Included in the sale is Union's indirect, wholly-owned subsidiary GUT, LLC (GUT) and the 40% ownership interest in Kenai Kachemak Pipeline, LLC ("KKPL") held by GUT. KKPL is the Lessee for the Right-of-Way Lease for the Kenai Kachemak Pipeline ("Lease"), ADL 228162. GUT is the owner of a forty percent (40%) ownership interest in KKPL. Marathon Oil Company owns the remaining sixty percent (60%) and Marathon Pipe Line, LLC is the operator of the pipeline for KKPL. Marathon Oil Corporation is the parent company of the owner and the operator of the Kenai Kachemak Pipeline.

Pursuant to AS 38.35.120 and the Lease, Union and Hilcorp request that the Commissioner authorize the transfer of Union's interest in KKPL to Hilcorp.

II. Administrative Record:

The following documents constitute administrative record for this analysis:

- The Kenai Kachemak Lease and associated case file;

- An application from Union and Hilcorp dated September 12, 2011 and a supplemental application submitted November 10, 2011 together with materials submitted with and in support of these applications;
- The Hilcorp Assurance Package dated December 19, 2011 (submitted to the Commissioner's office); and
- The Guarantees of Hilcorp Alaska, LLC and Hilcorp Energy I, L.P., dated December 27th, 2011.

III. Background:

The Right-of-Way Lease for the Kenai Kachemak Pipeline ("Lease") was entered into and made effective between the State of Alaska and Kenai Kachemak Pipeline, LLC (KKPL) on November 26, 2002. The State has received unconditional guarantees from Unocal Corporation and Marathon Oil Corporation, which are attached to the Lease as Exhibit C, and subsequently from Chevron Corporation upon its acquisition of Union. In general, the guarantees irrevocably and unconditionally guarantee to the State of Alaska the full performance, fulfillment, and satisfaction of all of the duties, obligations, and liabilities of KKPL arising under the Lease. The SPCO was not requested by KKPL to approve the transfer of control from Unocal Corporation to Chevron Corporation.

On September 12, 2011, the Commissioner received a transfer of interest request and the \$200 filing fee for the Lease (ADL 228162) from Union and Hilcorp.¹ A supplemental application was submitted November 10, 2011, along with the Hilcorp Assurance Package, dated December 19, 2011, which assures the State of Alaska that Hilcorp Alaska, LLC will have the financial resources to meet the obligations of the Lease. The Guarantees of Hilcorp Alaska, LLC and Hilcorp Energy I, L.P. dated December 27, 2011 guarantee to the State of Alaska the full performance, fulfillment, and satisfaction of the duties, obligations, and liabilities under or pursuant to AS 38.35 and ADL 228162.

The Corporations database on the Department of Commerce, Community and Economic Development, Division of Corporations, Business and Professional Licensing was checked on December 9, 2011. As of that date, Hilcorp, Union, GUT, Marathon Oil Company, and Kenai Kachemak Pipeline, LLC are in active status, good standing and qualified to do business in Alaska.

Hilcorp is a Delaware limited liability company authorized to do business in Alaska. Hilcorp is wholly-owned by Hilcorp Energy I, L.P. ("HEI"), which is a Texas limited partnership, the general partner of which is Hilcorp Energy Company ("HEC").

¹ The Assignment/Transfer of Interest of Right-of-Way Lease forms were signed by Union and Hilcorp's corporate officers who are authorized by the respective companies to execute the assignments. The Commissioner received a copy of a Resolution from Chevron, representing Union/GUT that approved the Kenai Kachemak Lease Assignment/Transfer of Interest and granted authority to individuals acting on behalf of Chevron. Additionally, the Commissioner received a Union Oil Company of California Certificate regarding the resolution to sell assets to Hilcorp, and a copy of the Resolution from KKPL, LLC with Union agreeing to transfer its interest to Hilcorp and granting authority to the Managing Owner (Union or GUT) to act on behalf of KKPL.

HEC is one of the largest privately-held independent oil and natural gas exploration and production companies in the United States, with over 700 employees operating in the Gulf Coast region, the Gulf of Mexico, and the Rockies.

The application included copies of the annual financial statements and balance sheets of its parent company, Hilcorp Energy I, L.P., for the last three years (2008-2010); the financial information is confidential pursuant to AS 38.05.035(a)(8), AS 40.25.120(a)(4), and AS 45.50.910, et seq. The financial statements were prepared in accordance with generally-accepted accounting and auditing principles and certified by a firm of reputable and independent certified public accountants.

According to the application, HEC has identified the Cook Inlet basin as a region holding significant potential of continued oil and gas exploration and development opportunities, and consistent with its overall corporate mission, has entered into an agreement to acquire Union's interest in the region through Hilcorp. Upon completion of acquisition, Hilcorp intends to pursue a maintenance and development program at existing fields, as well as a comprehensive exploration program.

In the application, Hilcorp asserts it will establish a dedicated midstream team to manage the proposed ownership interest being acquired from Union. Hilcorp will have access to other HEC entities, including Arrowhead Pipeline, L.P., ("Arrowhead") and its general partner, Harvest Pipeline Company ("Harvest"), which own and operate over 1,250 miles of pipelines, manage regulatory compliance of more than 550 miles of oil and gas pipelines, gather approximately 90,000 barrels of crude oil and 140,000 mcf of natural gas per day, and process over 100,00 mcf of natural gas per day.

Per the pending application, no change will occur in the operation of KKPL as a result of the transaction; Marathon Pipe Line, LLC is and will remain the operator of KKPL.

IV. Analysis:

A. Transfer of Interest Requirements

The powers and obligations of the Commissioner relating to the assignment and transfer of Gut and Union's interest in the KKPL Lease arise under AS 38.35.100, 38.35.120 and the following provisions of the KKPL Lease, ADL 228162:

8. Covenants by Lessee

(i) As more fully set out in section 25 of this lease, Lessee will not transfer, assign, or dispose of in any manner, directly or indirectly, or by transfer of control of the Lessee, its interest in this lease, or any rights under this lease or any Pipeline System subject to this lease to any person other than another owner of the Pipeline System (including subsidiaries, parents and affiliates of the owners), except to the extent that the Commissioner, after consideration of the protection of the public interest

(including whether the proposed 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), authorizes; the Commissioner shall not unreasonably withhold consent to the transfer, assignment, or disposal;

25. Transfers of Interest

(e)(1) Subject to the exception set forth in section 25(e)(2), all transfers of an ownership interest in the Lessee or in a transferee or assignee to a third party or parties, including transfers to other owners of the Pipeline System (including subsidiaries, parents and affiliates of the owners) which do not require approval under section 8(i) herein, must be reported to the Commissioner. For those transfers to parties other than other owners of the Pipeline System (including subsidiaries, parents and affiliates of the owners), the Commissioner reserves the right to determine whether such transfers of ownership interest constitute a “transfer of control” for purposes of section 8(i) of this lease. The Commissioner’s determination must be in writing and based on substantial evidence.

(e)(2) If the Lessee, transferee or assignee is a publicly held corporation, meaning a corporation whose stock is and will normally remain available for trade on a national stock exchange, only transfers of ownership interest of 30 percent or more need to be reported under section 25(e)(1) of this lease.

Thus, per the Kenai Kachemak Lease and AS 38.35, this analysis must consider whether this transfer is in the public interest, including whether the transferee, Hilcorp, is “fit, willing and able” to perform under the lease in a manner that will reasonably protect the lives, property, and general welfare of the people of Alaska.

B. Fit, Willing and Able Determination

In determining whether an applicant is “fit, willing and able,” the Commissioner must address the following questions:

1. Does the proposed use of the right-of-way unreasonably conflict with existing uses of the land involving a superior public interest?
2. Does the applicant have the technical and financial capability to protect State and private property interests?
3. Does the applicant have the technical and financial capability to take action to the extent reasonably practical to prevent any significant adverse environmental impact, including but not limited to, erosion of the surface of the land and damage to fish, wildlife and their habitat?
4. Does the applicant have the technical and financial capability to take action to the extent reasonably practical to undertake any necessary restoration or re-vegetation?

5. Does the applicant have the technical and financial capability to protect the interests of individuals living in the general area of the ROW who rely on fish, wildlife and biotic resources of the area for subsistence purposes?
6. Does the applicant have the financial capabilities to pay reasonably foreseeable damages for which they may become liable or claims arising from the construction, operation, maintenance or termination of the pipeline?

To begin, there are no changes in the current use or additional use of the KKPL Right-of-Way proposed in conjunction with the requested assignment or transfer of interest. The KKPL Lease was originally crafted to protect the State's interest and contains numerous provisions specific to protection of fish and wildlife, restoration of the Right-of-Way, and prudent operation of the pipeline, among other things. Additionally, since issuance of the Lease, the State Pipeline Coordinator's Office has had continuous oversight of KKPL and has found the pipeline to be operated in a prudent manner. According to the application, Marathon Pipe Line, LLC will continue to operate KKPL. Hilcorp has agreed to be bound by the terms and conditions of the KKPL Lease.

With regard to the applicant's technical capabilities, the Commissioner has considered HEC's operational history in the oil and gas industry. Hilcorp has stated it will have access to other HEC entities, including Arrowhead and Harvest. As discussed in the background section, Arrowhead and Harvest have significant experience, including owning and operating over 1,250 miles of pipelines, managing regulatory compliance of more than 550 miles of oil and gas pipelines, gathering approximately 90,000 barrels of crude oil and 140,000 mcf of natural gas per day, and processing over 100,00 mcf of natural gas per day.

Accordingly, Hilcorp has the technical capability to protect State and private property interests, prevent significant adverse environmental impact, undertake necessary restoration, and protect individuals living in the general area of the Right-of-Way and their subsistence resources.

With regard to the applicant's financial capabilities, the Commissioner reviewed the confidential 2008-2010 annual financial statements and balance sheets of Hilcorp Energy I, L.P., the Hilcorp Assurance Package dated December 19, 2011 and the Guarantees of Hilcorp Alaska, LLC and Hilcorp Energy I, L.P., dated December 27, 2011. The financial statements were prepared in accordance with generally-accepted accounting and auditing principles and certified by a firm of reputable and independent certified public accountants. The Commissioner looked specifically at total current assets, total assets, total current liabilities, total liabilities and partners' capital, total operating revenues, total operating expenses, operating income, and other income (expenses). The Hilcorp Assurance Package assures the State of Alaska that Hilcorp Alaska, LLC will have the financial resources to meet the obligations it will take on upon completion of the transfer of interest. Additionally, the Guarantees of Hilcorp Alaska, LLC and Hilcorp Energy I, L.P. contain undertakings by each to guarantee to the State of Alaska the full performance, fulfillment, and satisfaction of the duties, obligations, and liabilities of KKPL under or pursuant to the KKPL Lease, ADL 228162.

Accordingly, Hilcorp is financially capable of protecting State and private property interests, preventing significant adverse environmental impact, undertaking necessary restoration, protecting individuals living in the general area of the Right-of-Way and their subsistence resources, and paying reasonably foreseeable damages for which Hilcorp becomes liable or claims arising from the construction, operation, maintenance or termination of the pipeline.

C. Review of Guarantees

The Kenai Kachemak Lease requires:

12. Guaranty and State as Additional Insured

(a) This lease is contingent upon Unocal Corporation (UNOCAL) and Marathon Oil Corporation (Marathon) or a subsequent Lessee's guarantor, as applicable, unconditionally guaranteeing, and remaining capable of guaranteeing the performance of all of Lessee's duties and obligations under and by virtue of this lease. UNOCAL's and Marathon's unconditional guarantees are attached to this lease as Exhibit C. If the Commissioner determines at any time that UNOCAL and/or Marathon unconditional guarantees are insufficient to guarantee the performance of all the Lessee's duties and obligations under and by virtue of this lease, the Commissioner may require the substitution and delivery of a new form of guaranty from the same or another guarantor with any provisions the Commissioner reasonably finds necessary. Lessee shall submit, on an annual basis, the annual financial statement and balance sheet for UNOCAL and Marathon or another guarantor if applicable.

(b) If the Lessee, at its option, obtains commercially available insurance coverage for the Leasehold and the Lessee's activities in, on or related to the Leasehold, the Lessee shall name the State as an additional insured on all such insurance policies obtained and maintained by the Lessee, except that such insurance coverage shall not cover or apply where the sole proximate cause of the injury or damage is the willful misconduct by the State or anyone acting on behalf of the State. Any commercially available insurance purchased by Lessee under this section will not be construed to limit in any way the Lessee's liabilities or responsibilities under this lease.

25. Transfers of Interest

(b) An unapproved transfer, assignment, or other disposal does not relieve Lessee of any obligation assumed under this lease, is ineffective to transfer interests in and obligations assumed under this lease, and constitutes a default under this lease. The guarantees of UNOCAL and Marathon shall extend to guarantee the duties, liabilities and obligations of any transferee, or assignee under and by virtue of this lease, unless the Commissioner determines that another guaranty or security sufficient to

protect the public interest has been provided. In the event that approval is requested for a transfer, assignment or other disposal to a proposed assignee, transferee, or other receiving party which would not receive its interest in the transaction directly from the Kenai Kachemak Pipeline, LLC, the Commissioner shall not consider the existence of UNOCAL and Marathon guarantees in making the determination whether the proposed assignee, transferee, or other party receiving is fit, willing and able. If the Commissioner determines that a guaranty or other security is required for the proposed assignee, transferee, or other receiving party, the Lessee or the proposed assignee, transferee, or other receiving party may secure a replacement guaranty or other security satisfactory to the Commissioner. Upon the determination by the Commissioner that a replacement guaranty or other security is sufficient to protect the public interest, the guarantor providing the replacement guaranty or other security shall be the primary guarantor for this lease. The Commissioner may make demand upon a prior guarantor only if the primary guarantor has defaulted on its obligations under its guaranty and if the prior guarantor has not yet been released from its guaranty. Nothing in this section requires the Commissioner to release any existing guarantor from its guaranty.

Additionally, AS 38.35.120(a)(14) states that a lessee:

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 Pipeline Activities.

The Commissioner has determined that KKPL's net assets are insufficient to protect the public from damage for which KKPL may be liable and that KKPL must "furnish other security or undertaking" to protect the public from damage for which KKPL may be liable (AS 38.35.120(a)(14)). The Commissioner, therefore, has required a parental guarantee and a financial assurance package.

The Commissioner reviewed the confidential 2008-2010 annual financial statements and balance sheets of Hilcorp Energy I, L.P., the Hilcorp Assurance Package, and the Guarantees of Hilcorp Alaska, LLC and Hilcorp Energy I, L.P. The Guarantees of Hilcorp Alaska, LLC and Hilcorp Energy I, L.P. contain undertakings by each to guarantee to the State of Alaska the full performance, fulfillment, and satisfaction of the duties, obligations, and liabilities of KKPL under or pursuant to ADL 228162. Additionally, the Hilcorp Assurance Package assures the State of Alaska that Hilcorp Alaska, LLC will have the financial resources to meet the obligations of abandonment it will take on upon completion of the transfer of interest.

Accordingly, Hilcorp can adequately cover the duties, obligations and liabilities of the KKPL Lease, ADL 228162. If the Commissioner determines at any time that the

Hilcorp Assurance Package or Guarantees of Hilcorp Alaska, LLC and Hilcorp Energy I, L.P. are insufficient to guarantee performance of KKPL's duties, obligations, and liabilities under the KKPL Lease, the Commissioner may require KKPL to procure and furnish additional 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.

V. Conclusion.

The requirements for the transfer of interest have been met and the applicable statutes have been satisfied. Therefore, the transfer of Union's interest in the KKPL Lease to Hilcorp Alaska, LLC is approved.

Hilcorp has the financial capability to protect the State and public interest and can guaranty the complete and timely performance of KKPL's duties, obligations, and liabilities that arise under the KKPL Lease, ADL 228162. Therefore I accept the Hilcorp Assurance Package for Hilcorp Alaska, LLC and the Guarantees of Hilcorp Alaska, LLC and Hilcorp Energy I, L.P.



Daniel S. Sullivan
Commissioner, Department of Natural Resources

28 Dec 2011
Date