

**November 18, 2014**  
**Alaska Department of Natural Resources**  
**State Pipeline Coordinator's Office**

**Analysis of Transfer of Interest Request for  
the Milne Point Oil Pipeline Right-of-Way Lease, ADL 410221, and  
the Milne Point Natural Gas Liquids Pipeline Right-of-Way Lease,  
ADL 416172, from BP Transportation Inc. to Harvest Alaska, LLC.**

**I. Nature of the Request:**

The Milne Point Pipeline Leases (collectively "Milne Pipelines"), ADL 410221 and ADL 416172, are currently held by BP Transportation Alaska Inc. (BPTA) as the sole member of the Milne Point Pipeline, LLC. In a letter dated May 29, 2014, BPTA requests that the Department of Natural Resources (DNR) approve a transfer of a controlling interest in the Milne Point Pipeline, LLC to Harvest Alaska, LLC. Supplemental information for this request was submitted from BPTA to the State Pipeline Coordinator's Office (SPCO) on July 17, 2014.

BPTA also requests to be partially released, to the extent of BPTA's 50% interest in Milne Point Pipeline, LLC being sold to Hilcorp, of the BP Corporation North America, Inc. (BPCNA) guaranties associated with the Milne Pipelines for point-forward operational risk from the effective date of the transfer, but retaining secondary guaranty liability for dismantlement, removal, and remediation (DR&R) obligations of the pipelines as they exist on the date of the transfer of BPTA's interest to Harvest Alaska, LLC.

The proposed transfer is part of a larger transaction by which Harvest Alaska is purchasing all of BPTA's ownership interests in Northstar Pipeline Company, LLC, all of BPTA's and Amoco Endicott Pipeline Company's partnership interests in Endicott Pipeline Company, 50% of BPTA's 100% membership interest in Milne Point Pipeline, LLC, and related upstream interests of BP Exploration Alaska, Inc. (BPXA).

In order to transfer control of a lessee's interest in a right-of-way lease, the Commissioner of the Department of Natural Resources (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.

**II. Background**

Milne Point Pipelines

The Milne Point Oil Pipeline Lease and Milne Point Natural Gas Liquids Pipeline leases were entered into and made effective between the State of Alaska and BPTA on February 4, 1985 and December 5, 2000 respectively. BPTA has been operating the pipelines through its contract operator, BPXA.

The Milne Point Oil Pipeline was built in 1984 and 1985 to transport processed sales oil from the Milne Point Unit to the Kuparuk Pipeline System. The approximately 10-mile Milne Point Oil Pipeline connects the Milne Point Central Facilities Pad at Module 58 to the Kuparuk Pipeline at a point that is shortly beyond Module 68, after crossing under Spine Road.

The Milne Point Natural Gas Liquids Pipeline was built in 2000 and placed on Milne Point Oil Pipeline vertical support members. The eight-inch pipeline transported natural gas liquids from Oliktok Pipeline to the Milne Point Central Facilities Pad for use in enhanced oil recovery processes. BPXA shut down the Milne Point Natural Gas Liquids pipeline in 2002 and, in December of 2006, purged and physically disconnected it from Oliktok Pipeline, in compliance with SPCO and federal regulations.

#### The Right-of-Way Leases

The two existing Milne Point leases have been written in accordance with AS 38.35 and include all covenants required under AS 38.35.120. The leases have been written in a manner that is intended to provide mitigations to potential conflicts with existing uses, and specific protections of the state and private property interests. The leases contain environmental mitigation stipulations and require the implementation of an approved surveillance and maintenance program and an approved quality assurance program to be adhered to during operations and any construction. These programs detail how the lessee will implement mitigation measures and administer programs to prevent potential significant adverse environmental impacts and damages to fish and wildlife. The leases also address protection of interests of individuals living in the general area and continued public access upon the leasehold.

#### Financial Assurances

The Milne Pipeline leases require that if the Commissioner finds that the net assets of the lessee are insufficient to protect the public from damages for which the lessee may be liable, the Commissioner may require an unconditional guaranty of full and timely payment of all liabilities and obligations of the lessee in connection with the lease. Currently the leases have unconditional guaranties from BPCNA on behalf of the Milne Pipelines. The guaranties provide, in summary, that the guarantor will submit a "...valid and unconditional guaranty of the full and timely payment of all liabilities and obligations of the lessee to the State under or in connection with the lease."

#### Current Operations

BPTA has been operating the pipelines through its contract operator BPXA for the duration of the ROW lease. BPXA was incorporated in 1969 and is based in Anchorage, Alaska. BPXA currently operates 13 North Slope oil fields.

The Milne Pipeline leases have specific stipulations that address a surveillance and maintenance program and a quality assurance program. These programs are used by SPCO staff to evaluate the lessee for compliance with the right-of-way lease. The programs detail the lessee's programmatic adherence to applicable federal and state laws governing the operations of pipelines. Additionally, these programs provide details on the procedures for inspections, record keeping, repair/replacement, damage prevention,

integrity management, and other stipulations contained within the lease. BPTA has been successfully administering these programs for the life of the lease.

#### Transferee

The proposed transferee, Harvest Alaska, LLC (Harvest Alaska), is a Delaware limited liability company that is 100% owned by Hilcorp Alaska, LLC, a Delaware limited liability company authorized and registered to do business in Alaska. Hilcorp Alaska, LLC (Hilcorp Alaska) is 100% owned by Hilcorp Energy I, L.P. (HEI), a Texas limited liability company, the general partner of which is Hilcorp Energy Company (HEC). HEC is one of the largest privately-held independent oil and natural gas exploration and production companies in the United States. Headquartered in Texas, HEC has over 1,170 employees and operates in 13 geographic areas including Alaska's Cook Inlet, the Gulf Coast region, south Texas, Ohio, and Pennsylvania. Hilcorp Alaska, LLC is currently operating six oil and gas pipelines in the Cook Inlet region of Alaska.

### **III. Administrative Record:**

The following documents constitute the administrative record for this analysis:

- The Milne Point Oil Pipeline Lease, ADL 410221 and associated case file
- The Milne Point Natural Gas Liquids Pipeline Lease, ADL 416172 and associated case file.

### **IV. Proposed Transfer**

The transfer request proposes that Harvest Alaska will acquire 50% of BPTA's 100% membership interest in the Company (the "Company Interest"). The proposed transfer of the Company Interest is part of a larger transaction by which Harvest Alaska is purchasing all of BPTA's ownership interests in Northstar Pipeline Company, LLC, all of BPTA's and Amoco Endicott Pipeline Company's partnership interests in Endicott Pipeline Company, 50% of BPTA's 100% membership interest in Milne Point Pipeline, LLC, and related upstream interests of BPXA. Upon approval of this transfer, Harvest Alaska will take over as manager of the Company and operator of the pipelines.

BPTA requests to be partially released, to the extent of BPTA's 50% interest in Milne Point Pipeline, LLC being sold to Hilcorp, of the BPCNA guaranties associated with the Milne Pipelines for point-forward operational risk and for DR&R of any additions or modifications to the Milne Pipelines after the effective date of transfer. The BPCNA guaranties associated with the Milne Pipelines will otherwise remain for 100% of the DR&R of the Milne Pipelines as they exist on the date of transfer of BPTA's 50% interest in Milne Point Pipeline, LLC to Hilcorp although the BPCNA guaranties will be secondarily liable to the Hilcorp guaranties as to 50% of any obligation or liability for DR&R of the Milne Pipelines as they exist on the date of transfer. The BPCNA guaranties will continue to cover 100% of obligation or liability for events that are attributable to BPTA's operation of the pipelines prior to the effective date of transfer. The BPCNA guaranties of operational liability prior to the effective date of the transfer will be 50% primary and 50% secondary to the Hilcorp guaranties.

The requested transfer of interest does not include changes in the current use or request additional uses of the Milne Pipelines Rights-of-Way. According to the application, Harvest Alaska has agreed to be bound by the terms and conditions of the Milne Pipelines Right-of-Way Leases.

#### **V. Technical Review:**

The technical review was conducted on the four operating transmission pipelines of a sale of oil and gas assets that also included production facilities, roads and pads, drill sites, in-field flowlines, gas-handling facilities, support facilities, camps, ocean structures, production wells, and injection wells.

SPCO staff reviewed the technical condition of the Endicott, Milne oil, Northstar oil, and Northstar gas pipelines. After review the SPCO staff believes that the pipelines are in relatively good condition. Separate lines of evidence support this conclusion. (The Milne NGL pipeline is currently decommissioned and will be evaluated under a separate process if it is used again.)

SPCO staff submitted a list of technical questions and data requests in order to investigate the condition of the pipelines. BP produced documentation that successfully answered these items.

The technical questions covered several subject areas including:

1. In-Line Inspection (ILI, or smart pigging), including spatial geometry pigging to assess the condition of trenched stream crossings
2. Planned repairs
3. Needed maintenance and incomplete work orders
4. Wind-Induced Vibration
5. Settlement and heave of buried sections
6. The condition of the Vertical Support Members (VSMs)
7. BP Transportation technical risk analyses
8. Pipe physical condition, including internal and external corrosion, mechanical damage and stress
9. Condition of the landfalls and causeway
10. Coatings and corrosion protection systems

The SPCO review did not reveal any major corrosion problems, coating damage, failures of corrosion protection systems, outstanding major repair or maintenance problems, settling or heaving, general integrity issues, or other technical or operating deficiencies. Recent in-line inspections (smart pigging) disclosed a number of small anomalies on the Endicott and Milne pipelines. None of the anomalies was considered a major, or immediate, threat to pipeline integrity. It should be noted that 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 revealed that the subsea segment of the Northstar pipeline is likely the greatest operational risk, as it always has been. However, inspection of the requested

information and review of other sources found no immediate operational issues. It was noted that the settlement is lower than design allowances and that erosion, ice gouges, and strudel scour have been monitored and remediated. The subsea segment of the pipeline has a secondary leak detection system that augments the primary one and is designed to greatly reduce risks of oil leaks.

The Endicott pipeline portion located on the Endicott causeway has added risks, compared to a pipeline located completely on the mainland, but it is visible and near traffic, with gravel to first absorb a leak in such an event. Because of its proximity to any leak, the causeway would also act to limit movement of any oil should it reach water.

The Milne pipelines and the onshore segments of the Endicott and Northstar pipelines are considered lower risk. Although these pipelines are in wetlands, little of their routes are near significant flowing waterways. Therefore, any discharge will likely affect a limited area.

In addition to the SPCO efforts, BPXA's Pipeline Technical Authority produced a condition report on the pipelines. The report noted minor problems such as the corrosion sites and mechanical damage sites, pipeline vibration dampeners failing and three vertical support members that have jacked over eight inches. It did not list any major integrity problems on any of these four pipelines.

## **VI. Financial Review:**

The financial review, like the technical review, addresses all five of the AS 38.35 pipeline leases proposed to be transferred. Hilcorp has submitted audited financial statements for Hilcorp Alaska, LLC and Hilcorp Energy I, L.P.(HEI) with a request that they be kept confidential under AS 38.05.035(a)(8)(D).

### Reviewed Documents

1. Hilcorp Alaska, LLC Pro-Forma 2014 Financial Statements and Z-Score Calculation
2. Hilcorp Alaska, LLC Financial Statements (Unaudited) Quarter Ended June 30, 2014
3. Hilcorp Alaska, LLC Financial Statements Years Ended December 31, 2013 and 2012
4. Moody's and Standard and Poor's Rating Agencies' Announcements and Rating Actions

### Transaction background

Hilcorp Alaska, LLC (Hilcorp Alaska) through its 100% subsidiary Harvest Alaska, LLC has acquired 68.46% partnership interest in Endicott Pipeline Company from BPTA and Amoco Endicott Pipeline Company, 50% membership interest in Milne Point Pipeline, LLC from BPTA, and 100% membership interest in Northstar Pipeline Company, LLC from BPTA and Murphy Exploration (Alaska) Inc. Endicott Pipeline Company is a party to the Right-of-Way Lease ADL 410562 and is the owner and operator of Endicott Oil Pipeline. Milne Point Pipeline, LLC is a party to the Right-of-Way Leases ADL 410221 and 416172, and is the owner and operator of Milne Point Oil Pipeline and Milne Point

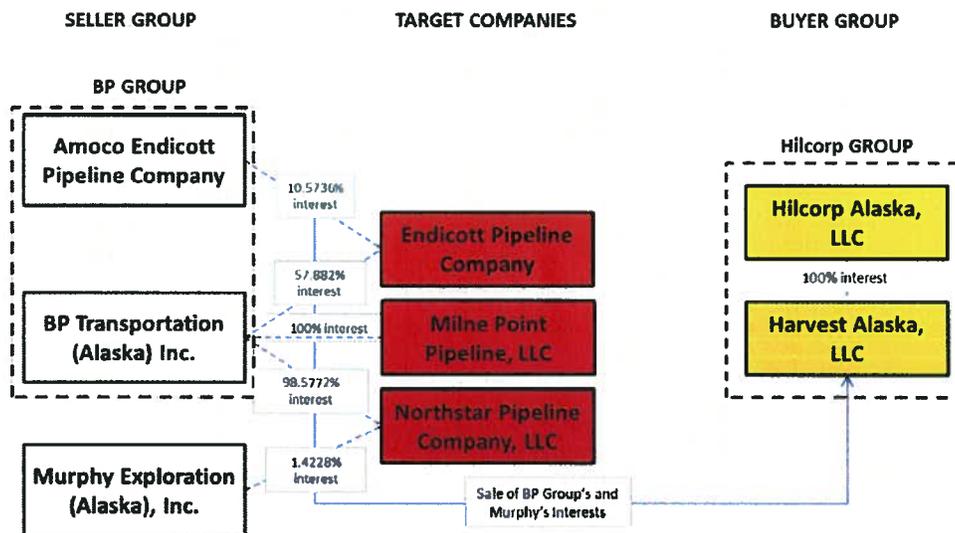
Gas Pipeline. Northstar Pipeline Company, LLC is a party to the Right-of-Way Leases ADL 415975 and ADL 415700 and is the owner and operator of Northstar Oil Pipeline and Northstar Gas Pipeline.

This acquisition is a part of Hilcorp Alaska’s larger acquisition of certain North Slope upstream and midstream assets and interests pursuant to a Purchase and Sale Agreement, by and between BPXA, BPTA and Amoco Endicott Pipeline Company (together “BP”) as sellers and Hilcorp Alaska as a buyer, dated April 16, 2014; and a Purchase and Sale Agreement, by and between Murphy Exploration (Alaska) Inc. as a seller and Hilcorp Alaska as a buyer, dated August 6, 2014.

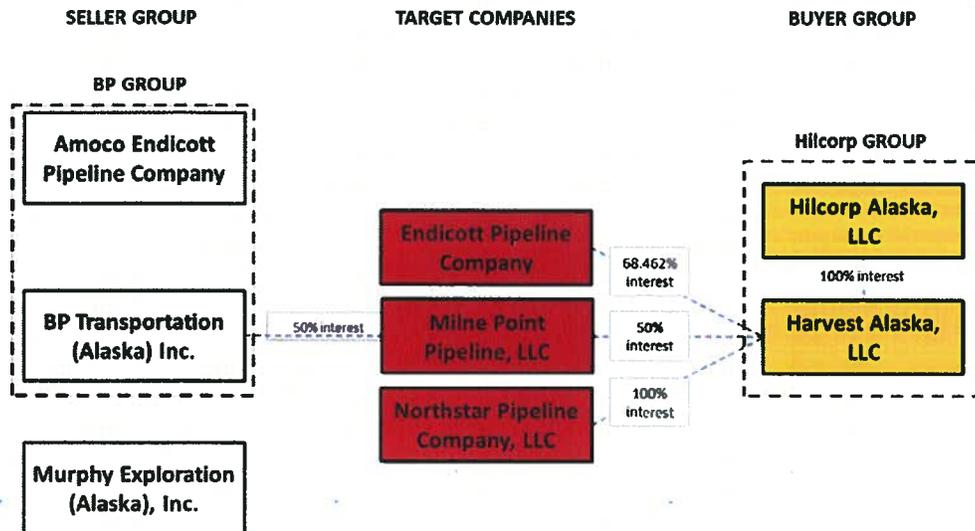
As a part of this transaction, in addition to ownership interest in the pipeline companies described above, Hilcorp Alaska has purchased interest in Liberty Unit, Milne Point Unit, Duck Island Unit, and Northstar Unit, with associated oil and gas leases, interests and assets. Under this acquisition each respective pipeline company will retain the responsibilities of the operator for relevant pipelines.

Below you will find a graphical illustration of the corporate ownership as it pertains to the abovementioned pipeline companies before and after the acquisition.

**Pre-Acquisition Ownership of Endicott Pipeline Company, Milne Point Pipeline, LLC and Northstar Pipeline Company, LLC**



**Post-Acquisition Ownership in Endicott Pipeline Company, Milne Point Pipeline, LLC and Northstar Pipeline Company, LLC**



Hilcorp Group

Hilcorp Alaska is a subsidiary of Hilcorp Energy I, L.P. (HEI), which is the main holding company for Hilcorp Group. HEI is one of the largest privately-owned oil and gas exploration companies in the US. It is rated Ba2 by Moody’s and BB by Standard and Poor’s (S&P) rating agencies. Moody’s bases its rating on the company’s “record of strong production and reserves growth, and modest debt levels”, while S&P has recently revised its outlook to positive for possible rating upgrade assuming that the company will “increase its asset and production base in the next 12 months...,while maintaining leverage below 2x on a sustained basis.” The rating agency analysts believe that HEI’s profile will benefit from the acquisition of North Slope assets, which will add scale, diversity, and oil reserves to the group. The company is capable to fully finance the acquisition with debt, while still keeping its leverage below 1.5x on average.

Hilcorp Alaska, LLC

In the last several years Hilcorp Alaska has firmly established itself as a key player in the Cook Inlet, and has continued to grow organically and through acquisitions. After this acquisition, Hilcorp Alaska will become an important player in the North Slope and throughout the state. For Hilcorp Group, Alaska will become a key growth and production region.

DNR reviewed the financial statements of Hilcorp Alaska for 2012, 2013 and first six months of 2014 and also pro-forma financial statements for year end 2014 that take into account the effect of the North Slope asset acquisition. The financial statements for 2012 and 2013 were prepared in accordance with generally-accepted accounting and auditing principles and certified by a firm of reputable and independent certified public accountants. The financial statements for the first six months of 2014 are unaudited, and pro-forma financial statements for year end 2014 are Hilcorp Alaska’s forecasted financial statements. The Commissioner looked specifically at Revenue, Earnings Before

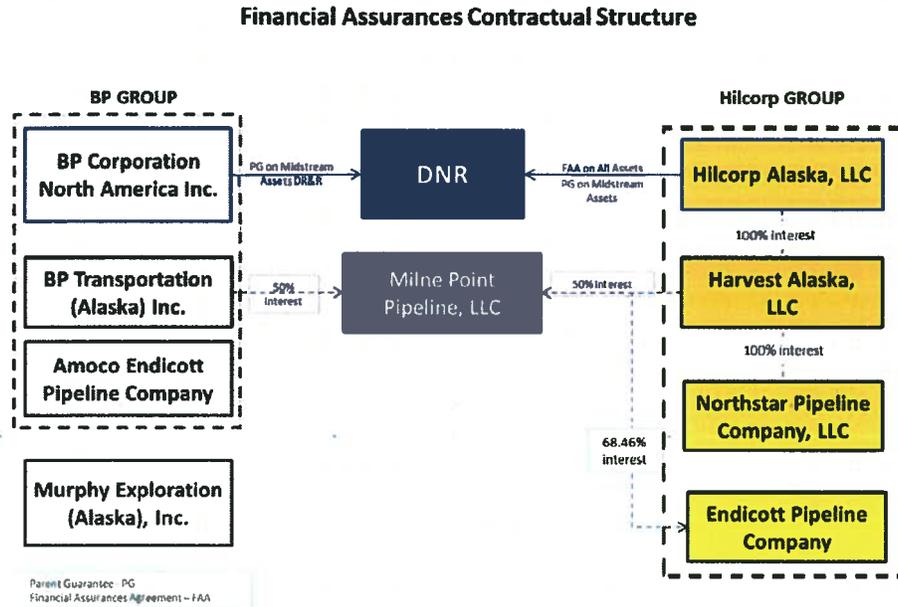
Interest, Tax, Depreciation, and Amortization (EBITDA), Debt, Equity, Cash from Operations, Cash and Cash Equivalents, EBITDA/Revenue, Net Debt/EBITDA, EBITDA/Net Interest Expense, and Altman's Z-score to evaluate its medium and long term default risk. Hilcorp Alaska has demonstrated considerable growth potential and is in acceptable financial health, both from revenue generation capability and balance sheet risk profile. Given the confidential nature of the provided financial and commercial information, the specific findings are not disclosed.

#### Applicant's Financial Capability and Recommendations

Given that Harvest Alaska, LLC is a newly created entity and we have no financial information that we can rely on to evaluate its standing, we have looked to its parent company, Hilcorp Alaska, as a source of financial capability to cover any potential liabilities. Overall, Hilcorp Alaska has adequate financial capability and is fit, willing, and able to meet its obligations to the State stemming from above-mentioned right-of-way leases. The Commissioner will continue monitoring Hilcorp Alaska's financial capabilities to make sure that its credit quality remains adequate to address the requirements established by AS 38.35.100. To ensure the State's financial position and minimize risks that may arise from Endicott Pipeline Company's, Milne Point Pipeline, LLC's and Northstar Pipeline Company, LLC failure or inability to perform, the Commissioner will require the following mitigation measures:

1. Hilcorp Alaska's full irrevocable and unconditional guaranty covering without limitation Endicott Pipeline Company's, Milne Point Pipeline, LLC's and Northstar Pipeline Company, LLC's all and every obligation under the relevant right-of-way leases.
2. BP Corporation North America Inc. that currently guarantees Endicott Pipeline Company's, Milne Point Pipeline, LLC's and Northstar Pipeline Company, LLC's obligations under the right-of-way leases will be required to retain its liability for DR&R obligations stemming from these leases as of the assignment approval date.
3. Hilcorp Alaska will enter a Financial Assurances Agreement (FAA) that sets out an incremental bonding mechanism for meeting the Endicott Pipeline Company's, Milne Point Pipeline, LLC's and Northstar Pipeline Company, LLC's DR&R obligations arising under the right-of-way leases. Under this agreement, Hilcorp Alaska, as the guarantor and the parent company with audited financials, will regularly undergo a financial adequacy test, and based on the results of this test will maintain one or a series of bonds and parent guaranty from HEI that will be pledged to the State of Alaska as security for fulfilling estimated DR&R obligations. Based on the initial financial test, Hilcorp Alaska needs to maintain a combination of third-party bonds and HEI parent guaranties equal to 17.5% of the proportionate DR&R liability assumed by Hilcorp Group. This percentage will be reevaluated based on a periodic financial strength test (Altman's Z-score and Net Worth test), and could increase incrementally if Hilcorp Alaska's financial standing deteriorates. Moreover, the actual DR&R estimate for the assumed obligations will be reevaluated periodically and the bonding amount will be changed to reflect any changes in the estimate.

The reliance on Hilcorp Alaska’s financial standing in tandem with the proposed above mitigation mechanism will effectively protect the State’s interests while allowing the Lessee and the group to efficiently deploy capital. This is a graphical representation of the proposed financial assurances structure.



**VII. Fit, Willing and Able Analysis of Transfer Request:**

In accordance with the lease and AS 38.35.120(a)(9) the Commissioner is required to consider the protection of the public interest, including whether the proposed transferee, Harvest Alaska, LLC 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.

Harvest Alaska has agreed to accept the terms of the lease without modification to the existing stipulations or terms. Harvest Alaska will assume all of the responsibilities for implementing plans and programs to continue operations of these pipelines in accordance with the lease agreements.

The Commissioner has considered Hilcorp Alaska, LLC’s operational history in the oil and gas industry as part of this analysis. As discussed in the background and technical sections, Hilcorp Alaska has experience in exploration, production, and transportation of resources. Hilcorp Alaska currently operates or owns, directly or indirectly, six regulated oil and gas pipelines in the Cook Inlet region of Alaska, which together comprise over 200 miles of pipe.

As part of this analysis, DNR requested and reviewed technical documents from BPXA in order to assess the condition of the pipelines and their fitness for continued service and operations. DNR, via the SPCO, has also been involved with active surveillance and

monitoring of BPXA's maintenance, surveillance, and quality programs that ensure conformance with the lease requirements. DNR has also been building a lease compliance relationship with Hilcorp Alaska on the Kenai Kachemak Pipeline in the Cook Inlet region. DNR is familiar with Hilcorp Alaska's operations and management style. Hilcorp Alaska has demonstrated that they have the technical capability to operate a pipeline on state land and adhere to the lease agreement with the Kenai Kachemak Pipeline.

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 Hilcorp Alaska as an operator and owner it appears that Hilcorp Alaska is fit to own and operate the Milne Pipelines.

#### Financial Assurances

Section 5 (ADL 410221) and Section 12 (ADL 416172) of the Milne Pipeline leases state that the lease is contingent upon the lessee's guarantor unconditionally guarantying the performance of all of that lessee's duties and obligations under and by virtue of the lease. The leases also includes the condition that the Commissioner may require substitution and delivery of a new form of guaranty with any provisions the Commissioner finds necessary, if the Commissioner determines that the guarantee is insufficient.

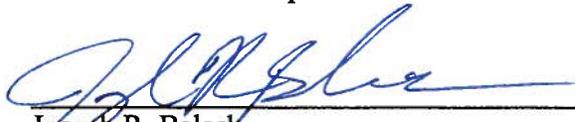
DNR will require Hilcorp Alaska, LLC to provide a full irrevocable and unconditional guarantee covering without limitation Milne Point Pipeline Company, LLC's obligations under the right-of-way lease.

BPCNA, which currently guarantees Endicott Pipeline Company's obligations under the right-of-way lease will be required to retain its liability for DR&R obligations stemming from the lease.

As stated more thoroughly in the financial review, Hilcorp Alaska will enter a FAA that sets out an incremental bonding mechanism for meeting the Milne Point Pipeline Company, LLC's DR&R obligations arising under the right-of-way lease. Under this agreement, Hilcorp Alaska, as the guarantor and the parent company with audited financials, will regularly undergo a financial adequacy test, and based on the results of this test will maintain one or series of bonds and parent guarantee from HEI that will be pledged to the State of Alaska as security for fulfilling estimated DR&R obligations.

#### **VIII. Conclusion:**

The requirements for the transfer of interest have been met and the applicable statutes have been satisfied. Therefore, the transfer of BP Transportation (Alaska) Inc.'s interests in the Milne Point Pipeline Leases to Harvest Alaska, LLC is approved.

  
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Joseph R. Balash  
Commissioner, Department of Natural Resources

11/18/14  
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Date