

**THE STATE PIPELINE COORDINATOR'S
RIGHT-OF-WAY RENEWAL REPORT
FOR THE
KUPARUK PIPELINE RIGHT-OF-WAY LEASE
ADL 402294**



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EXECUTIVE SUMMARY

This State Pipeline Coordinator's report is presented to outline and document the State Pipeline Coordinator's Office (SPCO) review of the application for renewal of the Kuparuk Pipeline Right-of-Way (ROW) Lease, pursuant to the provisions of AS 38.35.110 and of 11 AAC 80.065 --.085. Under the provisions of AS 38.35.110 the Kuparuk Pipeline Right-of-Way Lease shall be renewable, for a period up to 30 years, so long as the Lessee is:

1. in commercial operation;
2. in full compliance with state law; and
3. in compliance with all terms of the lease.

This report thus focuses on, and identifies evidence and documentation of, the Lessee's compliance with these three statutory renewal requirements, in order to provide the Commissioner of the Department of Natural Resources (DNR) with the factual record necessary for his determination on the application for renewal of the Kuparuk Pipeline ROW Lease.

Process: On February 11, 2002, the Kuparuk Transportation Company submitted a Pipeline ROW Lease Renewal Application for the Kuparuk Pipeline, ADL 402294, satisfying the renewal application requirement of 11 AAC 80.065(a). On February 27 and 28, 2002, the SPCO published public notices of the application for renewal in newspapers throughout the State, and began a comprehensive review process to determine and document the Lessee's compliance with State laws and regulations, and compliance with all terms of the lease. That review has resulted in this report.

The regulatory renewal process (11 AAC 80.065 -- .085) will continue through: (1) the DNR Commissioner's issuance of his proposed determination on the renewal application; (2) a public comment process that includes public hearings; (3) DNR's review and consideration of public comments received on the Kuparuk Pipeline ROW Renewal Application; and (4) final determination on the renewal application by the Commissioner.

Background: The SPCO, through cooperative operation with other State and federal regulatory agencies, oversees and administers operation of the Kuparuk Pipeline. The primary method of oversight is through a Compliance Monitoring Program. The Compliance Monitoring Program, in use on the North Slope since 1999, is similar to the Comprehensive Monitoring Program instituted in 1994 to assess safety of the Trans-Alaska Pipeline. The Comprehensive Monitoring Program was initially developed in 1994 by the firm of Booz-Allen and Hamilton, Inc., one of the world's largest management and technology consulting firms. The Compliance Monitoring Program is a structured approach to pipeline oversight, focusing on construction, maintenance and operational activities.

The Compliance Monitoring Program verifies Lessee's compliance with the terms and requirements of the Lease. The findings from the Compliance Monitoring Program are compiled in a Compliance Assessment Report. The Compliance and Assessment Report summarizes the observations and identifies any specific findings that may require corrective actions. The report uses surveillance checklists, photographs, written surveillance summaries, and any other relevant information, to document the status of compliance with the lease and applicable laws and regulations, and to identify any potential compliance issues. The Lessee is provided a copy of the report. If any corrective actions are necessary, the Lessee is given an opportunity to respond and address the problem. The

Compliance and Assessment Report has provided the majority of the evidence relied upon by the SPCO for the Kuparuk Pipeline ROW Lease renewal review.

In addition to the SPCO in-house monitoring of Lease compliance, many Lease sections and stipulations impose requirements that are the same as, or overlapped by, legal requirements of State and/or federal laws and regulations, and that are thus administered and enforced by regulatory agencies outside of the SPCO. In cases where another regulatory agency's program monitors and enforces compliance with requirements that include the requirements of a specific Lease section or stipulation, the State Pipeline Coordinator relies primarily on that agency's focused, regulatory enforcement to assure compliance with the included lease requirements. This reliance limits duplication of efforts while utilizing the subject matter expertise of each regulatory agency to best effect.

Summary/Findings: Based on the Kuparuk Pipeline ROW Lease renewal review effort outlined above, the SPCO review has found:

(1) The Lessee is in commercial operation, as evidenced by: production and transportation reports filed daily, monthly and yearly for volume of oil produced and transported through the Kuparuk Pipeline System; payment of royalties and taxes on that production, and collection of tariffs on that transportation; and payment of State and local property taxes for Kuparuk Pipeline facilities.

(2) The Lessee is in full compliance with State law and regulation, based upon reports, prepared for Kuparuk Pipeline lease renewal by each State regulatory agency that identify all of the respective agency's statutes and regulations applicable to the Kuparuk Pipeline Lessee, and affirmative determinations of the Lessees' compliance with those statutory and regulatory requirements.

(3) The Lessee is in compliance with all terms and stipulations of the Kuparuk Pipeline Right-of-Way Lease, based on the administrative record including:

- a. State agency compliance reports, for Lease requirements that are overlapped by requirements of a specific agency regulatory program; and
- b. SPCO compliance assessments reports, developed through the Compliance Monitoring Program that is carried out as the normal SPCO oversight and monitoring effort.

Conclusion: Based upon these findings -- that Lessees' have met the three statutory requirements of AS 38.35.110 for renewal of the Kuparuk Pipeline ROW Lease -- the State Pipeline Coordinator recommends to the Commissioner that the Lease should be renewed. In addition, based on the physical features of the pipeline, namely that it is of relatively short length, above ground, with no ancillary or related facilities, and that the Lessee has comprehensive surveillance and maintenance programs, including corrosion monitoring program, that are closely reviewed by the SPCO, the State Pipeline Coordinator has found no reason to constrain the duration of the renewal to a period of less than 30 years.

State Pipeline Coordinator’s Report
Kuparuk Pipeline ROW Lease Renewal
ADL 402294

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**The State Pipeline Coordinator’s Report
for
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I. Overview of Kuparuk Pipeline ROW Lease Renewal Application, and AS 38.35 Lease Renewal Process

a. Current North Slope ROW Renewal Applications

The State Pipeline Coordinator’s Office (SPCO) is reviewing renewal applications for five North Slope right-of-way leases (Kuparuk, Kuparuk Extension, Oliktok, Milne Point, and Endicott). Each of these State of Alaska right-of-way leases was issued pursuant to the provisions of AS 38.35 (the “Right-of-Way Leasing Act”). Each of these leases was issued at different times in the 1980’s, and all five leases expire on May 2, 2004, unless they are renewed. The requirements and procedures for renewal are established in State law and regulations, and are also contained in the lease. The following is a report of the SPCO's review and findings on the application for renewal of the Kuparuk Pipeline Right-of-Way Lease.

b. Kuparuk Pipeline ROW Background Information

The Kuparuk Pipeline Right-of-Way starts at Central Production Facility 1 (CPF1) in the Kuparuk River Unit and terminates at Pump Station 1 of the Trans-Alaska Pipeline System (TAPS). The pipeline is a 26.2-mile, 24-inch diameter pipeline located entirely on State owned land. The entire pipeline, except for road and animal crossings, is suspended above the tundra on vertical support members (VSMs). There are four pipeline valves within the right-of-way, one at its origin at CPF1, another at the Milne Point Pipeline tie-in, and one on each side of the Kuparuk River. There are no work pads along the pipeline right-of-way. The right-of-way crosses the Kuparuk River, and the first and second tributaries of the Kuparuk and Putuligayuk Rivers. The pipeline was constructed between 1983 and 1984 and commissioned in 1984.¹

The Kuparuk Pipeline currently transports between 350,000-360,000 barrels of crude oil per day. Many factors at the several fields can impact the daily production levels. The oil comes from production at the Kuparuk, Milne Point, and Alpine fields.

The Kuparuk Pipeline Right-of-Way Lease ADL 402294 was entered into August 26, 1980, between the Kuparuk Pipeline Company² (the “Lessee”) and the State of Alaska, and expires on

¹ The Kuparuk pipeline originally was a 16” crude oil pipeline, constructed and commissioned in 1980. In 1983-84, the original line was replaced with the 24” line, and the 16” line was converted to a natural gas line and renamed the Oliktok Pipeline. The 24” pipeline is entirely within the original ROW and construction of the new line did not require any amendments or revisions to the lease.

² The Lessee is now the Kuparuk Transportation Company (KTC), with the Kuparuk Pipeline Company (KPC) as the managing partner. The KTC is comprised of KPC (57%); BP Transportation (Alaska) Inc. (38%); and Union Kuparuk Pipeline Company (5%). The State of Alaska approved the assignment and transfer of interest from KPC to KTC in 1984.

May 2, 2004, unless renewed. On February 11, 2002, the Lessee submitted a renewal application for the Kuparuk Pipeline Right-of-Way Lease.

The lease is a contract between the State and the Lessee, consisting of 25 Sections and four supporting exhibits “A-D.” Exhibit “C” contains lease stipulations³ in three distinct categories, “General,” “Environmental,” and “Technical.” These stipulations impose additional requirements upon the Lessee for the establishment of specific programs, plans, or processes to ensure safety and environmental protection throughout all phases of pipeline operations.

In many areas the Lease overlaps with State laws and regulations. Notable areas are public safety, worker safety, common carrier transportation, taxation, and environmental compliance. Some of these laws and regulations were in place when the lease was executed. Some legislation was enacted after. In areas where statutory or regulatory authority overlaps with the lease, the SPCO relies on the agency enforcement determinations for determining lease compliance. In those instances, the SPCO coordinates with the agencies for the oversight of the pipeline and right-of-way management. The following is a discussion of the process through which the SPCO manages oversight of the lease and identification of any compliance issues concerning State law.

c. Statutory Renewal Requirements

Under the provisions of AS 38.35.110⁴ (and of Section 2 of the lease) the Kuparuk Pipeline ROW Lease shall be renewable, for a period up to 30 years, so long as the Lessee is:

1. In commercial operation;
2. In full compliance with State law; and
3. In compliance with all terms of the lease.

This report thus focuses on, and identifies evidence and documentation of the Lessee's compliance with these three statutory renewal requirements, in order to provide the Commissioner of the Department of Natural Resources (DNR) with the factual record necessary for his determination on the application for renewal of the Kuparuk Pipeline ROW Lease.

Additionally, the Lessees' rights and obligations to comply with the terms of the Lease are also addressed by statute:

Sec. 38.35.225. Binding effect of covenants. By entering into a lease under this chapter, the Lessee is bound by all the covenants provided for in the lease to the full

³ Exhibits A and B are maps of the pipeline route, and locations of the pipeline facilities, respectively, and Exhibit D is a schematic of a typical pipeline road crossing. While useful during pipeline construction activities, discussion of these lease exhibits is not directly relevant to these lease renewal discussions.

⁴ **Sec. 38.35.110. Term of lease; continuation.** (a) Each lease of State land for pipeline right-of-way purposes must contain a provision that the lease shall run for a specified term of not greater than 30 years, and shall be renewable for additional period up to 30 years each, so long as the Lessee is in commercial operation and is in full compliance with all State law, including but not limited to State law pertaining to regulation and taxation of the pipeline facility, and is in compliance with all terms of the lease. In making this determination, the Commissioner shall take into consideration the cost of the proposed pipeline, its useful life, and the probable financing requirement for the proposed pipeline.

extent of the power of the State to impose those covenants under its authority as owner of the land to be leased or under its police or regulatory powers or otherwise; provided that the right of the Lessee to challenge the power of the State to require such a covenant as owner of the land to be leased or under its police or regulatory powers or otherwise is preserved until such time as action to enforce the covenant is taken by the State.

And within the lease under Section 25, "*Binding Effect of Covenants:*"

The parties acknowledge that all covenants of this Lease are required by the COMMISSIONER OR HIS DESIGNEE. By entering into this Lease, the LESSEE is bound by such covenants to the full extent of the power of the STATE to impose the covenants under its authority as owner of the land herein leased or under its police or regulatory powers or otherwise; provided that the rights of the LESSEE to challenge the power of the STATE to require any of these covenants as owner of the land herein leased or under its police or regulatory powers or otherwise is preserved until such time as action to enforce the covenant is taken by the STATE. Before commencing any such action the COMMISSIONER OR HIS DESIGNEE shall give the LESSEE written NOTICE OF INTENT to enforce, and he shall not commence enforcement proceedings unless LESSEE has failed to initiate good faith efforts to comply with the notice within thirty (30) days of said notice. Compliance with any covenant or with any such notice by the LESSEE, shall not constitute a waiver of its or their rights to challenge, from time to time, the power of the STATE to require or to enforce the same or any other covenant in any subsequent action to enforce taken by the STATE. A judicial finding that any of these covenants is unlawful or invalid shall not operate to invalidate this Lease or any other covenant of the Lease.

Furthermore, the grounds and processes that the Commissioner has available to bring an action in Superior Court for forfeiture of the lease is addressed:

Sec. 38.35.170. Forfeiture of lease. Failure to begin construction of the pipeline facility within a reasonable time of the granting of a right-of-way lease under this chapter for reasons within the control of the Lessee or failure of an owner of an interest in the granted right-of-way substantially to comply with the terms of the right-of-way shall be grounds for forfeiture of the right-of-way interest of the Lessee or owner in an action brought by the Commissioner in the superior court. Before the commencement of any action for forfeiture of an interest in a right-of-way under this section, the Commissioner shall give the Lessee or owner of the interest notice in writing of the alleged default and shall not commence the proceeding unless the Lessee or owner of the interest has failed to initiate good faith efforts to cure the default within 60 days of the notice of the alleged default.

And similar language is used within the lease under Section 17, "*Forfeiture of the Lease:*"

Failure to begin construction of the PIPELINE within a reasonable time of the granting of this Lease for reasons within the control of, or failure of, the LESSEE of an interest in the Right-of-Way to substantially comply with the terms of the Lease

shall be grounds for forfeiture of the Right-of-Way interest of the LESSEE in an action brought by the COMMISSIONER OR HIS DESIGNEE in the Superior Court. Before the commencement of an action for forfeiture of an interest in the Right-of-Way under this section, the COMMISSIONER OR HIS DESIGNEE shall give the LESSEE or owner of the interest notice in writing of the alleged default and shall not commence the proceeding unless the LESSEE of the interest has failed to initiate good faith efforts to cure the default within 60 days of the notice of the alleged default.

d. Administrative Review Process

Title 11 of the Alaska Administrative Code establishes procedures for review of a right-of-way renewal application. In short, the process requires receipt of an application, public notice, publication of a written determination by the Commissioner of whether the requirements for renewal are satisfied, an opportunity for public review and comment on the Commissioner's determination, and then Commissioner/DNR review of comments received and final determination on the renewal application. Relevant provisions of the regulations and a further discussion of the process are as follows:

11 AAC 80.065. Applications for Renewal. (a) A Lessee who seeks to renew a lease of State land for pipeline right-of-way purposes must submit an application for renewal of the right-of-way lease no later than two years before lease expiration, unless otherwise provided in the right-of-way lease. Upon request by the Lessee, the Commissioner may waive the deadline. (b) Upon receipt of an application for renewal, the Commissioner will publish notice of it consistent with AS 38.35.070.

On February 11, 2002, more than two years before the lease expiration date, the Lessee submitted a "Pipeline ROW Lease Renewal Application for the Kuparuk Pipeline, ADL 402294", thus satisfying the renewal application requirement of 11 AAC 80.065(a). On February 27 and 28, 2002, the SPCO published public notices in newspapers throughout the State of the Lessees' application for renewal, (11 AAC 80.065(b)), and began a comprehensive review process to determine and document the Kuparuk Pipeline Right-of-Way Lessee's compliance with State laws and regulations, and compliance with all terms of the lease. That review has resulted in this report.

The criteria that must be met and the process that must be employed by the Commissioner in making the renewal determination are set forth by regulation. It provides:

11 AAC 80.075. Renewal Determination. (a) Within a reasonable time after receipt of the Lessee's application to renew a lease of State land for pipeline right-of-way purposes, the Commissioner will make, in the exercise of reasoned discretion, a written determination whether the requirements of AS 38.35.110 have been satisfied. (b) The Commissioner will obtain and evaluate information that the Commissioner considers reasonably necessary to make a determination under (a) of this section, including

- (1) information from the Lessee, as required; the Commissioner may require the Lessee to provide information that the Commissioner considers relevant to determining compliance with AS 38.35.110; and
- (2) independent analyses and reviews.

(c) The Commissioner will base the written determination on the administrative record developed under (b) of this section, and will include a statement of the reasons and findings supporting the determination.

The final steps of the renewal process are outlined in 11 AAC 80.085, as recently amended to read:

11 AAC 80.085. Notice and Comment. (a) The Commissioner will provide the written determination required by 11 AAC 80.075 to the Lessee.

(b) Consistent with AS 38.35.070, the Commissioner will publish notice of the written determination and a statement regarding whether the Commissioner intends to renew the right-of-way lease. The Commissioner will

(1) make copies of the written determination and the Lease available to the public for viewing;

(2) provide copies of the written determination, upon request, to the public at cost; and

(3) if the terms of the Lease will change upon renewal, provide copies of the new proposed lease, upon request, to the public at cost.

(c) The Commissioner will provide the public at least 30 days to submit written comments on the written determination, and may schedule one or more public hearings.

(d) If the Commissioner revises the written determination following close of the public comment period, the revised written determination will be published consistent with AS 38.35.070. The written determination, or if revised, the revised written determination published by the Commissioner, is the final administrative decision 30 days after the end of the public comment period, unless the Commissioner, in writing, extends that 30 day period for a specified period of not more than 90 additional days to allow for a full consideration of the comments received.

In summary, the Commissioner publishes the written renewal determination along with notice of a public comment period of not less than 30 days during which written comments are accepted. For this lease renewal, the Commissioner has directed that public hearings be held during the public comment period. After the expiration of the public comment period, the Commissioner has discretion whether to revise the written determination, or let the original stand. The written determination, or a revised version of that determination if issued, becomes final 30 days after the close of the public comment period, unless the Commissioner extends that effective date for a period not to exceed 90 additional days.

II. DNR Ongoing Oversight and Administration of Kuparuk Pipeline ROW lease

a. Compliance Monitoring -- Annual Work Plan

The SPCO oversees the Lessee's operation and maintenance of the Kuparuk Pipeline ROW Lease through a Compliance Monitoring Program, similar to the Comprehensive Monitoring Program instituted in 1994 to assess the operation and safety of the Trans-Alaska Pipeline. The Compliance Monitoring Program develops an annual monitoring plan for each pipeline, to provide a structured approach to oversight of construction, maintenance and operational activities.

The Compliance Monitoring Program first focuses on oversight of Lessee's internal plans and procedures for operations and maintenance, to determine conformance of those plans and procedures with lease requirements. The SPCO then carries out surveillance activities, through document review and direct inspections, to verify that Lessee is operating in conformance with the approved plans and procedures.

In practical terms, the Lessee is the Kuparuk Transportation Company (KTC). The Kuparuk Transportation Company (KTC) is a partnership between Kuparuk Pipeline Company (KPC), BP Transportation (Alaska) Inc., and Union Kuparuk Pipeline Company. KPC is the managing partner of the KTC. Phillips Alaska, Inc. (PAI) is the operator of the Kuparuk Pipeline and the Kuparuk River Unit (KRU). Both KPC and PAI are wholly owned subsidiaries of Phillips Petroleum Company and have adopted many of Phillips Petroleum Company's internal processes, programs, and systems for safe operations, worker safety, protection of human health and the environment, as well as procurement, contracting, engineering and design requirements. The operator reviews and develops specific procedures to apply the programs of the parent company to Kuparuk Pipeline operations, implements the program, and self-audits and reports on their own performance and results to the Lessee. The Lessee then reviews and audits the monitoring programs of the operator, to assure that they are being properly implemented, and meet the requirements of the lease.

SPCO reviews the Lessee's surveillance and monitoring program, both to determine that the operator's programs and procedures fulfill the requirements agreed to for lease compliance, and that the Lessee's audit of its performance, and the performance of its operator and subcontractors, conforms to the approved program and procedure.

The Lessee's Annual Report is a primary document utilized by the SPCO in development of its annual compliance program workplan, as it identifies Lessee's regularly scheduled maintenance activities; reports on Lessee's responses to unscheduled events and accidents; and reports the status of corrective actions and implementation of any SPCO directives identified from previous SPCO surveillances. From that outline, the SPCO identifies issues for which documentation is requested and reviewed, and plans on-site inspection/review of the pipeline facilities and right-of-way, to verify Lessee's compliance documentation.

Because the Kuparuk Pipeline is located within a uniform geotechnical environment, underlain by permafrost with the pipeline suspended over the tundra on above ground VSMs, visual inspection of the pipeline system is easily accomplished. In addition, technical inspection

programs, such as the Corrosion Monitoring Program (Stipulation 3.4), using “smart pigs” to detect corrosion within the pipe walls, and the Surveillance and Monitoring Program (Stipulation 1.10) to detect frost jacking of the VSMs, are carried out by the Lessee to meet lease requirements concerning pipeline safety and integrity, and are monitored by the SPCO to ensure full implementation as proposed by the Lessee.

Development and continued surveillance of the Corrosion Monitoring Program and the Surveillance and Monitoring Programs has shown success. Only limited corrosion investigations were performed on any of the North Slope right-of-way pipelines before 1997. In 1997, evidence of weld pack failures and advanced external corrosion was observed. Detailed corrosion control plans and extensive surveillance and maintenance activities to abate the problem were developed by the Lessee, and bad weld packs and other areas of corrosion were repaired. Oversight of these programs was monitored by the SPCO. By 1999, the Lessee had implemented aggressive corrosion control and surveillance and monitoring programs, and the necessary corrective action had taken place. A comprehensive Corrosion Monitoring Program is now included as a standard component of pipeline operations.

b. Compliance Monitoring -- Other State Regulatory Agencies

Oversight of the Kuparuk Pipeline is accomplished by State and federal agencies that share regulatory or management responsibilities related to oil and gas pipelines. Thus, in addition to the SPCO in-house monitoring of lease compliance, many lease sections and stipulations impose requirements that are the same as, or overlapped by, legal requirements of State and/or federal laws and regulations, and that are thus administered and enforced by regulatory agencies outside of the SPCO. In cases where another regulatory agency’s program monitors and enforces compliance with requirements that include the requirements of a specific Lease section or stipulation, the State Pipeline Coordinator relies primarily on that agency’s focused, regulatory enforcement to assure compliance with the included Lease requirements. This reliance limits duplication of efforts while utilizing the subject matter expertise of each regulatory agency to best effect.

For this lease renewal review effort, the SPCO has executed a Reimbursable Services Agreement (RSA) with each State regulatory agency, under which each agency has produced a report that: (1) identifies all laws and regulations for which that agency is responsible that have application to Lessee; and (2) states a determination of Lessee’s compliance with those requirements. Those agency reports are attached to this SPCO Report as "Attachment B," and are used by the SPCO in the lease renewal process both to determine compliance with State laws and regulations and, where applicable, to determine compliance with lease terms and stipulations that include requirements that overlap with State regulatory requirements.

The following is a brief discussion of these State agencies and their respective authority. Many of these agencies have staff committed to (working within) the SPCO; and coordination between the agencies on pipeline and right-of-way activities affecting human health, safety and the environment is an integral function of the SPCO.

The Alaska Department of Natural Resources (DNR) manages all State owned land, water and natural resources (except fish and game) for the State of Alaska. DNR, through the State Pipeline Coordinator located in the Joint Pipeline Office, coordinates State management

concerns for State right-of-way leases issued under AS 38.35, AS 38.05 and AS 41. The State Pipeline Coordinator coordinates permit issuance and monitoring of preconstruction, construction, operation, maintenance, and termination of common carrier pipeline activities with affected agencies.

The Alaska Department of Environmental Conservation (ADEC) has primary responsibility for the adoption and enforcement of regulations setting standards for the prevention and abatement of all water, land, subsurface land, and air pollution. ADEC regulates facilities and issues permits to protect human health and the environment. The ADEC administers AS Title 46, and evaluates potential impacts related to air and water quality, oil and hazardous substances discharge prevention and response, hazardous materials management, and sanitation and waste management.

The Alaska Department of Fish and Game (ADF&G) regulates activities affecting fish passage, anadromous fish streams, and hazing of wildlife in connection with oil spills. The ADF&G administers AS Title 16 and evaluates potential impacts on fish and wildlife, their habitat, and subsistence harvests.

The Alaska Department of Transportation and Public Facilities (ADOT/PF) designs, constructs, operates, and maintains State transportation systems, buildings, and other facilities. The ADOT/PF administers AS Title 19 and evaluates potential impacts on State transportation systems and facilities.

The Alaska Department of Labor and Workplace Development (ADLWD) aims to protect workers by reviewing practices and procedures pertaining to occupational safety and health; mechanical, electrical and pressure systems; and wage and hour codes. The ADLWD administers AS Title 23 and evaluates projects for impacts relating to occupational safety and health for protection of employees.

The Division of Governmental Coordination (DGC) coordinates review of projects under the Alaska Coastal Management Program and consolidates State comments on national Environmental Policy Act (NEPA) issues. The DGC administers AS 46.40, coordinates coastal consistency reviews on North Slope projects and makes appropriate consistency determinations.

The Regulatory Commission of Alaska (RCA) regulates public utilities by certifying qualified providers of the public utility and pipeline services; and ensuring that they provide safe and adequate services at just and reasonable rates, terms and conditions. The RCA administers AS 42.06 (the "Pipeline Act"), and regulates intrastate oil pipeline carriers under these statutes. An entity may not construct or operate an intrastate oil pipeline until it has obtained a Certificate of Public Convenience and Necessity from the RCA. The Alaska Pipeline Commission (predecessor of the RCA) approved the Certificate of Public Convenience and Necessity to the Kuparuk Pipeline Company to operate a common carrier pipeline from the Kuparuk Development Center to Pump Station 1, on July 3, 1980. The RCA annually reviews the pipeline operations for compliance with public utility statutes and regulations. Once a Certificate of Public Convenience and Necessity is granted to a pipeline, that pipeline cannot abandon service without RCA approval.

The Alaska Department of Revenue (DOR) administers AS Title 43, and regulates revenue and taxation issues associated with oil and gas development and transportation in Alaska.

The Alaska Department of Public Safety, Division of Fire Prevention (DPS) regulates fire prevention and protection systems along the pipeline and conducts inspections to assure that the systems meet the applicable requirements. DPS administers AS 18.70.

The Alaska Department of Law (DOL) provides legal services to all State agencies and is responsible for prosecuting violations of State laws. The DOL has reviewed the Lease renewal application and related documents, and provides the State legal advice on the application.

c. Compliance Monitoring -- Surveillance Process

For an individual SPCO issue/monitoring assignment, the complete process of:

- (1) reviewing the Lessee's records documenting their ongoing operational and maintenance activities;
- (2) verifying through inspection of the pipeline and the right-of-way; and
- (3) publishing a report of findings on the particular activity or lease requirement,

is termed a "Surveillance" by the SPCO. Surveillances are the basic project elements of an annual workplan, and are scoped and carried out by comparing requirements contained in the lease sections and stipulations with programs and procedures implemented by the Lessee, using a checklist to identify compliance.

The initial, primary scope of an individual surveillance is determined by identifying the plans, procedures or activities the Lessee must perform to comply with a particular lease term or stipulation. A surveillance workplan is then developed to review the Lessee's records and to inspect/observe Lessee's operations to determine that required plans and procedures are in place, and that the required activities are being performed as they are designed.

After completing the document review and inspection work of a surveillance, SPCO staff generates a surveillance and assessment report. The report summarizes the observations and identifies any specific findings that may require corrective actions. The report uses the surveillance checklists, photographs, the written summary of the surveillance, and any other relevant information, to document the status of compliance with the lease and applicable laws and regulations, and to identify any potential compliance issues. The Lessee is provided a copy of the report. If any corrective actions are necessary, the Lessee is required to respond and address the problem.

In 1999, SPCO surveillance and assessment reports identified 24 corrective actions items concerning the Kuparuk Pipeline Right-of-Way Lease. All of the corrective actions involved administrative and notification procedures, such as location of training lists, formalizing procedures into writing, and updating notification lists. None of these corrective action items raised immediate concern on pipeline integrity, safe operations, human health or environmental issues. Many of these items were resolved on the spot. For the others, a follow up surveillance

in 2000 found all 24 of the items had been satisfactorily addressed and were closed out. The surveillance performed in 2001 found no corrective action items that needed to be resolved.

If the Lessee fails to address the concerns identified in a surveillance and assessment report, there are remedies available to the State, both in the lease and in statute. Lease Section 25, and AS 38.35.225 provide the basis and notification procedures for pursuing an action to enforce the terms of the lease. In addition, Lease Section 17 and AS 38.35.170 establish the authority and the procedures for the commencement of an action for the forfeiture of an interest in the right-of-way. To date, neither of these actions has ever been initiated for this lease.

At the end of the year, the SPCO prepares a report on the overall state of the pipeline and the right-of-way for each North Slope lease, based on surveillance and assessment reports, any engineering project reports or reviews, and the Lessee's Annual Report. The SPCO year end report focuses on pipeline safety and integrity, and identifies and reviews Lessee's resolution of any outstanding SPCO directives, orders, and implementation of any have key audit action items.

d. Compliance Monitoring -- Lessee Provided Information

In September of 1999, consistent with the requirements of Lease Sections 4c and 4d, and Stipulation 1.3.3, the SPCO, by letter No. 99-160-GS, directed the Lessee to provide an annual comprehensive report on pipeline activities and the state of the pipeline system. The Lessee's Annual Report (LAR) is a key piece of information the SPCO uses to understand and monitor the overall picture of the pipeline system and the right-of-way. The LAR includes the results of the Lessee's Surveillance and Monitoring Program during the preceding year, including annual and cumulative changes in facilities and operations, the effects of the changes, and proposed actions to be taken as a result of the noted changes such as:

- A summary of the scope of all internal surveillance, audits, self-assessments or other internal evaluations performed by the Lessee.
- A summary of the findings, action items and observations identified as a result of all internal surveillance, audits, self-assessments or other internal evaluations by the Lessee.
- A description of the corrective and preventive actions planned or implemented as a result of all internal surveillance, audits, self-assessments or other internal evaluations by the Lessee.
- A list of those internal surveillances, audits, self-assessments or other internal evaluations planned for the next year.

The LAR also addresses the state of, changes to and results in the last year from the Lessee's risk management program, Quality Assurance Program, and internal and external safety programs. The LAR summarizes the Lessee's performance under the right-of-way lease, in regard to any construction, operation, maintenance and termination activities that occurred along the right-of-way. The LAR discusses any events, incidents and issues, which had the potential to adversely impact the integrity of the pipeline, the environment, or worker and public health and safety.

Included is a summary of any oil and hazardous substances discharges along or within the right-of-way.

A couple of sections in the LAR the SPCO relies upon for monitoring lease compliance merit additional discussion. The first is the Kuparuk Pipeline Compliance Matrix. The Compliance Matrix summarizes the methods the Lessee uses to comply with the terms and stipulations of the lease. The Compliance Matrix identifies the requirement for complying with each lease term, the program or procedure the Lessee uses to satisfy the requirement, and the person responsible for the managing that program.

The LAR also contains individual sections on the Surveillance and Monitoring Program, and Corrosion Control Program. Both of these programs are key elements in ensuring pipeline integrity and safe operations. The SPCO review of the LAR and their annual surveillance activities are combined to review these programs, along with the Lessee's records, and verify the Lessee is satisfying the surveillance and maintenance activities discussed and proposed in the LAR.

SPCO review of the LAR is a major component used in determining lease compliance. Some of the plans and programs referenced in the LAR require SPCO approval. Some require approval by other regulatory agencies. The SPCO review first determines whether the necessary approvals have been obtained, then focuses on whether the Lessee implements the plans and procedures as they propose, and finally verifies that the Lessee has the necessary records that document compliance.

III. State Pipeline Coordinators Findings on Kuparuk Pipeline ROW Lease Renewal.

The purpose of this State Pipeline Coordinator's report is to outline and document the SPCO review of the application for renewal of the Kuparuk Pipeline ROW Lease, pursuant to the provisions of AS 38.35.110 and of 11 AAC 80.065 --.085. As stated above, AS 38.35.110 expressly provides that the Kuparuk Pipeline Right-of-Way Lease shall be renewable, for a period up to 30 years, so long as the Lessee is:

1. In commercial operation;
2. In full compliance with State law; and
3. In compliance with all terms of the lease.

This section of the report summarizes the State Pipeline Coordinator's findings on Lessees' compliance with these three statutory renewal requirements, and briefly identifies the evidence and documentation relied upon for the respective findings.

a. Commercial Operation

For renewal, both the statute (AS 38.35.110) and the lease (Section 2) require the Lessee to be in "commercial operation." The Lessee operates under a valid "Certificate of Convenience and Necessity" issued to the KTC by the Alaska Pipeline Commission (predecessor to both the Alaska Public Utilities Commission (APUC) and the RCA), on October 17, 1984. The Lessee has a current Alaska Business License, and the KPC holds a Certificate of Compliance, authorizing them to transact business in Alaska. They have an approved tariff and the pipeline

transports oil every day. State resource and regulatory agencies receive daily, monthly and yearly production and transportation figures for the volume of oil that is produced from the units and fields that tie in and transport oil through the Kuparuk Pipeline. The Lessee pays State and local property taxes for the Kuparuk Pipeline. Considering all the above, the State Pipeline Coordinator finds that the Lessee is in commercial operation.

b. Compliance with State Laws

Both the statute and the Lease require the Lessees to be in full compliance with State law for lease renewal. In this renewal review effort, “compliance with State law” is being determined based upon a report produced by each State regulatory agency that administers a statute or regulation that applies to the Lessee. The State Pipeline Coordinator has entered into RSAs through which each State regulatory agency has accepted responsibility to analyze its regulatory program for application to Lessees and to issue a compliance determination. Those reports, including compliance determinations, of each regulatory agency are included in Attachment B to this report. A brief summary of what each State agency reported follows:

The Department of Public Safety reported that there are no records of violations or noncompliance with State law for any of the North Slope pipelines.

The Department of Labor and Workforce Development reported that they have no civil proceedings, criminal proceedings, notice of violations, compliance orders or instances of noncompliance issues with any of the North Slope pipelines mentioned in the memo.

The Department of Revenue reported that Kuparuk Transportation Company, and all of its owner companies, are in full compliance with the corporate income tax requirements of AS 43.20, the motor fuel tax requirements of AS 43.65 and the ad valorem tax requirements of AS 43.56.

The Department of Law reported that it does not directly administer any statutes or regulations that apply to Lessee, and therefore has nothing to report concerning the operation of North Slope pipelines.

The Department of Fish and Game reported that they have visually inspected the stream crossings along the Kuparuk Pipeline where it is located next to Spine Road. ADF&G is not aware of any significant adverse impacts from the pipeline or related facilities to fish and wildlife resources or their habitats.

The Department of Environmental Conservation searched their computerized enforcement database, the Complaint Automated Tracking System, from 1999 to the present, and interviewed department managers and staff with regulatory oversight for North Slope oil and gas, and pipeline operations. DEC reported no instances of non-compliance with DEC laws or regulations involving any of the five North Slope pipeline right-of-way leases up for renewal.

The Regulatory Commission of Alaska staff reviewed their records of the North Slope common carrier pipelines, for compliance with the statutes and regulations applicable under the authority of the RCA, for the period January 1, 1999, to the present. The RCA reports that there are no new or ongoing proceedings, other than rate proceedings, involving the North Slope carriers. The RCA has not issued any Notice of Violation to any of the North Slope common carrier pipeline owners or operators.

Based on these comprehensive agency reviews, and resulting reports and compliance determinations, the State Pipeline Coordinator finds that Lessee is in full compliance with all State laws and regulations.

c. Compliance With the Lease

Some of the requirements of the lease overlap with requirements of State laws and regulations administered by various State regulatory agencies. As discussed above, the SPCO requested and received reports from State agencies regarding the Lessee's compliance with all laws and regulations for which that agency is responsible. In some areas of overlapping requirements, the regulatory agencies' monitoring programs and their determinations of regulatory compliance also provide a basis for determining whether the Lessee is in compliance with these overlapping terms and stipulations of the lease.

In addition, there are several terms and stipulations of the lease that cannot be referenced to a statute or regulation, but are a condition of the contract between the parties. To determine lease compliance for these provisions, the SPCO reviewed each term and stipulation of the lease, identifying the necessary requirements for satisfying the lease term (i.e., what actions the Lessee must take to satisfy the provision), and then addressing whether the Lessee has any outstanding compliance issues with meeting the requirement of the term or stipulation.

A major process the SPCO uses to determine compliance with the lease is a review of the Lessee's Compliance Matrix (submitted as part of the LAR, and discussed at Section III, b., above) and surveillance of the Lessee's implementation of the Compliance Matrix. The Compliance Matrix is the Lessee's method for reviewing each lease term and stipulation, and then determining the necessary management process or program they use to satisfy the requirement. The SPCO Compliance Monitoring Program (Section II a., above) includes staff review of the Lessee's records and surveillance of the processes as they are implemented. If the Lessee satisfies these requirements, they are found to be compliance with the lease.

In March 2002, SPCO staff completed a "North Slope Compliance Assessment Report for the Kuparuk Pipeline Right-of-Way (2002 Compliance Assessment Report).⁵" The 2002 Compliance Assessment Report reviews each lease term and stipulation for the Kuparuk Pipeline Right-of-Way Lease, and identifies the "scope" (the applicability of the provision, i.e., whether it is a legal or administrative provision, applies during construction activities, or is applicable throughout the all phases of pipeline operations) of the term or stipulation. The Compliance Assessment Report then reviews the Lessee's compliance activities with each lease term and stipulation. The Compliance Assessment Report identified no compliance issues related to any of the lease terms or stipulations, and the State Pipeline Coordinator therefore finds Lessee is in compliance with all terms of the lease.

IV. Recommendation

Based on the comprehensive review outlined and documented by this report, the State Pipeline Coordinator finds no legal or regulatory basis for not renewing the lease. The Lessee is in

⁵ Attachment "A" to this report.
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compliance with all the terms and stipulations of the lease, and all other relevant State laws and regulations. The Lessee is in commercial operation, and has been so continuously since 1981. The Lessee has met the requirements for renewal of the lease, as specified by the Right-of-Way Leasing Act and supporting regulations.

V. Term of Renewal

AS 38.35.110 was amended, effective July 1, 2001, extending the maximum term applicable to a right-of-way lease renewal from 10 years to 30 years. Section 2 of the Lease has been amended to reflect the 30-year maximum renewal term. The Lessee's application for Lease renewal requests a 30-year renewal term.

In determining the appropriate term of renewal, the SPCO has considered a number of factors. The Lessee has invested a significant amount of resources in this venture. The estimated construction costs for the Kuparuk Pipeline (including the Kuparuk Extension) exceeded \$135 million. Further, in 2001 alone, the annual cost to operate and maintain the system was \$4.3 million. The Lessee has demonstrated sufficient technical and financial capability to correct any unforeseen problems, and has made all necessary upgrades and modifications to the system to maintain safe operations. Current estimates indicate there are sufficient North Slope crude oil reserves to support operation of the Kuparuk Pipeline System for at least 30 years.

The continued operation of the Kuparuk Pipeline serves a number of public purposes. Economic benefits to the State include jobs, plus royalty and tax revenues. About 35% of North Slope production is transported through the Kuparuk Pipeline. Continuing exploration and the potential for additional development west of Prudhoe Bay enhances the importance of the Kuparuk Pipeline as necessary infrastructure for future development of North Slope reserves. North Slope development improves national security by making petroleum products available to the military and reducing dependency on imported oil. Furthermore, once a Certificate of Public Convenience and Necessity is granted, service cannot be abandoned without regulatory approval.

The Kuparuk Pipeline is 26.2 miles in length. It is entirely above ground (except for occasional road and animal crossings), insulated, and suspended on VSMs. The pipeline has four valves, and there are no ancillary or support facilities along the pipeline or within the right-of-way. The Lessee's established Surveillance and Monitoring Programs identify any potential threats to human safety, the environment, and pipeline integrity. The Corrosion Monitoring Program detects and evaluates both internal and external corrosion. Corrosion monitoring is performed on a regularly scheduled basis that complies with State and federal requirements. Internal corrosion detection activities include ultrasonic or x-ray inspections. External corrosion monitoring includes tangential radiographic ultrasonic or x-ray, and visual inspections. Pipeline pig runs, for detecting internal and external corrosion, are currently performed every three years. As previously discussed, pipeline corrosion problems were identified in 1997, and successful corrective actions were implemented by 1999. Continued surveillance activities by the Lessee, and review of surveillance and monitoring programs by the SPCO have successfully reduced the corrosion threat to the pipeline. There has never been a leak caused by corrosion on the Kuparuk Pipeline.

The Surveillance and Monitoring Programs include a Maintenance Program that provides for routine maintenance, based on a regular schedule, and corrective maintenance, based on information generated from surveillance and monitoring activities and inspections. The Maintenance Program includes processes for notification and development of corrective action plans. These programs and records are reviewed by the SPCO as part of our surveillance and management of the Lease and the right-of-way. Continued implementation of these programs, combined with SPCO surveillance oversight, forms a strong basis for determining that the integrity of the pipeline, and the maintenance processes and standards adopted by the Lessee, support a determination that the safe operation of the pipeline will result in a useful life in excess of the 30 years applied for by the Lessee. The State Pipeline Coordinator finds no basis to reduce the term of the renewal to a period of less than 30 years.

Having reviewed and considered all the necessary information on the application to renew the Kuparuk Pipeline Right-of-Way Lease, it appears that the Lessee has satisfied the renewal requirements of AS 38.35.110. The State Pipeline Coordinator recommends the application to renew the Kuparuk Pipeline Right-of-Way Lease be approved, and that the Kuparuk Pipeline Right-of-Way Lease be renewed for 30 years.

John Kerrigan, State Pipeline Coordinator
Department of Natural Resources

Date

VI. References

The Right-of-Way Lease for the Kuparuk Pipeline, ADL 402294

The Right-of-Way Leasing Act (AS Title 38.35.110, et. seq.)

The Alaska Administrative Code (AAC Title 11, et. seq.)

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Pipeline ROW Lease Renewal Application, Kuparuk Pipeline, February 2002

Kuparuk Pipeline Right-of-Way case file, SPCO Office

Regulatory Commission of Alaska 2001 Report to SPCO

Alaska Department of Public Safety 2001 Report to SPCO

Alaska Department of Labor and Workplace Development 2001 Report to SPCO

Alaska Department of Revenue 2001 Report to SPCO

Alaska Department of Law 2001 Report to SPCO

Alaska Department of Fish and Game 2001 Report to SPCO

Alaska Department of Environmental Conservation 2001 Report to SPCO