Agenda Report

Date: August 26, 2008

To: Stephen W. Helvey, City Manager

From: David A. Pelser, Director of Public Works

Subject: Whittier Main 2008 Mineral Extraction Project

RECOMMENDATION

It is recommended the City Council:

1. Approve the Oil, Gas And Mineral Lease and other referenced documents for bidding in relation to a proposed Whittier Main 2008 Mineral Extraction Project;
2. Adopt the attached Resolution of intention to lease property for production of oil, gas and other hydrocarbons;
3. Authorize the City Manager to execute the Lease; and
4. Direct staff to publish the Resolution of intention as required by law and described in the Resolution.

BACKGROUND

The City owns approximately 1300 acres of former oil fields in the hills north of the developed areas of the City (see Exhibit A to the attached Resolution of Intention). This was commonly known as the Whittier Main Field which was in oil production for over 100 years. The majority of this land was purchased from Chevron and Unocal with Measure A funds in order to preserve this land as open space and wildlife habitat. This land is managed for the City by the Puente Hills Landfill Native Habitat Preservation Authority (Habitat Authority), a joint powers agency with members including the City of Whittier, County of Lo Angeles, Los Angeles County Sanitation Districts, and Hacienda Heights Improvement Association. When oil production stopped, the oil was worth about $12 per barrel. Today, the oil is valued at approximately $100 per barrel. If the oil could be successfully extracted now, the City could receive a new source of revenue for its General Fund in the form of royalty payments from an oil company. In addition to the change in value of the remaining oil deposits, technology has also changed. New methods of drilling and pumping are much less invasive to the surface land uses and the environment. We estimate the same 1300 acres of oil deposits could now be developed from approximately three surface sites of 2-3 acres each (less than half of 1% of the land). Furthermore, most of the drilling and pumping equipment can be placed in soundproof underground vaults that would not be visible. Therefore, it now appears feasible to access the valuable oil and gas resources while continuing to preserve our precious open space and wildlife habitat.

Project Concept

Extracting oil and natural gas will require an experienced oil company to partner with the City. The relationship with the oil company will be in the form of a mineral lease in which with the City will lease its mineral rights to the land and the oil company will pay the city royalties on the oil and natural gas produced. Under State law, the City must use a competitive process to solicit bids for the mineral lease. The highest qualified bidder will then have the opportunity to explore and extract the oil and natural gas. The request for bids is accomplished in the form of a resolution of intention. Attached is a proposed RESOLUTION OF INTENTION TO LEASE PROPERTY FOR PRODUCTION OF OIL, GAS AND OTHER HYDROCARBONS and a proposed OIL, GAS AND MINERAL LEASE.

The successful bidder on the mineral lease must still apply to the City for a Conditional Use Permit (CUP) in order to do any work on the ground surface such as set up a drill rig, pumps, and other equipment required to actually extract the minerals. The CUP application will describe exactly what the oil company plans to do, and will define the "project" that will be subject to review under the California Environmental Quality Act (CEQA) which will require an Environmental Impact Report (EIR). The Draft EIR will be circulated for public comment. The proposed OIL, GAS AND MINERAL LEASE has no guarantee that the successful bidder will be able to obtain a CUP once the environmental impacts are presented in the EIR. Also, if a CUP is issued, it will contain many specific requirements and mitigation measures for the oil company to follow. City staff and the Habitat Authority have already given this much thought and cooperated to provide the attached List of Potential Mitigation Measures in order to inform potential bidders and the public of the extent of environmental protections expected to be include in any future CUP. While it is unusual to anticipate mitigation measures prior to preparing an EIR, staff wants the public and the bidders to be aware of the high value the City places on the open space and wildlife habitat uses of this land. The actual mitigation measures and CUP conditions will be determined later by the City Council following public review of potential environmental impacts disclosed in the EIR.

Project Schedule
At this time, our best estimate of a project schedule follows:

Date	Event
August 26, 2008	City Council adopts Resolution of Intention to Lease Property for Production of Oil
	City receives bids on lease (bid for royalty amount)
	City Council awards Lease Agreement to highest bidder
3 – 8 months after lease awarded	Oil Company files application for Conditional Use Permit – identifies facilities and locations requested for exploration and production operations

Public Involvement
The public will have multiple opportunities to be informed and to comment while the process unfolds. Already, the City Council has heard a staff report at its meeting on April 22, 2008 and a presentation by Mayor Pro Tem Bob Henderson on June 24, 2008. Information was posted on the City's web site to keep the public informed. Several front page articles appeared in the Whittier Daily News. The CEQA process including the preparation of an EIR will include multiple opportunities for public review and comment, as will the consideration of issuing a CUP. All through this process, there will be several government agencies which will have additional permitting and oversight authority to impose additional project requirements. For example, the California Department of Conservation, Division of Oil, Gas, and Geothermal Resources (DOGGR) has multiple regulations related to oil and natural gas exploration and production.

City Project Team
The City Manager assembled a team of key staff and consultants to work together in assessing the feasibility of a project to extract minerals from City-owned land in the Whittier Hills area. Specific staff members involved will vary according to the needs of the project at any particular time. During the preparation of the proposed RESOLUTION OF INTENTION and OIL, GAS AND MINERAL LEASE the City team included the following:

Bob Henderson, City Councilman and Chairman of the Board of the Puente Hills Landfill Native Habitat Authority
Steve Helvey, City Manager
Dick Jones, City Attorney
David Pelser, Public Works Director
Jeff Collier, Community Development Director
Rod Hill, Controller

Jim Day, Partner with Day Carter Murphy, LLP law firm
Kyle Rhorer, Vice President of RW Beck (finance and procurement specialist)
Tom Walker, Vice Pres. of Evans and Walker Consulting Petroleum Engineers

DISCUSSION

In this discussion section are presented some of the key features of the proposed bidder submittal requirements and proposed lease agreement provisions.

Request for Bids
The Resolution of Intention serves as a request for bids and must be published four consecutive weeks in the Daily News prior to receiving bids. This will comply with State law.

Also in compliance with State law, there will be only one variable on which to bid – royalty payments to the City. The Royalty payments are set at a minimum bid of 20% initial royalty plus an additional increment as price or production increases. Bidders may bid higher initial royalty, a higher incremental royalty, or both. The royalty is based on either published market price or gross proceeds of sale per month. Royalty payments are made when production begins, even if it occurs during the Primary Term of the lease while rent payments are also paid.

Bidders are required to submit a check for $400,000 as initial deposit toward the City's costs including running the bid process and preparing an EIR. The deposit will be increased if City costs reach 90% ($360,000) of the initial deposit. Alternatively, a refund will be made to the Bidder if the City costs total less than the amount on deposit.

To protect the city from wasting time with unqualified bidders, the ROI includes Exhibit "B" - "Minimum Qualifications and Submittal Requirements". The bidders will be required to demonstrate their technical, financial, and experience qualifications. Only bidders that meet the minimum qualifications will be considered for award of a lease. The same minimum qualifications will be required as a condition of assignment of the lease should the successful bidder desire to assign the lease to another company at a later date.

Proposition A Compliance
The City's purchase of the Whittier Hills land subject to the proposed mineral lease was funded by a grant of Proposition A funds. Conditions of this funding prevent the City from using the land for anything other than open space. In order to make available for drilling and pumping approximately 8 acres of the surface in the 1300 acre mineral lease area, the City will have to either reimburse a portion of the Proposition A funds, or provide an additional comparable area of land that can be used for open space to compensate for that area used for surface facilities in oil production. City staff is in contact with the Los Angeles County Proposition A District to determine the appropriate approach to compliance with this requirement. The proposed lease includes a provision that a CUP will not be issued by the City until a release from protected area status is obtained from the Proposition A District.

Limitations on Property Access
Prior to CEQA compliance and issuance of a CUP, the successful bidder will not be allowed to enter the property, except for visual inspections or surveys in support of preparing a CUP application.

Lease Payments During Primary Term
The Primary Term of the lease is three years, during which time CEQA compliance must be completed, a CUP issued, and drilling operations started. The first year's rental payment is $10.00 per acre (approximately $13,000) and is paid in advance with the

proposal submittal. The rent for the next two years total is $140.00 per acre, or approximately $182,000.

Funding for Ecologist and Habitat Enhancement
The proposed lease requires the successful Bidder pay the Habitat Authority an annual Management Fee of $60,000, increasing to $80,000 one year after drilling operations begin. The lease also requires payment to the Authority a Habitat Enhancement Fee of $100,000 annually upon starting drilling operations. Both of these fees will be adjusted over time by a consumer price index. *

Payment of Taxes
The proposed lease requires the successful bidder pay all taxes including property taxes.

Insurance
The proposed lease requires workers compensation coverage, $1,000,000 in employer's liability insurance and $5,000,000 in both auto and general liability insurance. It also provides for naming the City and the Habitat Authority as an additional insured.

Potential Mitigation Measures and CUP Conditions
As mentioned above in the Background Section of this report, the successful Bidder will have to apply to the City for a Conditional Use Permit. The CUP application will provide the basis for a project description that will be subject to CEQA review. Most likely, a full EIR will be required. CEQA compliance is likely to require mitigation measures be included in the proposed project. In addition, the City will likely have a number of conditions in a CUP. City staff and the Habitat Authority have already given this much thought and cooperated to provide the attached List of Potential Mitigation Measures in order to inform potential bidders and the public of the extent of environmental protections expected to be include in any future CUP. While it is unusual to anticipate mitigation measures prior to preparing an EIR, staff wants the public and the bidders to be aware of the high value the City places on the open space and wildlife habitat uses of this land. The actual mitigation measures and CUP conditions will be determined later by the City Council following public review of potential environmental impacts disclosed in the EIR. The actual conditions adopted may be even more extensive than this List. The attached List is in intended to serve as a starting point for public discussion and review.

Hazardous Substances, Pollution, Well Abandonment, Restoration
While there are many safeguards that will be in place in the lease, in State regulations, and in various permits to assure safe and environmentally responsible operations, the lease also holds the successful Bidder responsible for all hazardous substances, waste materials, spills, and environmental pollution that may occur. The Bidder will be responsible for any cleanup and restoration due spills, pollution, and the like.

Furthermore, the lease agreement includes reference to anticipated CUP conditions for establishment of a fund that will have sufficient moneys to pay for well abandonments and restoration of surface conditions upon completion of oil production operations.

Property Description

The Resolution of Intention uses a map (Exhibit A, attached) to identify the parcels of land that are intended to be subject to the lease. The lease agreement will include a more detailed and formal legal description which is available for review in the City Clerk's office.

FISCAL IMPACT

The recommended actions in this report have no immediate significant direct fiscal impact. Publishing the RESOLUTION OF INTENTION in compliance with State laws will result in a modest cost estimated to be on the order of several hundred dollars. Once bids are received and analyzed, the fiscal impact of awarding a lease agreement could result in significant revenues to the City, perhaps on the order of magnitude of the tax revenues from a large car dealer or big box retailer (several millions of dollars annually).

The successful Bidder on the mineral lease will have to reimburse the City for these and other costs including the preparation of an EIR. The Bidder is required to submit a check for $400,000 as a deposit towards the City's total estimated costs including the EIR. The City will select the EIR consultant and manage the CEQA process. Similarly, the City selected the other consultants in the City's project team identified above.

Submitted by:

David A. Pelser
Director of Public Works

Attachments: Attachment 1 - Resolution of Intention to Lease
Exhibit A – Property Map
Exhibit B – Minimum Qualifications of Bidders
Attachment 2 - Proposed Oil, Gas and Mineral Lease
Exhibit A – Property Legal Description
(on file with City Clerk)
Attachment 3 - List of Potential Mitigation Measures

proposal submittal. The rent for the next two years total is $140.00 per acre, or approximately $182,000.

Funding for Ecologist and Habitat Enhancement
The proposed lease requires the successful Bidder pay the Habitat Authority a monthly Management Fee of $5,000, increasing to $7,000 when drilling operations begin. The lease also requires payment to the Authority a Habitat Enhancement Fee of $100,000 annually upon starting drilling operations. Both of these fees will be adjusted over time by a consumer price index.

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Exhibit B – Minimum Qualifications of Bidders
Attachment B - Proposed Oil, Gas and Mineral Lease
Exhibit A – Property Legal Description
(on file with City Clerk)
Attachment C - List of Potential Mitigation Measures