

Agenda Report



Date: October 28, 2008
To: Stephen W. Helvey, City Manager
From: David A. Pelser, Director of Public Works
Subject: Whittier Main 2008 Mineral Extraction Lease – Award

RECOMMENDATION

It is recommended the City Council:

1. Award the bid for the Whittier Main 2008 Mineral Extraction Lease to Matrix Oil Corporation of Santa Barbara, California; and
2. Approve and authorize the City Manager to sign the Whittier Main 2008 Mineral Extraction Lease and the Whittier Main 2008 Short Form Lease.

BACKGROUND

On August 26, 2008, the City Council adopted a Resolution of Intention (ROI) to lease property for the production of oil, gas and other hydrocarbons. A proposed Oil, Gas, and Mineral Lease Agreement form was also approved by the Council at that time. The ROI served as a type of request for proposals for the lease. In compliance with State law, the ROI was published four consecutive weeks in the Daily News prior to bid opening. On October 2, 2008 at 2:00 p.m. in the Council Chamber, proposals were publicly opened. The City Clerk received one proposal from Matrix Oil Corporation of Santa Barbara, California with Clayton Williams Energy, Inc. of Midland, Texas as Project Guarantor. This proposal was reviewed by the City's staff and a team of consultants for compliance with requirements of the ROI.

The remaining paragraphs of this Background Section essentially repeats the information provided in the August 26 staff report.

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 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 Los 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.

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 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 and during the review of the proposal received 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 Pelsler, 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

Request for Bids

Also in compliance with State law, there was only one variable on which to bid – royalty payments to the City. The Royalty payments were set at a minimum bid of 20% initial royalty plus an additional increment as price or production increases. Bidders were allowed to bid a 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 were 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 were 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 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.

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

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 a List of Potential Mitigation Measures in order to inform potential bidders and the public of the extent of environmental protections expected to be included in any future CUP. While it is unusual to anticipate mitigation measures prior to preparing an EIR, staff wanted 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 List is intended to serve as a starting point for public discussion and review. The List was made available to potential bidders and was attached to the August 26, 2008 staff report.

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.

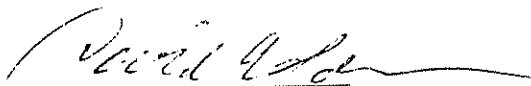
DISCUSSION

At the appointed time and place City staff publicly opened the one bid received from Matrix Oil Corporation with Clayton Williams as Project Guarantor. City staff and the team of project consultants reviewed the proposal (s) submitted and found that it complies with the submittal requirements. The royalty amount bid was 30% which is well above the minimum 20% required. The team also determined that the Matrix and Clayton Williams team meets the qualifications requirements. The bid package included the required check for \$400,000.00 (towards City costs) which was deposited and cleared by the bank.

FISCAL IMPACT

At this time, it is not possible to estimate with any certainty the fiscal impact of the proposed lease agreement. As described above the details of a proposed project to develop the mineral resources that are the subject of this lease will be included in an application for a Conditional Use Permit which is expected to result in preparation of an Environmental Impact Report. The \$400,000 deposit by the bidder is expected to cover the City's costs of processing a CUP application including the cost of a consultant to prepare an EIR. If Matrix is successful in obtaining the necessary CUP and other permits, and if their oil exploration is successful, the City could benefit greatly over many years as a result of royalty payments made pursuant to the terms of the proposed lease agreement. The potential future royalty revenue to the City could be as much as millions of dollars annually for many years.

Submitted by:



David A. Pelser
Director of Public Works

Attachments:

- A – Proposal Letter from Matrix Oil Corporation
- B – Project Guarantor Acknowledgement Form by Clayton Williams Energy, Inc.
- C – Whittier Main 2008 Mineral Extraction Lease Agreement
- D – Whittier Main 2008 Mineral Extraction Short Form Lease Agreement

ATTACHMENT A



101 West Chapman Street Suite 100
Anaheim, CA 92801 TEL: 714-935-3311 FAX: 714-935-3312

October 2, 2008

VIA Hand Delivery
City of Whittier
13230 Penn St
Whittier, CA 90602

RE: Bid for Oil and Gas Lease
City of Whittier Resolution No 8155 (the "Resolution")

Ladies and Gentlemen:

Matrix Oil Corporation ("Matrix") as bidder and Clayton Williams Energy, Inc. ("Williams") as Project Guarantor hereby submit this bid for the Oil and Gas Lease described in the Resolution:

Bid:
Initial Royalty: 30%
Incremental Royalty: 1.25%
Highest Total Royalty not to exceed 50 %

Enclosed herewith is: (i) check in the amount of Four Hundred Thousand Dollars (\$400,000.00) for the initial deposit; (ii) the Project Guarantor Acknowledgement form executed by Williams; and (iii) a notebook of documentation as required and set forth in Exhibit "B" to the Resolution.

As evidenced in the attachments hereto, Matrix and Williams together meet all of the requirements of a qualified bidder. Matrix has operated the adjoining West Whittier field since 2000. In 2006 Matrix and Williams commenced a successful development program in this field which increased production 278%. We firmly believe that our understanding of the geology and our operations at the Rideout Heights and Honolulu Terrace facilities demonstrate that the Matrix/Williams team are not only a qualified bidder, but the most qualified bidder.

If you need any additional information, please do not hesitate to call. We look forward to working together with the City on this project.

Respectfully Submitted,

A handwritten signature in cursive script that reads "Johnny Jordan".
Johnny Jordan
President

ENCLOSURES



CLAYTON WILLIAMS ENERGY, INC

PROJECT GUARANTOR ACKNOWLEDGEMENT

Matrix Oil Company ("Bidder") has submitted herewith a Bid in response to the City of Whittier, California ("City") to provide services under the Whittier Main 2008 Oil Extraction Project and the City's Oil, Gas, and Mineral Lease.

The Project Guarantor hereby certifies that it will irrevocably, absolutely and unconditionally guarantee the performance of all of the Bidder's obligations under the Oil, Gas, and Mineral Lease negotiated by the parties.

Name of Guarantor: Clayton Williams Energy, Inc

Name of Authorized Signatory:
T. Mark Tisdale

Signature: *T. Mark Tisdale*

Title: Vice President