

EXHIBIT E

PRC 7911.1
PRC 4000.1

STATE OF CALIFORNIA

ARNOLD SCHWARZENEGGER, *Governor*

CALIFORNIA STATE LANDS COMMISSION

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February 5, 2009

File Ref: PRC 7911

PRC 4000

W 40813

Mr. Charles W. Cappel, President
Carone Petroleum, Inc.
1145 Eugenia Place, Suite 200
Carpinteria, CA 93013

RE: PRC 7911/4000 Development from OCS Platform Hogan

Dear Mr. Coombs:

Staff of the California State Lands Commission (State) has received and considered Carone's January 20, 2009 response to the State's September 2008 letter as well as to the discussions between Carone and Staff since then. In these discussions, Staff attempted to work with Carone to help Carone fulfill the terms of lease assignments, but never consented to placing an indefinite hold on its requests that Carone move forward. Carone's recent response, however, places an indefinite hold on Carone's compliance with all Staff requests that would require Carone to spend money. The inability of Carone to spend money on operations to develop the leases raises an even more fundamental question, which is the capacity of Carone to continue to hold the leases.

Staff requested that Carone commit to the development of the leases by (1) executing a new reimbursable agreement for CEQA and submitting an initial deposit for the CEQA work, (2) executing a contract with a structural integrity contractor for the remaining analysis of Platform Hogan and (3) initiating the process for making a complete application with the Minerals Management Service for a Right of Use and Easement. Staff said that if Carone were unable or unwilling to do so, then Carone shall submit to the Commission by December 15, 2008, quitclaims for both lease PRC 4000 and lease PRC 7911. In its response, Carone states that until the NYMEX crude oil price is at least \$60 per barrel for three consecutive months it is not financially able to comply with all of Staff's requests for committing to the pursuit of this project and intimates that it has no intention of quitclaiming the leases.

Mr. Charles W. Cappel
Carone Petroleum, Inc.
RE: PRC 7911/4000 Development from OCS Platform Hogan
February 5, 2009
Page 2

As Staff said in the September 2008 letter, it would bring to the Commission its recommendation that Carone is in default under both leases if Carone had not complied with Staff's three requests for moving the project forward or had not quitclaimed the leases. Staff appreciates the current economic climate and the problems with securing credit. However, Staff believes that Carone's current economic problems do not mitigate twelve years of delay. What little Carone promises in its January 20, 2009 letter does not involve monetary expenditures necessary to provide Staff with a full project application and causes Staff great concern about the financial ability of Carone to continue to hold these leases. Carone's stated intent to put off all actions appears to be dependent upon oil prices stabilizing at or above \$60 per barrel, something that is extremely difficult to predict. If oil prices continue to be volatile as they have been in the recent past, then the State has no assurance that Carone ever will be financially capable of carrying out its long-term obligations under the leases.

Staff, therefore, will recommend to the Commission that it find Carone in default under both lease PRC 4000 and lease PRC 7911. If the Commission finds Carone in default, Carone will have 90 days to cure the default. Complying fully with Staff's requests outlined in its September 2008 letter would cure the default. This includes fully funding the reimbursable agreement for CEQA and Staff processing in the amount of \$650,000. You may of course also file quitclaims, making Staff's recommendation to the Commission for default unnecessary. Because the Commission's approval of the lease assignments to Carone in 1996 was conditioned upon Carone's submission of a plan for development within two years and the commencement of drilling within three years, Staff's recommendation of default twelve years later does not appear to be precipitous.

Sincerely,



Gregory D. Scott, Assistant Chief
Mineral Resources Management Division

cc: Honorable John Garamendi
Lt. Governor
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State Capitol, Room 1114
Sacramento, CA 95814

Honorable John Chiang
State Controller
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Mr. Charles W. Cappel
Carone Petroleum, Inc.
RE: PRC 7911/4000 Development from OCS Platform Hogan
February 5, 2009
Page 3

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