

EXHIBIT F

CALENDAR ITEM

41

A 35

PRC 7911.1

PRC 4000.1

M. Voskanian

S 18

J. Planck

**CONSIDER FINDING CARONE PETROLEUM CORPORATION
IN DEFAULT OF SUBSURFACE (NO SURFACE USE)
OIL AND GAS LEASE NOS. PRC 7911.1 AND PRC 4000.1,
OFFSHORE CARPINTERIA,
SANTA BARBARA COUNTY**

LESSEE:

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

AREA, LAND TYPE, AND LOCATION:

Oil and Gas Lease No. PRC 7911.1 contains approximately 1,541 acres of submerged land, which originally comprised the southern portion of Oil and Gas Lease No. PRC 3150.1, and Oil and Gas Lease No. 4000.1 contains approximately 204 acres of submerged land. Both are offshore Carpinteria, Santa Barbara County, California.

BACKGROUND:

Background – Lease Acquisitions, Conditions and the Development Plan

Oil and Gas Lease No. PRC 3150.1, consisting of approximately 5,553 acres offshore and south of the city of Carpinteria, was originally leased to Standard Oil Company of California (later Chevron) and Richfield Oil Corporation (later ARCO) in July 1964. The lessees installed two platforms (Hope and Heidi) on the leased lands, and drilling and production operations continued from 1966 until 1992. Between 1992 and 1996, Hope and Heidi and two other platforms on an adjacent lease were removed. ARCO and Chevron assigned the southern portion of lease No. PRC 3150.1, containing approximately 1,541 acres, to Carone Petroleum Corporation (Carone). That assignment was approved by the Commission on October 28, 1996. The assigned lease was re-designated Oil and Gas Lease No. PRC 7911.1, is limited to subsurface (no surface use) operations by Carone, and is to be accessed and developed from Platform Hogan which Carone

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operates in federal waters on the Outer Continental Shelf. The assignment was intended to further the best interests of the State by preventing drainage of oil and gas resources beneath these lands from Carone's operations on adjacent federal lands. The Commission later approved an assignment of the balance of Oil and Gas Lease No. PRC 3150.1 to Venoco for potential development by Venoco from its onshore facilities of a near shore geologic structure just offshore and under the city of Carpinteria.

Oil and Gas Lease No. PRC 4000.1, consisting of approximately 204 acres of submerged land lying between the southern boundary of Oil and Gas Lease No. PRC 3150.1 and the offshore 3-mile federal/state boundary, was issued to Standard Oil Company of California (later Chevron) and Atlantic Richfield Company (later ARCO) in August 1968. The Commission also approved the assignment of Lease No. PRC 4000.1, in its entirety, to Carone at the same October 28, 1996 meeting when it created Oil and Gas Lease No. PRC 7911.1 from the southern portion of Oil and Gas Lease No. PRC 3150.1 and approved its assignment to Carone.

In addition to lease requirements obligating Carone to exercise reasonable diligence in the development of these leases, the assignment of Oil and Gas Lease Nos. PRC 4000.1 and PRC 7911.1 was subject to an agreement between Carone and the State imposing various conditions upon the Commission's approval of the assignment. Among those conditions is one that required that Carone "submit to the Commission within two years of the effective date of the assignments of the leases [by November 1, 1998] a plan for the development of both leases" and "begin drilling operations on both leases within three years of the effective date of the assignments of the leases [by November 1, 1999]."

After several extensions of these deadlines, Carone submitted to staff a development plan application on October 25, 1999. On November 23, 1999, staff responded with a letter finding the application incomplete. Upon continued urging by staff to provide the materials needed to complete the application, Carone provided some but not all of the requested materials on or about October 23, 2000. That response was supplemented with more materials on October 24, November 3, and November 21, 2000. On December 11, 2000, staff responded with a second incomplete letter stating that Carone had still failed to provide a complete application. Carone finally provided all materials required to make the application complete on or about January 14, 2001.

The EIR Process

Under the California Environmental Quality Act (CEQA, see Public Resources Code sections 2100 et seq.), the Commission cannot approve the development plan proposed in Carone's application until all the necessary environmental

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documents have been prepared. As such, completion of the CEQA process is a necessary precondition that Carone must satisfy prior to any operations occurring that would restore production of oil or gas to the leased lands and under the lease terms, Carone must exercise reasonable diligence in completing the CEQA process in order to avoid termination of the lease (Lease Paragraph 1. "... Lessee shall commence and thereafter prosecute with reasonable diligence ... other operations which shall result in the restoration of production of oil and gas from leased lands."). The Commission is the lead agency under CEQA and is the primary agency responsible for ensuring the proper completion of the CEQA process.

Staff deemed the application for the proposed development plan complete on February 28, 2001, pending the receipt from Carone of a signed reimbursement agreement covering the costs of preparing the EIR for the development project as required by statute (PRC § 21089). The notice of preparation (NOP) for the EIR was issued on June 6, 2001. The scoping meeting, bid review, and interviews of the prospective consultants occurred between June 6 and July 31, 2001. After the consultant was selected, work began on the EIR on March 27, 2002.

On October 29, 2002, work on the EIR was suspended for 180 days in order to perform and analyze results of an American Petroleum Institute (API) level 3 structural survey that was needed to determine if any major work was required to strengthen Platform Hogan, the platform in federal waters from which the development of the state leases would occur, and if such work were required, whether this work had to be considered in the EIR. An additional extension of 120 days was requested by Carone and approved by staff because the analysis of the survey was not yet available. The analysis of the survey showed that although some maintenance and repair work was required, no major modifications of the platform would be needed so that there would be no construction requiring consideration in the EIR. However, left unresolved was the seismic analysis required by the State (to a 1000 year event) using new site specific standards. When the MMS determined that a structural requalification of Platform Hogan would be required, the parties agreed to finish the seismic analysis through that process.

Upon expiration of the suspension, staff contacted Carone to resume work on the EIR. Carone requested further suspension of work on the EIR on June 10, 2003 and October 24, 2003 in order to finish the expensive maintenance and repair work required by the API survey on its two federal platforms, Platform Hogan and Platform Houchin.

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In February of 2004, after continued requests by staff, Carone reaffirmed its commitment to the development project and represented unequivocally that it would authorize resumption of work on the EIR no later than May 1, 2004, and if it failed to do so, it would quitclaim the leases. On May 1, 2004, Carone directed staff to resume work on the EIR. An Administrative Draft of the EIR was completed for staff review in January 2005.

The federal review process, requiring, among other matters, an expanded structural analysis of Platform Hogan (see below) and finalization of the seismic analysis, caused further delays and requests from Carone for suspension of the EIR process. Ultimately, Carone did not seek resumption of the work on the EIR and the EIR contract with the State's consultant expired in January 2008. As of March 2009, eight years have passed since the EIR process was started and four years have passed since the process stalled at the Administrative Draft phase. Carone has not taken the necessary steps to resume the EIR process.

The Federal Process

In order for the Mineral Management Service (MMS) to approve Carone's proposal to drill into its State leases from Platform Hogan, MMS regulations require that Carone revise its field Development and Production Plan (DPP) or submit an application for a Right of Use and Easement (RUE). In June 2005, MMS reported to the staff, in response to staff's inquiry, that a revision to the Carpinteria Field DPP was the appropriate way for Carone to proceed and that Carone had not applied for such a revision.

A revision to the DPP would also require that the platform from which the drilling would occur be "requalified" structurally to show that it can accommodate the drilling and production operations over their estimated life. The State also requires that any new project from a platform analyze the structure's ability to withstand a 1000 year seismic event. At a January 2007 meeting with staff, and also in a follow up letter to staff, Carone stated that it had not yet made application for a revised DPP, but would do so within 30 to 45 days. In April 2007 in response to a staff request, the MMS informed staff that Carone still had not made an application for a revised DPP or a RUE to obtain authorization to use Platform Hogan. In July 2007, Carone sent staff another letter stating that it was still planning to submit a revised DPP. The MMS informed staff, in January 2008, that Carone had submitted an application for a RUE. In February 2008, the MMS sent a letter to Carone regarding deficiencies in its application (equivalent to a staff "incomplete" letter) and requested more information from Carone. As of March 2009, Carone had still not corrected the application deficiencies identified by the MMS staff, nor had it submitted any additional information or otherwise responded to the MMS request. The MMS also determined that a structural requalification of Platform Hogan would be required and has informed staff that it

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has not yet received a response from Carone regarding the requalification of Platform Hogan (which became part of staff's demands discussed below). Carone has informed staff that it has requalified its other nearby federal platform, Platform Houchin, and claims that it should take a very short time to requalify Platform Hogan because of its similarities with Platform Houchin. Based on its information from Carone, staff believes that the requalification of Platform Hogan has not been accomplished because of Carone's inability to obtain financing.

At this time, three and a half years after staff's first inquiry regarding Carone's securing MMS approval for using Platform Hogan to drill into and produce its state leases, seven years after requests for a complete structural integrity analysis of the platform, eight years after initiation of processing of its completed application for Commission approval of the project, and almost thirteen years after the Commission conditionally approved the assignment, Carone has failed to secure both the required approvals from the MMS and the required structural requalification of Platform Hogan.

Recent Staff Demands that Carone has Failed to Complete

On September 30, 2008, staff wrote to Carone requesting three actions from Carone, all of which Carone would be capable of doing without the approval of other governmental agencies. Compliance would require Carone to make a financial commitment to diligently pursue the development project for State Oil and Gas Lease Nos. PRC 4000.1 and PRC 7911.1. (This letter is attached as Exhibit C.) Staff set deadlines for the completion of each of these three actions. First, staff asked Carone for a fully executed and fully funded agreement for the resumption and completion of the CEQA process. The amount to be funded would be \$650,000, and it would be due by December 15, 2008. Second, staff asked Carone to submit by December 15, 2008, a fully executed contract with a structural integrity contractor for the structural requalification of Platform Hogan, and requiring the contractor to commence work by April 1, 2009. Third, staff requested that Carone provide to the MMS by December 15, 2008, a detailed written proposal for expeditiously proceeding with and concluding the process for obtaining MMS approval for Carone to drill into and produce the state leases from Platform Hogan. Staff also included a demand that Carone submit quitclaims for both Lease PRC 4000.1 and PRC 7911.1 if it failed to complete all three requests.

Carone did not comply with any of the actions set forth in the September 30 letter from staff. Instead, Carone provided its response in a letter to staff dated January 20, 2009. (This letter from Carone is attached as Exhibit D.) The basic premise of Carone's response was that it did not have the financial resources to pursue this project at this time and could make no financial commitments to the project until the monthly average NYMEX crude oil price is at least \$60 per barrel

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for at least three consecutive months. In other words, Carone has put the project on an indefinite hold. Carone also said that by the end of the first quarter of 2009, it anticipated final results on the requalification of Platform Hogan would be available, and it would submit to the staff a revised development plan and complete and submit a RUE application to the MMS. Staff is not aware of any progress having been made on completing any of these matters, none of which, even if completed, demonstrates a financial commitment by Carone to use reasonable diligence to pursue the development project intended to return these leases to production.

Staff responded to Carone in a letter dated February 5, 2009. (A copy of this letter is attached as Exhibit E.) In that letter, staff reiterated the statement in its letter of September 30, 2008, including that it would bring to the Commission a recommendation of finding Carone in default if it failed to comply with the required actions set forth in that letter or failed to file quitclaims for the two leases. Noting the severity of the current economic conditions and particularly the tightening of the credit market, staff, nonetheless, stated that these conditions do not mitigate twelve years of delay since Carone acquired the leases. If Carone's stated intent is to delay pursuit of project development until oil prices stabilize at or above \$60 per barrel, then the State has no assurance that Carone ever will be capable of carrying out its long-term obligations under the lease.

Staff, therefore, is recommending that the Commission find Carone in default of both Leases PRC 4000.1 and PRC 7911.1. Under the default provision of the leases (Lease Paragraph 6) the lease may be forfeited upon the failure of the lessee after 90 days written notice and demand to comply with any of the lease provisions. Paragraph 1 of both leases requires the lessee to "pursue diligently" drilling and other well operations that would restore production so that the lease would not terminate due to the absence of commercial production. Staff has worked with Carone for over twelve years to restore production on these leases. When the Commission approved the assignment of the leases to Carone in 1996, it conditioned its approval on Carone providing a development plan in two years and to begin drilling in three years, a condition to which Carone agreed. Twelve years have passed, and Carone has not met these conditions. During these twelve years, oil prices have been high and credit has been available, giving Carone ample opportunity to pursue and complete the required lease development. Waiting until oil prices stabilize at or above \$60 per barrel means waiting for an indefinite time to do what Carone could and should have done during the past twelve years. The assignment was approved to protect state resources from drainage and secure additional production from the lands. Since the approval of the assignment, there is still no production of the leased lands and Carone's operations on adjacent federal lands may still be draining state resources.

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The staff's recommendation of default is based specifically on Carone's failure to comply fully with the three actions demanded in the staff's September 30, 2008 letter to Carone, that were to demonstrate Carone's reasonable diligence in restoring production of oil and gas from these leased lands, as required in paragraph 1 of the leases. Pursuant to the lease terms, Carone has 90 days from a notice of default to cure the matters upon which the default is based. If the Commission were to find Carone in default, Carone would have 90 days to comply fully with all three requests or to file quitclaims for both leases. If these leases are quitclaimed, the leased lands will be placed in the coastal sanctuary as required by the California Coastal Sanctuary Act of 1994.

STATUTORY AND OTHER REFERENCES:

Public Resources Code Sections 6827 and 6829 and Lease Paragraphs 1 and 6

OTHER PERTINENT INFORMATION:

1. Pursuant to the Commission's delegation of authority and the State CEQA Guidelines [Title 14, California Code of Regulations, section 15060(c)(3)], the staff has determined that this activity is not subject to the provisions of the CEQA because it is not a "project" as defined by the CEQA and the State CEQA Guidelines.

Authority: Public Resources Code section 21065 and Title 14, California Code of Regulations, sections 15060 (c)(3) and 15378

2. This activity involves lands identified as possessing significant environmental values pursuant to Public Resources Code sections 6370, et seq., but such activity will not affect those significant lands.

Authority: Public Resources Code sections 6370 et seq.

EXHIBITS:

- A1. Land Description – PRC 7911.1
- A2. Land Description – PRC 4000.1
- B. Location Map
- C. Staff's September 2008 Letter
- D. Carone's January 2009 response to Staff's Letter
- E. Staff's February 2009 Letter

PERMIT STREAMLINING ACT DEADLINE:

N/A

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RECOMMENDED ACTION:

IT IS RECOMMENDED THAT THE COMMISSION:

CEQA FINDING:

1. FIND THAT THE ACTIVITY IS NOT SUBJECT TO THE REQUIREMENTS OF THE CEQA PURSUANT TO TITLE 14, CALIFORNIA CODE OF REGULATIONS, SECTION 15060(c)(3) BECAUSE THE ACTIVITY IS NOT A PROJECT AS DEFINED BY PUBLIC RESOURCES CODE SECTION 21065 AND TITLE 14, CALIFORNIA CODE OF REGULATIONS, SECTION 15378.
2. FIND THAT THIS ACTIVITY IS CONSISTENT WITH THE USE CLASSIFICATION DESIGNATED BY THE COMMISSION FOR THE LAND PURSUANT TO PUBLIC RESOURCES CODE SECTIONS 6370, ET SEQ.

AUTHORIZATION:

1. FIND CARONE PETROLEUM CORPORATION, AS LESSEE, IN DEFAULT UNDER THE OBLIGATIONS OF OIL AND GAS LEASE NOS. PRC 4000.1 AND PRC 7911.1, FOR FAILURE TO PURSUE WITH DILIGENCE THE DEVELOPMENT OF THOSE LEASES
2. DIRECT STAFF TO ISSUE A DEFAULT NOTICE THAT WILL PROVIDE THAT IF THE DEFAULT IS NOT CURED BY FULLY COMPLYING WITH THE THREE DEMANDS SET FORTH IN THE STAFF LETTER OF SEPTEMBER 30, 2008, WITHIN NINETY (90) DAYS OF THE DEFAULT NOTICE, THE LEASES SHALL BE FORFEITED AND CANCELED.
3. DIRECT STAFF AND THE ATTORNEY GENERAL'S OFFICE TO TAKE ALL OTHER ACTIONS NECESSARY TO CARRY OUT THE FOREGOING, INCLUDING ACTION TO COMPEL THE LESSEE TO QUITCLAIM OIL AND GAS LEASE NOS. PRC 4000.1 AND PRC 7911.1 TO THE STATE.