

**CALENDAR ITEM
C90**

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08/14/12
PRC 8039.2
V. Perez

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**CONSIDER RENEWAL AND AMENDMENT OF A
MINERAL EXTRACTION LEASE
ON STATE-OWNED SCHOOL LAND,
CHOCOLATE MOUNTAINS,
IMPERIAL COUNTY**

APPLICANT:

Western Mesquite Mines, Inc.
Attn: R. Cory Atiyeh
6502 E. Highway 78
Brawley, CA 92227

AREA, TYPE LAND AND LOCATION:

657.87 acres, more or less, of vacant, fee-owned State School Land located in Lots 1-10, inclusive, of Section 5 and Lots 1-10, inclusive, of Section 6, all in Township 13 South, Range 19 East, San Bernardino Base and Meridian (SBBM), Imperial County, and situated about six miles northeast of Glamis, CA.

BACKGROUND:

The Mesquite Gold Mine is an open pit cyanide heap leaching operation that has been operating since the mid-1980s.

The Commission issued State Mineral Extraction Lease No. PRC 8039.2 (Lease) to Newmont USA Limited, doing business as Newmont Mining Corporation, on October 1, 2002, for a primary term of 10 years. On April 5, 2004, the Commission approved assignment of the Lease to Western Mesquites Mines, Inc. (WMMI).

On June 6, 2012, during a site inspection by Commission staff, WMMI submitted an application for a renewal of the Lease. Gold placed on the heap leach pad would continue to be recovered during the 10-year renewal period. As monthly sales are made, the lessee would pay the State royalty in proportion to its ownership of the ore in the heap leach pad. After State ore is no longer added to the heap leach pad, the State ownership share will decline over time.

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ROYALTY AMENDMENT:

The lease provides for a sliding scale royalty for gold, silver ores and minerals processed by smelting or refining as a percentage of the Net Smelter Return (NSR). The NSR is the gross value of products that are sold or otherwise disposed of less allowed expenses for transportation and sampling. Such expenses are not to exceed one percent (1%) of the gross value of products sold.

The current sliding scale royalty is four percent (4%) of the NSR when the price of gold is \$350 per ounce or lower, and the percent of NSR equal to the price of gold minus 150 divided by 50 when the price of gold is between \$350 per ounce and \$450 per ounce, and six percent (6%) of NSR when the price of gold is \$450 or higher. This royalty was created in 2002, when gold prices were around \$300 per ounce. At that time, the percentage rate met the statutory minimum in Public Resources Code section 9895. The parties did not envision gold prices reaching nearly \$2,000 per ounce within the primary 10-year term of the lease. Currently, the average gold price is approximately \$1,600 per ounce. Therefore, the new royalty rate will be seven percent (7%) of the NSR.

Public Resources Code section 6895 requires that the Lessee pay a royalty of not less than 10 percent of the gross value of all mineral production from the leased lands, less any charges approved by the Commission that were made or incurred with respect to transporting or processing the state's royalty share of production.

In order to assure compliance with this statutory directive, the lease amendment provides for a revised sliding scale royalty as follows:

- six percent (6%) of NSR when the price of gold is \$1,300 per ounce or lower;
- seven percent (7%) of NSR when the price of gold is between \$1,301 and \$1,800 per ounce,
- eight percent (8%) of NSR when the price of gold is between \$1,801 and \$3,600, and
- nine percent (9%) percent of NSR when the price of gold is \$3,601 or higher.

WMMI uses the average price per month based on the London PM (source=www.kitco.com).

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STATUTORY AND OTHER REFERENCES:

- A. Public Resources Codes sections 6895 and 6898.
- B. Public Resources Code section 21084.
- C. California Code of Regulations, Title 14, Chapter 3, section 15096.
- D. California Code of Regulations, Title 2, section 2200, et seq.

OTHER PERTINENT INFORMATION:

- 1. The Mineral Resources Management Division (MRMD) received an application from WMMI on June 6, 2012 requesting a renewal of the existing Mineral Extraction Lease.
- 2. The Mineral Extraction Lease provides for a 10 year term with two (2) successive rights of renewal for periods of 10 years, not to exceed a maximum lease term of 30 years. This renewal is the first renewal allowed under the Lease.
- 3. Pursuant to the California Surface Mining and Reclamation Act (SMARA) of 1975, counties or cities are the lead agency for a Conditional Use Permit/Mining and Reclamation Plan (CUP), which provides how mining is to occur and how and when the land will be returned to a usable form. Under SMARA, annual inspections are required to be performed by the lead agency to determine the progress of mining and reclamation and to ensure that the permittee complies with all terms and conditions of the CUP. For Mineral Extraction Lease No. PRC 8039.2, Imperial County is the SMARA lead agency. The last annual inspection was conducted on April 4, 2011, and was found to be in compliance. WMMI's financial security for SMARA is in the amount of \$14,893,546 to ensure proper reclamation.
- 4. The Commission staff conducted inspections of lease operations on May 12, 2011, and June 6, 2012, and found these operations to be in compliance with the terms of the Lease.
- 5. Paragraphs 3 (Royalty and Rent), 4 (Interest and Penalties), 19 (Taxes), 20 (Bond,) 21 (Indemnification and Insurance), and 26 (Surrender of Premises) of the Lease will survive the expiration or earlier termination of the Lease until such time that all royalties on minerals held for future sale (extracted but not sold) at the time of the expiration or earlier termination of the Lease have been paid and the Lease Premises have been restored in accordance with Paragraph 26 of the Lease.

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6. **1996 Memorandum of Agreement Between the State Lands Commission and the Bureau of Land Management:** On March 4, 1996 the Commission and the Bureau of Land Management entered into a Memorandum of Agreement (Chocolate Mountain MOA) providing for the acquisition by the United States of state school lands within wilderness and national park units (commonly referred to as "Inholdings") within the California Desert Protection Area. In 1996 there were approximately 260,000 acres of Inholdings. Acquisitions were to be done by land exchanges and the Inholdings are to be appraised prior to conveyance to the United States and exchanges are made on the basis of equal value with a ledger maintained to ensure proper asset balance.
7. Under the Chocolate Mountain MOA, if the Commission receives royalties from a mineral lease, the United States is to receive title to Inholdings of corresponding value. Consequently the Commission has established a ledger to track the royalties received and the corresponding lands conveyed to the United States.
8. The Chocolate Mountain MOA also provides that the United States is to receive an overriding royalty of 25% of the net royalty income received from lands conveyed to the State pursuant to the Chocolate Mountain MOA and leased by the Commission for mineral production. However, this royalty is not paid until all of the approximate 260,000 acres of Inholdings within the California Desert Protection Area have been acquired by the United States.
9. In the current instance, pursuant to the Chocolate Mountain MOA, the United States patented on June 12, 1997, 658 acres of fee land in the Chocolate Mountains (the Leased Lands) to the State and the State conveyed to the United States lands equal in value to the surface estate of the Leased Lands. As discussed above the Commission has entered into the subject lease for mineral production and royalties paid to the Commission are entered into the ledger where the United States is credited with the royalties. It is not anticipated that the Commission will ever pay a 25% overriding mineral royalty to the United States because the Mesquite Mine lease is the only mineral lease subject to the overriding royalty and there are insufficient quantities of commercially valuable minerals in it to generate royalties in excess of the value of the Inholdings.
10. **Royalty Amendment:** The staff recommends that the Commission find

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that the subject royalty amendment does not have a potential for resulting in either a direct or a reasonably foreseeable indirect physical change in the environment, and is, therefore, not a project in accordance with the California Environmental Quality Act (CEQA).

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

11. **Lease Renewal:** Pursuant to the Commission's delegation of authority and the State CEQA Guidelines (Cal. Code Regs., tit. 14, § 15061), the staff has determined that this activity is exempt from the requirements of CEQA as a categorically exempt project. The project is exempt under Class 1, Existing Facilities; California Code of Regulations, Title 2, section 2905, subdivision (a)(2).

Authority: Public Resources Code section 21084 and California Code of Regulations, Title 14, section 15300 and California Code of Regulations, Title 2, section 2905.

12. This activity involves lands which have NOT been identified as possessing significant environmental values pursuant to Public Resources Code section 6370 et seq.; however, the Commission has declared that all lands are "significant" by nature of their public ownership (as opposed to "environmentally significant"). Since such declaration of significance is not based upon the requirements and criteria of Public Resources Code section 6370 et seq., use classifications for such lands have not been designated. Therefore, the finding of the project's consistency with the use classification as required by California Code of Regulations, Title 2, section 2954 is not applicable.

EXHIBITS:

- A. Land Description
- B. Site Map
- C. Lease Renewal and Amendment

RECOMMENDED ACTION:

It is recommended that the Commission:

CEQA FINDINGS:

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Royalty Amendment: Find that the subject royalty amendment is not subject to the requirements of CEQA pursuant to California Code of Regulations, Title 14, section 15060, subdivision (c)(3), because the subject activity is not a project as defined by Public Resources Code section 21065 and California Code of Regulations, Title 14, section 15378.

Lease Renewal: Find that the activity is exempt from the requirements of CEQA pursuant to California Code of Regulations, Title 14, section 15061 as a categorically exempt project, Class 1, Existing Facilities; California Code of Regulations, Title 2, section 2095, subdivision (a)(2).

AUTHORIZATION:

1. Consent to the renewal and amendment of the existing State Mineral Extraction Lease No. PRC 8039.2 to mine for production of precious metals, sand and gravel, and clay commencing October 1, 2012, and ending September 30, 2022, pursuant to the terms substantially in the form of Exhibit C, attached hereto. All other terms and conditions of the lease originally issued on October 1, 2002, shall remain in full force and effect.
2. Authorize the Executive Officer or his designee to execute any documents necessary and appropriate to implement this renewal and amendment.

EXHIBIT A

PRC 8039.2

LAND DESCRIPTION

Two parcels of State School Lands located in the County of Imperial, State of California, and described as follows:

Said parcels being Lots 1 through 10, inclusive, of Section 5 and Lots 1 through 10, inclusive, of Section 6 T13S, R19E, SBM., according to the Patent Number 04-97-0077, dated June 12, 1997 and recorded July 31, 1997 in Book 1899, at Page 987 in Official Records of said County.

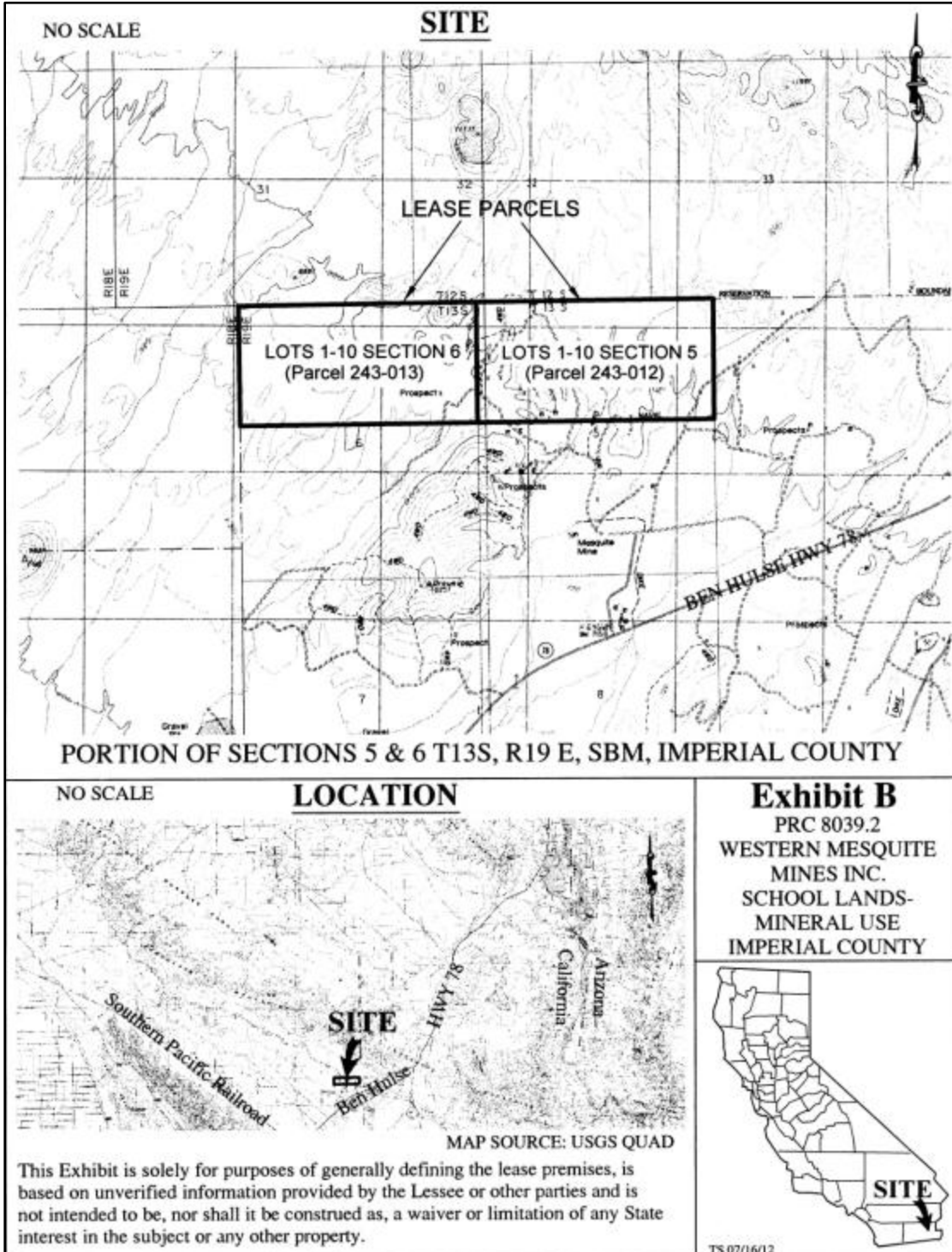
END OF DESCRIPTION

Prepared 07/16/2012 by the California State Lands Commission Boundary Unit.



EXHIBIT B

PRC 8039.2



**STATE MINERAL EXTRACTION LEASE PRC 8039.2
LEASE RENEWAL AND AMENDMENT**

This Lease Renewal and Amendment is entered into by the State of California, acting through the California State Lands Commission, as Lessor ("Lessor"), and Western Mesquite Mines, Inc., as Lessee ("Lessee").

Effective on October 1, 2002, the California State Lands Commission (Commission) authorized issuance of State Mineral Extraction Lease PRC 8039.2 ("Lease") to Newmont Mining Corporation (Newmont), containing 657.87 acres, more or less, of vacant State-owned school lands, identified as Lots 1-10 of Section 5 and Lots 1-10 of Section 6, all in Township 13 South, Range 19 East, San Bernardino Base and Meridian, Imperial County. On April 5, 2004, the Commission approved the assignment of Newmont's 100 percent interest in Mineral Extraction Lease No. PRC 8039.2 to Western Mesquite Mines, Inc. (WMMI).

The Lease was issued for an initial term of ten (10) years commencing October 1, 2002. Under the provisions of the Lease, the Lessee may renew the Lease for two (2) successive periods of ten (10) years each upon such reasonable terms and conditions as the State may prescribe. The initial term of the Lease will expire on September 30, 2012. The Lessee has elected to exercise its first right of renewal for a period of 10 years commencing on October 1, 2012. Lessor and Lessee have negotiated modifications of some of the terms and conditions of the Lease which are set forth below.

Therefore, Lessor and Lessee agree as follows:

1. Renewal of Lease: Section 1, Paragraph 1 of the Lease is amended to read as follows:

This Lease is renewed and extended for a period of ten (10) years, beginning October 1, 2012 and ending September 30, 2022, upon the same terms and conditions set forth in the original lease except as modified by this Lease Renewal and Amendment. Lessee shall have a preferential right to renew this Lease for one additional successive period of 10 years upon such reasonable terms and conditions as may be prescribed by Lessor, including, but not limited to, modification of the royalty or any other provision in a manner which, in the opinion of Lessor, will adequately protect the interests of Lessor. Lessee shall give Lessor at least two years notice of its

intent to exercise this right of renewal, and the right of renewal shall lapse and become void without such timely notice.

2. Section 3, Royalty and Rent, Subparagraph (2), Sliding Scale Royalty is amended to read as follows and shall be effective on October 1, 2012:

- (2) Sliding Scale Royalty

A sliding scale rate of royalty as follows:

6.0 percent of NSR when the price of gold is \$1300 per ounce or lower; 7.0 percent of NSR when the price of gold is between \$1301-\$1800 per ounce, 8.0 percent of NSR when the price of gold is between \$1801-\$3600 per ounce, and 9.0 percent of NSR when the price of gold is \$3601 per ounce or higher.

There is no inflation adjustment of the above gold prices. The NSR calculation for all products (gold and silver) will be based upon the price of such metals on the London P.M. fixed market.

3. Section 13. NOTICES, subparagraph is amended to read as follows:

All notices to be given under the Lease shall be in writing and shall be effective upon receipt when deposited with the United States Postal Service as registered or certified mail, postage prepaid, return receipt requested, or with a private overnight delivery company against receipt or in person, and addressed as follows:

To the Lessor: California State Lands Commission
200 Oceangate, 12th Floor
Long Beach, CA 90802

To the Lessee: Western Mesquite Mines, Inc.
6502 E. Highway 78
Brawley, CA 92227

4. Paragraphs 3 (Royalty and Rent), 4 (Interest and Penalties), 19 (Taxes), 20 (Bond,) 21 (Indemnification and Insurance), and 26 (Surrender of Premises) of the Lease shall survive the expiration or earlier termination of the Lease until such time that all royalties on minerals held for future sale (extracted but not sold) at the time of the expiration or earlier termination of the Lease have been paid and the Lease Premises have been restored in accordance with Paragraph 26.

5. All other terms and conditions of the Lease remain unchanged and in full force and effect.

LESSOR: CALIFORNIA STATE LANDS COMMISSION:


Dated: _____

By: _____

Marina Voskanian, Acting Chief
Mineral Resources Management Division

LESSEE: WESTERN MESQUITE MINES, INC.

Dated: August 1, 2012

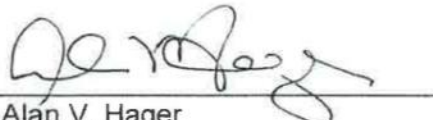
By: 

Title: President

CORPORATE SEAL

Approved as to form:
Kamala D. Harris
Attorney General of the State of California

Dated: July 23, 2012

By: 

Alan V. Hager
Deputy Attorney General

NOTARIAL CERTIFICATION

On this 1st day of August 2012, before me personally appeared Mr. Robert Gallagher, President of Western Mesquite Mines, Inc., whose identity was proved to me on the basis of satisfactory evidence to be the person whose name is subscribed to this document, and who signed the attached document.



Notary Public

Susan C. Toews
Barrister and Solicitor
1800-555 Burrard St
Vancouver, BC V7X 1M9