MEMORANDUM

TO: Honorable Warren Price III, Attorney General

ATTN: Mr. Johnson Wong, Supervisor
       Land/Transportation Division

FROM: William W. Paty, Chairperson
       Department of Land and Natural Resources

SUBJECT: Amendment of the Board of Land and Natural Resources’ Decision
         and Order Dated April 11, 1986, Reference CDUA HA-12/20/85-1830

BACKGROUND

Relative to the contested case (c/c) hearing on the Campbell Estate application to
explore and develop geothermal energy within the Kilauea Middle East Rift GRS, the Board
of Land and Natural Resources issued a Decision and Order (D/O) on April 11, 1986,
authorizing geothermal development activities within the Conservation District, identified as
TMK 1-2-10:-3, located on the island of Hawaii.

However, recent legislation (Act 378, SLH 1987) has amended Chapter 205, HRS, by
eliminating the c/c hearing provision associated with the issuance of a Conservation District
Use Permit (CDUP) within designated Geothermal Resource Subzones (GRS) and replaced it
with a mediation process.

CURRENT SITUATION

With regard to the above, the Department seeks to clarify what procedures should be
followed if a request is made to amend a specific condition of the Board’s D/O. Should a
request be received by the Department, we propose the following steps:
Honorable Warren Price, III
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(1) Receipt of a request to amend any condition of the D/O will be acknowledged by the Department and reviewed for completeness. If the application is found to be complete, Applicant will be so notified.

(2) The Department will submit a recommendation to the Board concerning the request for amendment.

(3) The submittal will be acted upon at a Board meeting. Parties to the original c/c hearing will be notified in writing of the pending request for amendment and of the date, time, and location of the Board meeting.

(4) Applicant will be asked to be present and be available to respond to questions raised by the Board. Interested parties will be afforded the opportunity to present testimony for or against the amendment.

(5) Upon consideration of all testimony received, the Board will render a decision on the request for amendment (or move for deferral).

Pursuant to a recent Attorney General's (AG) opinion (ref. Simpson vs. DLNR, Civil No. 88-0540(3)), the Department has been advised that all affected parties must be notified of their rights and responsibilities concerning contested case hearings under Section 13-1-26, HAR. The AG memorandum notes that notice concerning each party's right to a contested case hearing should also be made at any scheduled Board meeting and in the written notices sent to each party.

If a Board meeting is scheduled to hear a request for an amendment to the D/O, it is likely that a request for a contested case hearing will be made by one or more parties in attendance.

Therefore, clarification is needed as to whether a request for a c/c hearing, resulting from a proposed amendment to the CDUP (CDUA HA-12/20/85-1830) issued prior to the change in the statute (Section 205-5.1, HRS), is allowable. Or does the current provision of the law, whereby c/c hearings are eliminated and replaced by mediation, prevail?

Essentially, we are asking whether any action by the Board to amend a previously issued CDUP should be subject to current statutes or to those in place at the time the permit was issued.
CONCLUSION

If the current statutes prevail, it then appears that parties must be advised of their rights and responsibilities concerning mediation as set forth in Section 205-5.1, HRS, rather than those pertaining to c/c hearings, and that any decision by the Board can be appealed directly to the Supreme Court for a final decision.

However, if it is determined that a c/c hearing is appropriate and proper notice is given, should a request for a c/c hearing be considered as a re-opening of the original contested case hearing and administered on that basis?

The Department respectfully requests an opinion on the concerns outlined above. Should you have any questions, please contact Manabu Tagomori, Deputy Director, at Ext. 87533.
MEMORANDUM

To: Manabu Tagomori, Division Head DOWALD
From: Edwin P. Watson, Deputy Attorney General
Subject: Draft of Geothermal Resources Lease No. R-5

Attached is the revised draft of Geothermal Resources Lease No. R-5 dated April 20, 1987.

This draft reflects discussions with the attorney for the developer and your representation to me that the developer will not be insisting upon any deductions for treating, processing and transportation costs in determining the royalties to be paid to the State, in the event that geothermal resources are not sold to a third party, as reflected in the last paragraph on page 7 of the draft relating to royalties. In addition, we have made other minor changes for the purpose of clarifying some of the wording contained in the lease. Otherwise, the attached draft is similar to the previous leases issued by your department.

If you have any questions, please feel free to call me at ext. 8930.

Edwin P. Watson
Deputy Attorney General

EPW:jn
Enclosure
March 2, 1987

MEMORANDUM

To: William W. Paty, Chairperson
    Board of Land and Natural Resources

From: Edwin P. Watson, Deputy Attorney General

Subject: Proposed Changes to Geothermal Resources Mining Lease (Campbell Estate)

By memorandum dated November 10, 1986, the Department of Land and Natural Resources requested our review and advice on several changes to the standard geothermal resources mining lease proposed by the Estate of James Campbell (Campbell Estate) in its memorandum dated October 24, 1986 to James J. Detor, former Administrator, Land Management Division.

As a result, a meeting was held with Ben Matsubara, Esq., counsel for Campbell Estate, and Allan Kawada, Esq., counsel for True Geothermal Energy Company, on the proposed changes, at which time we requested that Mr. Matsubara submit his letter dated December 19, 1986 (copy attached) which modified the proposed changes.

Several meetings were held thereafter between our office and Mr. Matsubara and Mr. Kawada, whereupon the parties agreed that no changes will be made to (a) Para. 14, page 26, "Liens"; (b) Para. 18, page 27, "Indemnity"; and (c) Para. 19, page 30, "Revocation". It was agreed, however, that changes will be made to (a) Para. 5A, page 7; Para. 5B, page 9; and Para. 6(b), page 11, "Royalties"; and (b) Para. 28(a), (b) and (c); pages 38 & 39, "Records and Reports"; as proposed by Campbell Estate.
To: William W. Paty, Chairperson  
March 2, 1987  

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The foregoing changes were agreed to only after our office also met with staff of DOWALD and Land Management Division who concurred with the proposed changes.

As a result, the Land Department by Form L-1 dated February 13, 1987 informed our office that since DOWALD and Land Management staff met with our office on January 26, 1987 on the matter and the proposed language changes have been resolved, the Land Department requests that we assist them in preparing Geothermal Resources Mining Lease No. R-5 to the Estate of James Campbell.

Pursuant to your request of February 13, 1987, we return herewith the original and three (3) copies of Geothermal Resources Mining Lease No. R-5. Said lease, however, does not reflect the changes proposed by Allan Kawada in his memorandum dated February 20, 1987 (copy attached) to Dan Lum, DOWALD.

In a telephone conversation with Mr. Kawada, we informed Mr. Kawada that our office will "concur" with the new changes proposed in his letter of February 20, 1987, only if both DOWALD and Land Management Division approves of said proposed changes.

Therefore, should the Land Department wish to make additional revisions to Geothermal Resources Mining Lease No. R-5, kindly submit a request for revision of said documents.

Should you have any questions, please call me at ext. 8930.

Edwin P. Watson  
Deputy Attorney General

BPW:jn  
Enclosure
TO: DAN LUM
FROM: ALLAN G. KAWADA
DATE: FEBRUARY 20, 1987
SUBJECT: CHECKLIST OF REQUESTS FOR CLARIFICATION OF SECTIONS WITHIN THE STATE GEOTHERMAL MINING LEASE

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1. Page 7, Paragraph 5(a), Royalties
   Clarification of method to be used to determine the gross value of the geothermal resources "measured at the wellhead". Since there is no experience in Hawaii to determine the commercial value of steam at the wellhead, how will this value be determined?

2. Page 9, Paragraph 5(d),
   Clarification of what circumstances will this section come into effect.

3. Page 11, Paragraph 5(f)(1), Interest
   Request that statement "or such higher rates as may be permitted by law" be deleted to conform to Paragraph 4(c) on Page 7.
4. Page 16, Paragraph 12, Inspection of Premises and Records

Substantiation requested whether the confidentiality provision in Paragraph 28(b) applies to protect the disclosure required under Paragraph 12.

5. Page 16, Paragraph 13(a), Geothermal Operations (Removal of Derrick).

Request clarification of the meaning of "removal" and "ceased making use" as used in this section. Does "removal" require the transportation of the drilling rig and equipment off the property if further use is anticipated within a reasonable time (i.e. 6 to 12 months)?
December 19, 1986

Edwin P. Watson
Deputy Attorney General
State Capitol, 4th Floor
415 S. Beretania Street
Honolulu, Hawaii 96813

Re: Suggested language changes to proposed geothermal mining lease between the Estate of James Campbell and the State of Hawaii

Dear Mr. Watson:

I have included a modified Ramseyer format of the changes I would like to see incorporated in the above referenced lease. The request for changes is primarily based on the fact that the existing regulatory provisions regarding mining of geothermal resources permit the requested changes and that such changes would be in conformance with the spirit and intent of said regulations.


5. ROYALTIES

A. For Period of Initial Thirty-five Years

For the primary ten (10) year term and during the first twenty-five (25) years thereafter Lessee shall pay to Lessor the following royalties on production measured and computed in accordance with the regulations:

1. Geothermal Resources (Excluding Geothermal By-products)
   A royalty of ten (10%) percent of the gross proceeds received by the Lessee from the sale or use of geothermal resources produced from the leased lands and measured at the wellhead without any deduction for treating, processing and transportation costs (7). (Notwithstanding Rule 3.13 of Regulation 67)
2. Geothermal By-Products

Five (5%) percent of the gross proceeds received by the Lessee from the sale of any such by-product produced under this Lease, including demineralized or desalted water, after deducting the treating, processing and transportation costs incurred.

In the event that geothermal resources hereunder (i.e.) are not sold to a third party but (i.e.) are used or furnished to a plant owned or controlled by the Lessee, the gross proceeds of such production for the purposes of computing royalties hereunder shall be that which is reasonably equal to the gross proceeds being paid to other geothermal producers for geothermal resources of like quality and quantity under similar conditions (without after deducting any treating, processing and transportation costs incurred (7). (notwithstanding Rule 3.13b. of Regulation 6.)

No payment of royalty will be required on water if it is used in plant operation for cooling or generation of electric energy or is reinjected into the sub-surface. No royalty shall be paid for geothermal by-products used or consumed by Lessee in his production operations.

Gross proceeds shall not be deemed to include excise, production, severance or sales taxes or other taxes imposed on the Lessee by reason of the production, severance or sale of geothermal resources or geothermal by-products.

The basis for requesting this change is that we believe that the existing regulations of the BLNR should govern the method and computation of royalties and should not be abrogated by the lease. We are familiar with the regulatory provision (presently 13-183-31 and rka as 3.13b) governing royalties and are willing to be bound by that present standard as specifically enunciated. It removes any doubt as to the applicable standard which will be applied and provides us a basis upon which we can make our commitment to be bound.
2. Changes to Paragraph 5 B. page 8.

5. ROYALTIES

B. Readjustment After Thirty-five Years

Royalty rates on geothermal resources and geothermal by-products shall be readjusted, subject to the limitations specified in Sec. 13-183-31 of the regulations and in accordance with the procedures prescribed therein at the expiration of the thirty-fifth (35th) and fiftieth (50th) years of the Lease; provided, however, that such readjustment shall be only as to the royalty rate and not as to the basis for determining payment to the Lessor (−) and shall not, in any event, exceed a total interest of 20 (20%) percent.

If the royalty rates for any ensuing period have not been determined prior to the expiration of the preceding period, the Lessee shall continue to pay the royalty rates effective for the previous period, but the Lessee shall, within thirty (30) days after the new royalty rates have been so determined, pay the deficiency, if any.

Title 13, Chapter 183 of the State Geothermal Leasing and Drilling Regulations governs the provisions of the subject lease. Section 13-183-31(a) specifically provides that royalty payments to the State shall "...not be less than ten percent nor more than twenty percent of the gross amount or value of the geothermal resources produced..." We would like to clarify the lease provision by specifically stating the upper ceiling we will be bound to under the lease at twenty percent to remove any cloud from what it could argued to be.

The governing regulations at the time this lease is executed provides for an upper limit of twenty percent and it should be so incorporated in the lease.
3. Changes to Paragraph 5. F. 2. on page 11.

5. F. 2. Penalty - It is agreed by the parties hereto that any royalties, rentals or other monetary considerations arising under the provisions of this Lease and not paid when due as provided in this Lease, shall be subject to a five (5%) percent penalty on the amount of any such royalties, rentals, percentage or net profits, or other monetary considerations arising under the provisions of the Lease. For good cause shown, however, the Lessee may waive such penalty in whole or in part.

The complexity involved in calculating the amounts due may at times result in inadvertent errors being made in the computation of required payments. The Lessee requests that if good cause can be shown that the Lessor be provided with the discretion of waiving the penalty in whole or in part. The Lessee will still be responsible for the interest due and therefore request consideration of this change.


14. Liens

Lessee will not commit or suffer any act or neglect whereby the estate of the Lessor or the surface owner or occupier of the leased lands shall become subject to any valid attachment, lien, charge or encumbrance whatsoever, and shall indemnify and hold harmless the Lessor, surface owner and occupier, against all such attachments, liens, charges and encumbrances and all expenses resulting from any such act or neglect on the part of the Lessee.

Lessee will, before commencing construction of any improvements or any drilling operations or laying any pipe lines or doing any other work on or within the leased lands, deposit with Lessor, surface owner and occupier of such lands a bond or certificate thereof naming Lessor, said surface owner and occupier as obligees in a penal sum of not less than one hundred per cent (100%) of the cost of such construction, drilling or pipe line work and in form and with surety satisfactory to Lessor, the surface owner and occupier guaranteeing the completion of such work free and clear of all mechanics' and materialmen liens.
Edwin P. Watson  
Page Five  
December 19, 1986

Our concern in this instance is to insure that our right to contest any attachment, lien, charge or encumbrance imposed by a third party does not jeopardize our Lease during the pending or the action where we contest or oppose such a charge.

5. Change to Paragraph 16 page 27.

16. Indemnity

The Lessee agrees to hold harmless and indemnify the State of Hawaii and its divisions, departments, agencies, officers, agents and employees, together with the owner or lessee of the surface of the leased lands, if any, from any and all liabilities and claims arising from its own negligent or willful acts for damages and/or suits for or by reason of death or injury to any person or damage to property or any kind whatsoever, whether the person or property of Lessee, his agents, employees, contractors, or invitees, or third persons, from any cause or causes whatsoever caused by any occupancy, use, operation or any other activity on the leased lands or its approaches, carried on by the Lessee, his agents, employees, contractors, or invitees, in connection therewith; and the Lessee agrees to indemnify and save harmless the State of Hawaii, the Board, the Chairman, the Department, owner or lessee of the surface if there be one, and their officers, agents, and employees from all liabilities, charges, expenses (including counsel fees) and costs on account of or by reason of any such death or injury, damage, liabilities, claims, suits or losses.

The foregoing indemnity specified in this Lease and in the regulations is not intended to nor shall it be construed to require the Lessee to defend the Lessor's title to geothermal resources and in case of litigation involving the titles of the Lessee and the Lessor, Lessee and the Lessor will join in defending their respective interests, each bearing the cost of its own defense.

The purpose of this change is to limit Lessee's liability to only those things within its control under the Lease. The Lessee has no reservations to fulfill its responsibility under the Lease but would in turn request that its liability be limited to only those items over which it has control.
6. Changes to Paragraph 28(a)(b)&(c) on pgs 38-40.

28. Record And Reports

(a) Accounting Data. No later than the (twenty-fifth) thirtieth (30th) day of every month following the effective date of this Lease, Lessee shall submit a detailed accounting statement reflecting all information necessary in determining royalty payments [for lease operations specifying all (charges paid and) credits received under this Lease,] including (but not limited to) information showing the amount of gross revenue derived from all geothermal resources produced, shipped, used or sold and the amount of royalty due. The Lessee shall, at the option of the Lessor, provide more detailed statements and explanatory materials to aid the Lessor in interpreting and evaluating the information provided by Lessee [Lessee's accounting statement]. All such statements are subject to audit (and revision) by the Lessor and Lessee agrees that the Lessor may inspect all Lessee's books, records and accounts relating to matters necessary in determining royalty payments [operations under this Lease,] as provided above, including (but not limited to) the development, production, sale, use or shipment of geothermal resources at all reasonable times. (Any statutory or other rights that Lessee may have to object to such inspection by the Lessor are hereby waived.)

(b) Exploration Data. (Lessee agrees to supply to the Lessor within thirty (30) days of the completion thereof, or the completion of any recorded portion thereof, all physical and factual exploration results, logs, surveys and any other data in any form resulting from operations under this Lease or from any surveys, tests, or experiments conducted on the lease lands by Lessee or any person or entity acting with the consent of Lessee or with information or data provided by Lessee. Lessee agrees to supply to the Lessor within thirty (30) days of the completion thereof, or the completion of any recorded portion thereof, the results of all geological, geophysical or chemical tests, experiments, reports and studies, including but not limited to reservoir studies and tests, experiments, reports or-
Lessee shall furnish to Lessor for its confidential use copies of all physical and factual exploration results, logs and surveys which may be conducted, well test data, and other data resulting from operations under the Lease. Such information shall be kept confidential as a trade secret for a period of one year from date of receipt, or longer at the discretion of Lessor.

(C) Waiver by Lessee—Lessee hereby waives any and all rights and objections it may have to prevent an examination of the books and records at reasonable times of any individual, association, or corporation which has transported for, or received from Lessee, any geothermal resources produced from the leased lands. Further, Lessee waives any and all rights and objections it may have to prevent an examination and inspection of the books and records at reasonable times of any such individual, association or corporation with respect to such individual, association's, or corporation's, or to Lessee's operations, wells, improvements, machinery and fixtures used on or in connection with the leased lands.
Changes to 28(a):

Sec. 13-183-62(a) Records And Reports provides that:

"(a) Lessee shall at all times maintain full and accurate records of production and payments relating to lessee's operations and activities upon and in connection with the leased lands. All books and records of lessee pertaining to or necessary in determining royalty payments shall be open to inspection at all reasonable times by the authorized representatives of the department."

Lessees requested change to the lease provisions is for purposes of insuring that the scope of records and reports required are specifically enumerated for purposes of clearly setting forth that the records and reports required are those "necessary in determining royalty payments." Lessee strongly feels that only those records reflecting the basis of payments to the State should be open for inspection.

The deletion of the phrase "but not limited to" is for purposes of obtaining consistency with Section 13-183-62 or your regulations which limits the accounting information required to that "pertaining to or necessary in determining royalty payments."
Deletion of the phrase "are subject to ... revision" by the State is requested because such revisions could cause confusion to the integrated accounting arrangements between the operator - lessee and its non-operator partners and the shareholders of the non-operator. The State has the right to audit the accounting reports and statements of the Lessee to assure the integrity of the basis for determining royalty payments and the provision allowing it to revise the reports seems unnecessary.

Another deletion that the Lessee proposes concerns the phrase, "...any statutory or other rights that lessee may have to object to such inspection by the lessor are hereby waived...", appearing at the end of Paragraph 28(a) of the mining lease. The waiver concerns the right of the Lessee to object to any inspection by the State of its accounting reports, irrespective of the merit or relevance or the inspection.

The waiver is unnecessary because the State already has the right to inspect and demand production of the accounting reports of the Lessee to determine the accuracy and completeness of its accounting data. The Courts have generally determined that in order to be a valid waiver of any right, the person or entity waiving the right should know to a reasonable degree of certainty what the nature of the right involved is. It would appear against all common notions of fair play to require a person to waive any, and least of all, "all" statutory or other rights of whatever nature they may be. The wording in this instance appears to be much too expansive than is necessary to protect the State in this situation.

Our proposed language is offered as an alternative which will still protect the States interest in this regard.

* Changes to 28(b):

The Lessee desires to modify Paragraph 28(b), Exploration Data, found on Page 38 of the mining lease, on the basis that such paragraph is inconsistent with the leasing and drilling regulations, unnecessary for accomplishing the purpose of the lease, excessively broad and inconsistent with industry practice and federal regulations.
Section 62(b) of the leasing and drilling regulations, entitled Records and Reports, reads as follows: Section 13-183-62 Records and Reports.

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b. The lessee shall furnish to the Board for its confidential use, copies of all physical and factual exploration results, logs and surveys which may be conducted, well test data, and other data resulting from operations under the lease. Such information shall be kept confidential as a trade secret for a period of one year from date of receipt, or longer at the discretion of the Board.

A comparison between the proposed change by the Lessee and Section 62(b), reveals that they are identical in their wording and the proposed change appears as an embodiment of the leasing and drilling regulations itself.

In the instant situation, Section 62(b) or the leasing and drilling regulations reserves the confidentiality of trade secrets of the Lessee from disclosure by the expression, "such information shall be kept confidential as a trade secret for a period of one year from the date of receipt, or longer at the discretion of the Board." The only condition as to this reservation is that the information, including trade secrets, will be kept confidential from third parties only for a period of at least one year. There is no expressed waiver provision in the regulations except for the one year limitation.

However, Paragraph 28(b) of the mining lease, requires the Lessee to waive all of its rights to non-disclosure of its confidential, sensitive and proprietary information, including trade secrets, without any limitation or reservation. Furthermore, the mining lease allows disclosure of the confidential and proprietary information to third parties if it is in the public interest. This provision appears contrary to the provisions in the regulations itself and in excess of that authority since the regulations do not allow such disclosure.
Therefore, the requirement in the mining lease for an absolute waiver of all rights to keep sensitive and proprietary information confidential should be deleted and the mining lease should be made to conform to the terms of the regulations.

Changes to 28(c)

The Lessee requests that the entire deletion in the mining lease or Paragraph 28(c), entitled Waiver by Lessee. The requirement in this paragraph that the Lessee waive all rights and objections to production and non-disclosure of information, statutory or otherwise, is excessively broad and unnecessary for the State to accomplish its purposes under the mining lease.

In the Lessee's proposed Subparagraph (a) and (c) or Paragraph 28, the Lessee has already agreed to supply all the accounting records and exploration and operational data necessary for the State to verify the basis for determining the royalty payments due the State and for its scientific and monitoring responsibilities. In view of these rights granted to the State, the sweeping waiver is unnecessary.

In addition, the waiver requested in Subparagraph (c) is inconsistent with the provisions of the leasing and drilling regulations. The regulations as earlier stated herein, specifically enumerates the conditions under which the State may inspect and require disclosure of accounting information and disclosure and production of exploration and operational data. However, Subparagraph (c) requires the Lessee to consent to inspections and disclosure or information protected by the leasing and drilling regulations (See Section 13-183-62, of the regulations).

A practical negative consequence that would ensue from this waiver provision would be the jeopardy the Lessee would be place in if third parties transport for or receive from the Lessee. The Lessee may waive its rights to non-disclosure or non-production of documents but it cannot waive such rights for third parties who may have control and custody of such information.
Other jurisdiction in geothermal operations do not require waivers of rights to protect accounting data and exploration information not necessary for royalty purposes. The wholesale waiver is thus inconsistent with industry practice and custom.

Moreover, as stated, the rights and protection provided for in the leasing and drilling regulations should take precedence in any inconsistency with the mining lease.

Conclusion:

Our proposed request for changes as earlier indicated is based upon our desire to conform the terms and conditions of the lease to applicable regulatory provisions. Our negotiations at present represent good faith dealings between two parties relating to rights and obligations peculiar to a specific situation and as such we should not be bound by conditions and terms agreed to between other parties in other leases. As negotiating parties, we should have the right and flexibility to fashion a lease within the limits of statutes and regulations which will fairly and equitably benefit both sides.

The proposals contained herein are offered in that vein and welcome your comments. I look forward to meeting with you on December 23, 1986 and ask that you contact me if any questions arise before that.

Very truly yours,

UKISHINA & MATSUBARA

Benjamin M. Matsubara

BMW/kc