MINUTE ITEM

This Calendar Item No. C64 was approved as Minute Item No. 64 by the California State Lands Commission by a vote of 3 to Ø at its 4-17-06 meeting.

CALENDAR ITEM
C64

A 15

S 5

04/17/06
W 40913
PRC 4660.1
J. L. Smith

CONSIDER ACCEPTANCE OF THE FULL QUITCLAIM OF TOWNE EXPLORATION COMPANY'S INTEREST IN COMPENSATORY GAS AGREEMENT NO. PRC 4660.1, TIDE AND SUBMERGED LANDS AND CONSIDER APPLICATION FOR A NEGOTIATED SUBSURFACE (NO SURFACE USE) OIL AND GAS LEASE, MOKELUMNE RIVER, SAN JOAQUIN COUNTY

APPLICANT:

Towne Exploration Company
Attn.: Mr. Clifford L. Conkle, Agent
P. O. Box 520
San Francisco, CA 94104-0520

AREA, LAND TYPE, AND LOCATION:

Compensatory Gas Agreement No. PRC 4660.1 contains 56.9 acres, more or less, of State tide and submerged lands in the vicinity of the Mokelumne River and Beaver Slough, San Joaquin County, California (Exhibit A, attached hereto).

BACKGROUND:

Compensatory Gas Agreement No. PRC 4660.1 (CGA) was issued by the California State Lands Commission (Commission) to Texaco, Inc. (Texaco) and Union Oil Company of California (Union) collectively referred to as "Parties," on April 27, 1972. The Parties leased land which lay upland on either side of the South Fork of the Mokelumne River and Beaver Slough. Union controlled 100 percent (100%) of the leasehold west of the South Fork of the Mokelumne River with its "M & T, Inc." (M & T) lease. Union also controlled the upland east of the South Fork of the Mokelumne lying south of Beaver Slough with its "River Investment" and "Libby, McNeil & Libby" leases (Libby, et al). Texaco controlled the leasehold east of the South Fork of the Mokelumne River lying north of

000343
CALENDAR PAGE

000905
MINUTE PAGE

Beaver Slough with its Edna Gianelli (Gianelli) lease (Exhibit B, attached hereto)

At the time the CGA was issued, three wells had been drilled by Union and Texaco on their upland private leases. Union drilled and operated two of the wells, the "Milton and Towne" A5 and A6 gas wells. The third well, the "Gianelli" #1 gas well, was owned and operated by Texaco. Because these wells were potentially draining gas from adjoining State tide and submerged lands located in the bed of the South Fork of the Mokelumne River and Beaver Slough, the State entered into the CGA for the purpose of payment of compensation for such potential gas drainage. Under terms of the CGA, Texaco and Union agreed to pay compensation in the form of royalty to the State on gas produced from these wells beginning on April 18, 1968. As of September 1994, no gas was produced from any of the three wells that had been shut-in, so the State had not received any royalties under the CGA.

According to records filed with the California Division of Oil, Gas and Geothermal Resources (DOGGR), the "Milton & Towne" A5 and A6 gas wells were completely abandoned by Towne and the locations restored in or around November 2005. The DOGGR has declared the "Gianelli" #1 well an orphaned well and will have the well permanently abandoned this summer. None of these well sites or any portion of these wells is located on State property

On September 9, 2005, Commission staff received a request from Towne to quitclaim all of its interest in Lease No. PRC 4660.1, and for issuance of a negotiated subsurface (no surface use) Oil and Gas Lease in an area of the South Fork of the Mokelumne River south of Beaver Slough, located geographically within the original outer boundary of the CGA. On March 17, 2006, Commission staff received the document "(Full) Quitclaim Deed for State Oil and Gas Lease." This document was dated March 17, 2006, and quitclaims back to the State all of the lessee's right, title and interest in the leased lands described in Exhibit C, attached hereto, of CGA No. PRC 4660.1 dated April 27, 1972.

Public Resources Code section 6804.1 permits the Parties to make, at any time, a written quitclaim of all rights under their private lease or of any portion of their private leased lands. CGA Paragraph 6 states that in the event any Party surrenders or terminates leases covering lands which abut both sides of a portion of State lands, such party shall thereupon surrender to the State all of such Party's interest under the CGA, which are so abutted by said surrendered lands and all of the such Party's rights shall thereupon cease and terminate as to

said surrendered State lands.

Commission staff research has determined that leased lands abutting both sides of the South Fork of the Mokelumne River south of Beaver Slough that were a part of the CGA, have been quitclaimed by Union and its successor Enron. Furthermore, staff has determined these quitclaims satisfy the terms of the CGA with respect to the M & T and Libby et al. leaseholds and the termination of any rights or interest by any Party in and to State lands so abutted on both sides by them.

Towne is the successor of Union's interest in the CGA, no unpaid rents or royalties are due under the terms of the CGA, Towne has complied with all applicable laws and CGA provisions, and Towne has plugged and abandoned all wells affecting State lands under the CGA operated by them; therefore, Commission staff recommends acceptance of their quitclaim. The quitclaim will be effective as of the date filed with the State.

Towne has also submitted a complete application for a negotiated subsurface (no surface use) Oil and Gas Lease on about 13.74 acres in the Sacramento River, Sacramento County (Exhibit D, attached hereto), which encompasses some of the quitclaimed lands. Replacing the CGA with a lease gives the State more control over the operation and its resources. Because the State land is a waterway, surface locations for oil and gas operations (drill sites) are not available. However, oil and gas resources that may underlie the State land can be developed and protected pursuant to a negotiated subsurface (no surface use) Oil and Gas Lease, which would permit Commission-approved directional drilling from a county-approved drill site and would permit inclusion of the leased lands in a Commission-approved pooled area or unit.

Under the terms of the proposed Lease, the Lessee is required to pay an annual rental of $35.00 per net acre ($490.00 for 13.74 acres) and to commence drilling operations on the leased lands within three years.

Public Resources Code section 6815(a) authorizes the Commission to negotiate and enter into oil and gas leases on State lands if any of the following exists: wells drilled on private or public lands are draining or may drain oil and gas from the State lands; the Commission determines the State lands to be unsuitable for competitive bidding because of such factors as their small size or irregular configuration or their inaccessibility from surface drill sites reasonably available or obtainable; the State owns a fractional mineral interest in the lands; or the

Commission determines the lease to be in the best interests of the State.

Because Towne controls, by lease and agreement, all of the private property adjacent to the State land described in Exhibit E, attached hereto, and because Towne intends to drill a well into or adjacent to State land that is bounded by upland leases controlled by Towne, Commission staff has concluded that the criteria of Public Resources Code section 6815(a) have been satisfied. The Commission staff has determined that it will be economically advantageous to the State to issue a negotiated subsurface (no surface use) Oil and Gas Lease with Towne because it will protect oil and gas resources that may underlie the State land.

STATUTORY AND OTHER REFERENCES:

A. Public Resources Code, Division 6, Part 2, and CGA Paragraph 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 the quitclaim 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. Pursuant to the Commission's delegation of authority and the State CEQA Guidelines (Title 14, California Code of Regulations, section 15061), the staff has determined that the leasing is exempt from the requirements of the CEQA as a categorically exempt project. The project is exempt under Class 4, Minor Alterations To Land; Title 14, California Code of Regulations, section 15304.

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

3. This activity affects the subsurface only, but the surface lands have been identified as possessing significant environmental values pursuant to Public Resources Code section 6370, et seq. Based upon the staff's consultation with the persons nominating such lands and through the

CEQA review process, it is the staff's opinion that the project, as proposed, is consistent with its use classification

4. Drilling term of three (3) years; however, if all or part of the leased lands are included in a Commission-approved pooled area or unit, then drilling operations on and production from lands pooled or unitized with the leased lands shall be deemed to be drilling operations on and production from the leased lands that are included in the Commission-approved pooled area or unit.

5. Annual rental of $35 per acre ($490 for approximately 13.74 acres).

6. Royalty of 20 percent on gas and oil.

7. Performance bond or other security in the sum of $10,000.

EXHIBITS:

A. Location Map
B. Associated Leases for PRC 4660.1
C. Quitclaim Land Description PRC 4660.1
D. Site Map
E. Land Description

RECOMMENDED ACTION:

IT IS RECOMMENED 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 THE LEASING IS EXEMPT FROM THE REQUIREMENTS OF THE CEQA PURSUANT TO TITLE 14, CALIFORNIA CODE OF REGULATIONS, SECTION 15061 AS A CATEGORICALLY EXEMPT PROJECT, CLASS 4, MINOR ALTERATIONS TO LAND; TITLE 14, CALIFORNIA CODE OF REGULATIONS, SECTION 15304.

3. FIND THAT THE LEASING IS CONSISTENT WITH THE USE CLASSIFICATION DESIGNATED BY THE COMMISSION FOR THE LAND PURSUANT TO PUBLIC RESOURCES CODE SECTIONS 6370, ET SEQ.

OTHER FINDINGS:

1. FIND CERTAIN STATE LANDS MADE A PART OF COMPENSATORY GAS AGREEMENT NO. PRC 4660.1, AS DESCRIBED IN EXHIBIT E, ATTACHED HERETO, ARE ABUTTED ON BOTH SIDES OF THE MOKELUMNE RIVER BY SURRENDERED UPLAND PRIVATE LEASES.

2. DETERMINE THAT THE CRITERIA OF PUBLIC RESOURCES CODE SECTION 6815(a) HAVE BEEN MET, THAT A NEGOTIATED SUBSURFACE (NO SURFACE USE) OIL AND GAS LEASE IS THE BEST INSTRUMENT TO DEVELOP AND PROTECT OIL AND GAS RESOURCES THAT MAY UNDERLIE THE STATE LAND DESCRIBED IN EXHIBIT B, ATTACHED HERETO, AND THAT THE STATE LAND IS UNSUITABLE FOR COMPETITIVE BIDDING BECAUSE SURFACE DRILL SITES ARE NOT AVAILABLE AND WELLS DRILLED ON THE ADJACENT PRIVATE PROPERTY MAY DRAIN STATE OIL AND GAS RESOURCES.

AUTHORIZATION

1. ACCEPT FROM TOWNE EXPLORATION COMPANY, A CALIFORNIA COMPANY (LESSEE) THE (FULL) QUITCLAIM DEED FOR COMPENSATORY GAS AGREEMENT DATED MARCH 17, 2006, WHEREIN THE LESSEE QUITCLAIMS BACK TO THE STATE ALL RIGHT, TITLE AND INTEREST IN THE STATE LANDS DESCRIBED IN EXHIBIT C, ATTACHED HERETO, OF COMPENSATORY GAS AGREEMENT NO. PRC 4660.1, DATED MARCH 21, 1972.

2. RELEASE TOWNE EXPLORATION COMPANY FROM ALL OBLIGATIONS UNDER COMPENSATORY GAS AGREEMENT NO. PRC 4660.1 ACCRUING AFTER MARCH 17, 2006, THE FILING DATE OF THE QUITCLAIM DEED.

3. PURSUANT TO PUBLIC RESOURCES CODE SECTION 6815(a), ENTER INTO A NEGOTIATED SUBSURFACE (NO SURFACE USE) OIL AND GAS LEASE WITH TOWNE EXPLORATION COMPANY. THE LEASE WILL CONTAIN THE STATE LAND DESCRIBED IN EXHIBIT E, ATTACHED HERETO, (APPROXIMATELY 13.74 ACRES), A DRILLING TERM OF THREE (3) YEARS, ANNUAL RENTAL OF $35 PER ACRE ($490 FOR APPROXIMATELY 13.74 ACRES), ROYALTY ON GAS SUBSTANCES AND OIL FIXED AT 20 PERCENT AND PERFORMANCE BOND OR OTHER SECURITY IN THE SUM OF $10,000.

4. AUTHORIZE THE EXECUTIVE OFFICER OR HIS DESIGNEE TO EXECUTE ANY DOCUMENT NECESSARY TO IMPLEMENT THE COMMISSION'S ACTION.

EXHIBIT A

W 40913
PRC 4660.1

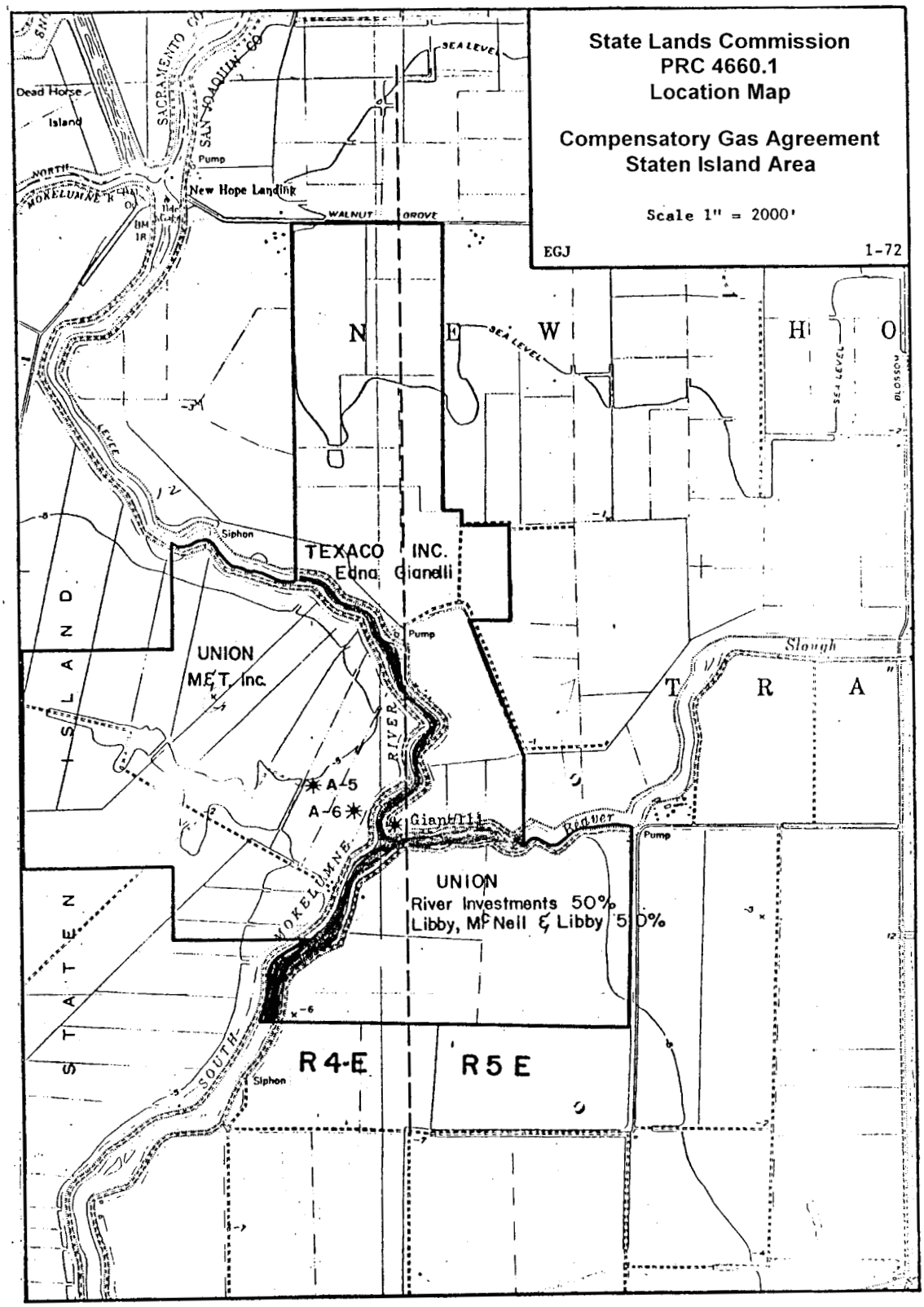


EXHIBIT B

W 40913
PRC 4660.1

Associated Leases for PRC 4660.1

Lessor	Lessee	Instrument No.	Date	Recording Data, San Joaquin County Book	Page
M & T, Inc. (100%) SA-Staten Island-3	Union Oil Co.	No. 45487	11-2-59	2232	115
River Investment Co. (50%) SA-Staten Island-600631	Union Oil Co.	No. 50769	12-18-67	3173	546
Libby, McNeil & Libby (50%) SA-Staten Island-600632	Union Oil Co.	No. 9826	2-29-68	3191	316
Edna Gianelli	Texaco, Inc.		6-13-61	2426	263

W 40913
PRC 4660.1

EXHIBIT C

QUIT CLAIM
LAND DESCRIPTION
PRC 4660.1

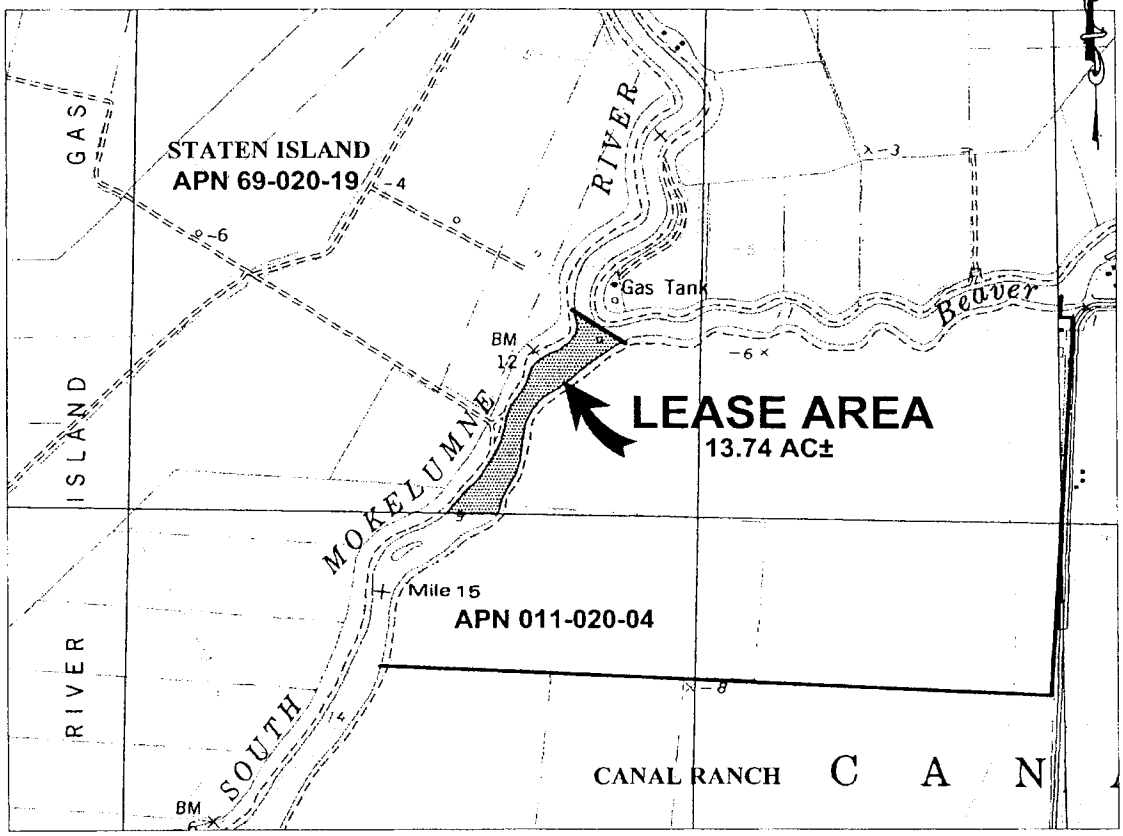
A parcel of tide and submerged land in the bed of South Fork of the Mokelumne River and Beaver Slough San Joaquin County, California, described in that certain Compensatory Gas Agreement Between the State of California and Union Oil Company of California and Texaco Inc. in PRC 4660 dated April 27, 1972 filed in California State Lands Commission records and being adjacent to parcels of lands described in those certain oil and gas leases recorded in Book 2232 OR Page 115, Book 3173 OR Page 546, Book 3191 OR Page 316, Book 2426 OR Page 263, San Joaquin County Recorders Office.

END OF DESCRIPTION

LICENSED LAND SURVEYOR
STEVE C. LEHMAN
Exp. 12/31/07
No. 7377
STATE OF CALIFORNIA

NO SCALE

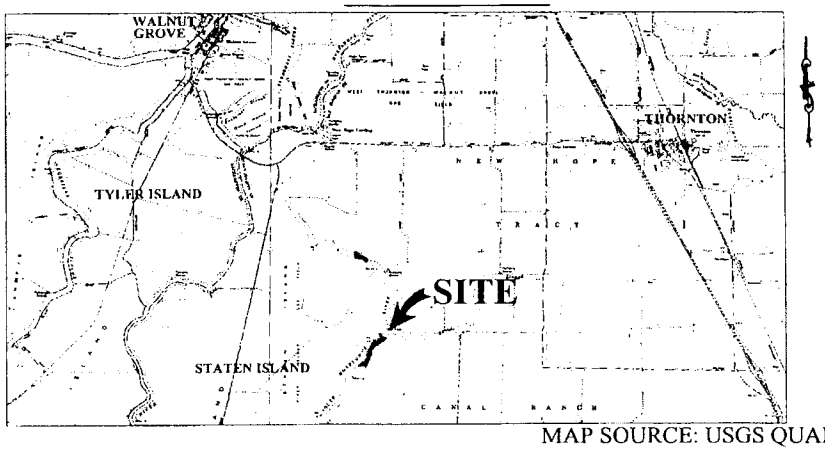
SITE



STATEN ISLAND AND CANAL RANCH
SOUTH FORK OF THE MOKLUMNE RIVER AND BEAVER SLOUGH

NO SCALE

LOCATION



MAP SOURCE: USGS QUAD

This Exhibit is solely for purposes of generally defining the lease premises, is based on unverified information provided by the Lessee or other parties and is not intended to be, nor shall it be construed as, a waiver or limitation of any State interest in the subject or any other property.

Exhibit D

W 40913
OIL AND GAS LEASE
TOWNE EXPLORATION
MOKELUMNE RIVER &
BEAVER SLOUGH
SAN JOAQUIN CO.

SCL 3-13-06

EXHIBIT E

W 40913
PRC 4660.1

LAND DESCRIPTION

A Parcel of tide and submerged land in the bed of the South Fork of the Mokelumne River and Beaver Slough situated in San Joaquin County, California, adjacent to those parcels of land as described in Oil, Gas and Mineral Lease on Staten Island recorded in Book 2232 Page 115 Official Records, San Joaquin County Records and Oil, Gas and Mineral Lease recorded in Book 3173 Page 546 Official Records, San Joaquin County Records, and more particular described as follows:

> Bounded to the northeast by a line beginning at a point on Staten Island having a CCS 27, Zone 2 coordinates of North = 192900 feet, East = 2149900 feet and a ending point having coordinates of North = 192600 feet, East = 2150400 feet; bounded on the southwest by the protracted south section line of Section 13 T. 4 N., R. 4 E. MDM; bounded on the northwest by the ordinary high water mark on the right bank of said Mokelumne River; bounded on the southeast by the ordinary high water mark on the left bank of said Mokelumne River and left bank of said Beaver Slough.

END OF DESCRIPTION

LICENSED LAND SURVEYOR
STEVE C. LEHMAN
Exp. 12/31/07
No. 7377
STATE OF CALIFORNIA