

PULLED

**Minute Item
C87**

**05/10/07
PRC 8674
J. L. Smith**

**TOWN EXPLORATION COMPANY
(APPLICANT)**

**Item C87 was removed from the agenda to be
heard at a subsequent meeting.**

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**CALENDAR ITEM
C87**

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05/10/07
PRC 8674.1
J. L. Smith

**CONSIDER APPROVAL OF THE FIRST AMENDMENT
TO NEGOTIATED SUBSURFACE (NO SURFACE USE)
OIL AND GAS LEASE NO. PRC 8674.1,
SOUTH MOKELUMNE RIVER AND BEAVER SLOUGH,
SAN JOAQUIN COUNTY**

APPLICANT:

Towne Exploration Company
Attn.: Mr. Edward B. Towne
P.O. Box 520
San Francisco, CA 94104-0520

AREA, LAND TYPE, AND LOCATION:

Negotiated subsurface (no surface use) Oil and Gas Lease PRC No. 8674.1 comprises about 13.74 acres in the South Fork of the Mokelumne River and Beaver Slough, San Joaquin County.

PROPOSED LEASE AMENDMENT:

The applicant proposes an amendment to the existing negotiated subsurface (no surface use) Oil and Gas Lease PRC No. 8674.1, that would add a right-of-way provision permitting the Lessee to drill through the Lease lands to a completion target that lies outside the boundaries of the lease (a "pass-through well"). The provision would provide compensation to the State in the form of a royalty for production from such wells. Presently, a well may only be drilled through the lease land for completion on adjacent or nearby lands where the State lease, with the consent of the Commission, has been pooled with the outside lands. The amendment would compensate the State for the use of its land as a conduit for production where the State lands are not pooled.

BACKGROUND:

On April 17, 2006, the California State Lands Commission (Commission) issued a negotiated subsurface (no surface use) Oil and Gas Lease PRC 8674.1 (Lease) to Towne Exploration Company (Towne). Under the present lease terms the Lessee has the right to prospect for, drill for, produce and take oil, gas and

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other hydrocarbon substances from the leased lands. Additionally, a well drilled through State land must be pooled by the operator in order to protect the State from potential drainage of resource and such a pool must be approved by the Commission. The Lessee desires to have the option of compensating the State with an overriding royalty interest in a well drilled into and through State land rather than of a pooled interest share. The Lessee is requesting a non-exclusive right-of-way clause be added to the lease providing for an overriding royalty interest as compensation to the State for a pass-through well.

A "pass-through well" is a well that is drilled through the leased lands and the productive interval location extends beyond the leased lands a distance of at least 1489 feet, which is the accepted drainage radius of a 160 acre circle for a gas well. Closer completions may be approved by the State, provided that the production interval will not subject the State land to uncompensated drainage of oil or gas. As consideration for the right-of-way or "Pass-Through" Agreement, the State would be compensated by the payment of an overriding royalty in the amount of four percent (4%) of all production from the pass-through well(s).

Under the terms of the 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.

OTHER PERTINENT INFORMATION:

1. Applicant has proposed to drill a well from a surface location adjacent to the State lands. The well would be drilled directionally through the leased lands to a completion location lying outside of the State lands. A dispute exists between the applicant and the surface owner of the proposed drillsite location as to the applicant's rights to use the surface owner's land for the drilling of such a well. The pending litigation may affect the timing and location of the proposed well, or perhaps, whether the well is actually drilled.
2. Additionally, PRC 8674 (the subject lease of this calendar item) is also before the Commission at this meeting as a request for a partial assignment from lessee Towne to Capitol Oil in calendar item C85.
3. 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

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State CEQA Guidelines.

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

EXHIBITS:

- A. Lease Site
- B. Amendment

PERMIT STREAMLINING ACT DEADLINE:

N/A (not a "development project" subject to the Act)

RECOMMEND ACTION:

IT IS RECOMMENDED THAT THE COMMISSION:

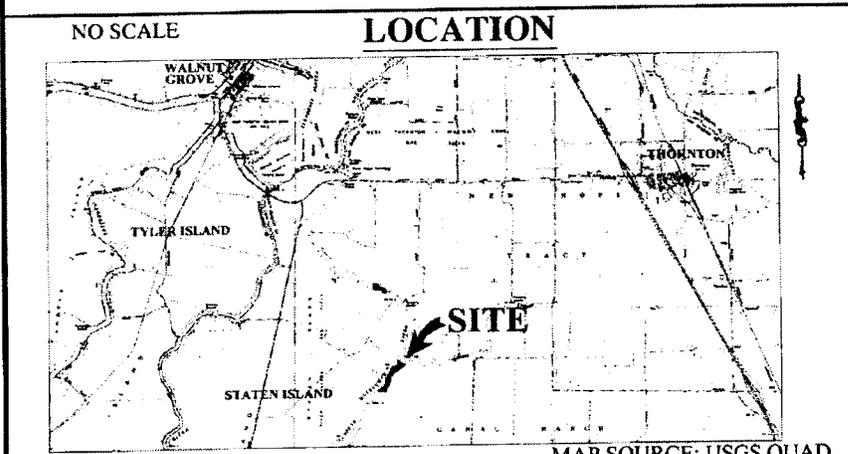
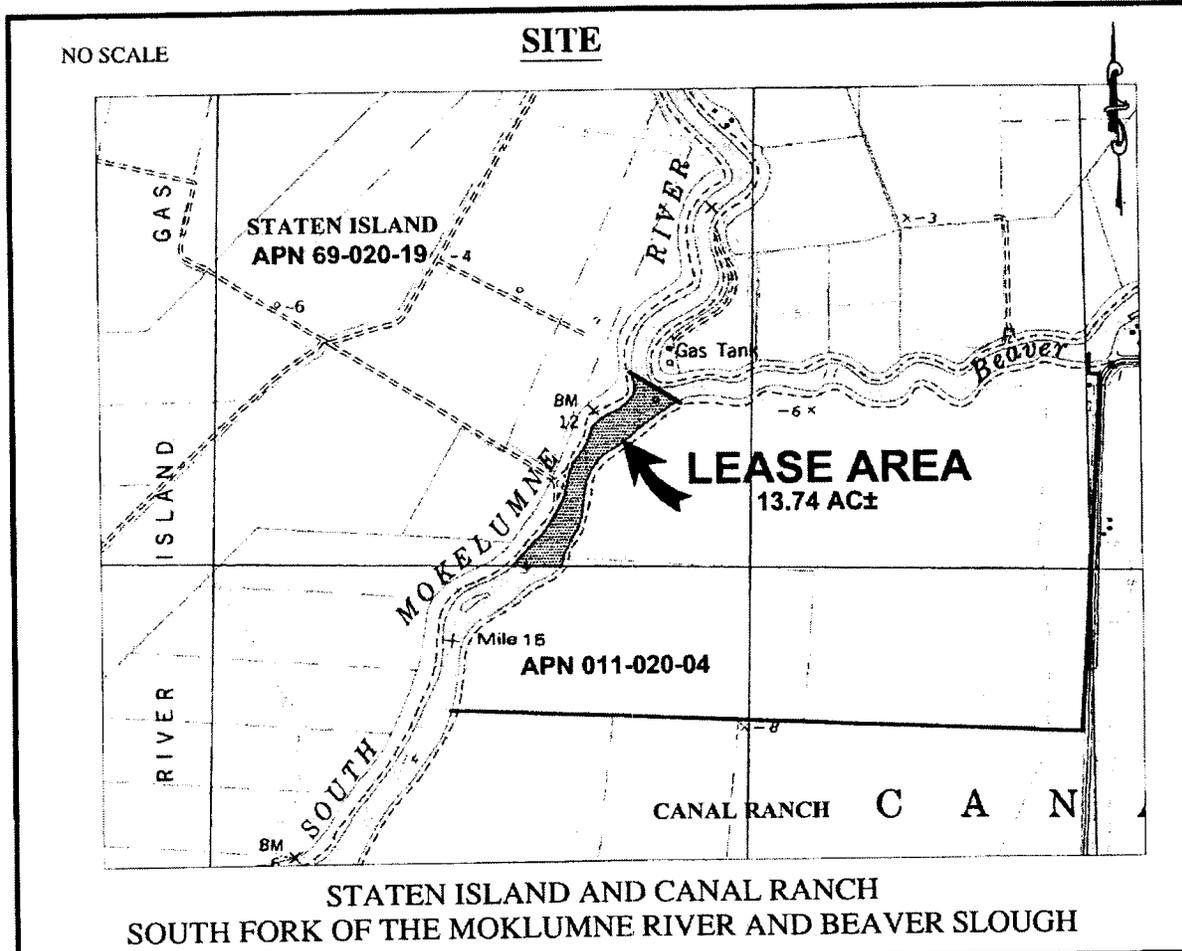
CEQA FINDING:

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 THE PUBLIC RESOURCES CODE SECTION 21065 AND TITLE 14, CALIFORNIA CODE OF REGULATIONS, SECTION 15378.

AUTHORIZATION:

1. AMEND THE LEASE DOCUMENTS TO INCLUDE ADDED PARAGRAPH 35 PROVIDING PASS-THROUGH RIGHTS AND TO PROVIDE FOR A PASS-THROUGH OVERRIDING ROYALTY PURSUANT TO PARAGRAPH 4, AMENDED EXHIBIT B, ATTACHED HERETO.
2. AUTHORIZE THE EXECUTIVE OFFICER OR HIS DESIGNEE TO EXECUTE ANY DOCUMENTS NECESSARY TO IMPLEMENT THE COMMISSION'S ACTION.

Exhibit A



PRC 8674.1
OIL AND GAS LEASE
TOWNE EXPLORATION
MOKELUMNE RIVER &
BEAVER SLOUGH
SAN JOAQUIN CO.



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 B

PRC 8674.1

STATE OF CALIFORNIA
STATE LANDS COMMISSION

AMENDMENT

THIS AMENDMENT is entered into by and among the State of California, acting by and through the State Lands Commission, herein referred to as "State", and Towne Exploration Company (Towne), herein referred to collectively as "Lessee".

Negotiated Subsurface (no surface use) Oil and Gas Lease PRC 8674.1 was entered into on April 17, 2006. The Lease contains 13.74 acres of submerged land in the bed of the South Mokelumne River and Beaver Slough in San Joaquin County.

The State and Lessee hereby agree to amend the lease to include a non-exclusive right of way to a "pass-through" agreement into and through the lease lands. As consideration for the pass-through agreement, the State would be compensated by the payment of an overriding royalty in the amount of four percent (4%) of all production from the pass-through well(s).

Under the terms of the 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.

The above changes are reflected in the Added Paragraph 35 and the Amended Exhibit B (attached hereto) for Lease No PRC 8674.1.

And it is further agreed that all other terms and conditions of said Lease are to remain unchanged and in full force and effect.

This Amendment will become binding on the Lessor only when duly executed on behalf of the State Lands Commission of the State of California.

IN WITNESS WHEREOF, the parties hereto have executed this Amendment as of the date hereafter affixed.

LESSEE:
Towne Exploration Company

LESSOR:
State of California

By: _____
(Signature)

By: _____
(Signature)

(Name of Officer)

Paul B. Mount II, P.E.

(Name of Officer)

(Title)

Chief, Mineral Resources Management

(Title)

Date: _____

Date: _____

ATTEST

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PRC 8674.1 – ADDED PARAGRAPH 35

35. RIGHT OF WAY FOR PASS-THROUGH WELL

In addition to the right to prospect for, drill for, produce and take oil, gas and other hydrocarbon substances from the leased lands as provided above, Lessee is hereby granted a non-exclusive right of way (the "ROW") to drill one or more pass-through well(s) into and through the leased lands, subject to the following terms and conditions:

- (a) A "pass-through well" is defined as a well that is drilled through the leased land at a depth greater than 500 feet below the surface, which produces oil, gas and/or other hydrocarbon substances from one or more producing intervals in the wellbore, no producing interval of which is located within 1489 feet of the leased lands. Notwithstanding the foregoing, with the prior written consent of the State a pass-through well may be completed with a producing interval within 1489 feet of the leased lands, provided it can be determined to the satisfaction of the State that such pass-through well will not subject the leased lands, or any part thereof to uncompensated drainage.
- (b) The ROW shall lapse and be of no force and effect if a pass-through well is not drilled and completed during the term of this lease. Provided the ROW is timely exercised, it shall remain in effect for: (i) so long as the pass-through well produces oil or gas in paying quantities, or Lessee is diligently conducting producing, drilling, repairing, redrilling or other necessary well maintenance operations; or (ii) forty-nine years from the effective date of this lease, whichever period is shorter. The parties acknowledge that the ROW may survive the termination of this Lease, in which event Lessee shall promptly surrender the lease in accordance with the provisions of Paragraph 30, excepting and reserving a 50-foot diameter right of way surrounding the borehole.
- (c) All applicable terms and conditions of the lease shall apply to any and all pass-through wells and govern operations under this ROW.
- (d) In consideration of the rights granted in this Paragraph 35, Lessee shall pay to Lessor, in addition to any other payment due under this lease, an overriding royalty in the amount of four percent (4%) of the current market price of all oil, gas and hydrocarbon substances produced from the pass-through well. The overriding royalty shall be calculated and payable monthly in the same manner as royalty under this lease.

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AMENDED EXHIBIT "B"
LEASE PRC 8674.1

RENTAL, ROYALTY PERCENTAGE AND BOND REQUIREMENTS

1. RENTAL

The annual rental for this lease shall be twenty dollars (\$35.00) per acre or fraction of an acre for a total of two hundred and twenty dollars (\$490.00) for approximately 13.74 acres.

2. ROYALTY PERCENTAGE

The royalty percentage on gas substances produced from the lease or under an approved pooling or unit shall be fixed at twenty percent (20%). The royalty percentage on oil shall be fixed at twenty percent (20%).

3. BOND

The performance bond or other security to be furnished and maintained by the Lessee shall be in the sum of ten thousand dollars (\$10,000.00). The State may review, from time to time, the sufficiency of the bond and modify its amount and its terms, as it deems necessary to ensure performance by the Lessee of all of the covenants and obligations under this lease.

4. PASS-THROUGH ROYALTY AGREEMENT

The State would be compensated by the payment of an overriding royalty in the amount of four percent (4%) of all production from pass-through well(s) as defined herein.