

MINUTE ITEM
This Calendar Item No. 36
was approved as Minute Item
No. 36 by the State Lands
Commission by a vote of 3
to 0 at its 5/22/87
meeting.

CALENDAR ITEM

A 4, 10, 26
S 2, 5, 7

36

05/28/87
E 415
Frey

ACCEPTANCE OF SETTLEMENT PURSUANT
TO AUDIT EXCEPTIONS

On June 3, 1940, the State and Chevron entered into an oil and gas lease covering 1,656 acres of State-owned land. The lease area is in the Sacramento - San Joaquin Rivers Delta and is part of the Rio Vista Gas Field encompassing approximately 13,123 acres. Over the years, portions of the State lease have been unitized with private lands. On March 15, 1966, the Decker Island Unit No. 1 was formed. The Rio Vista Unit was formed on June 3, 1964. And the Isleton Unit was organized on May 24, 1951. In addition to the units, other s vereign lands remain non-unitized. These include the Isleton Non-Unit lands and the Rio Vista Non-Unit (Deep Zones) lands.

On January 23, 1984, the Commission's auditing staff commenced a routine audit of the lease. A final audit report was issued to Chevron on June 21, 1985. The audit found three exceptions.

- 1) On September 22, 1967, Chevron and P G & E entered into a gas sales agreement for P G & E purchase of gas from the Rio Vista Non-Unit (Deep Zones) lands. Under this agreement, the parties were to determine the gas reserves and to produce the field under a specific formula. The parties failed to determine the reserves. Additionally, without state approval, the parties amended the agreement and substituted a different production formula. Finally, the parties failed to enforce the terms of the agreement. The end result was that the State suffered a loss of royalty.
- 2) With regard to the Rio Vista Unit, gas sales are governed by a sales agreement dated May 16, 1940. On May 25, 1950, the agreement was amended to provide for incremental price reductions whenever gas was delivered below specific pressure. By letter agreement dated July 17, 1980, Chevron and P G & E agreed to treble these price reductions. The error here is twofold.

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First, the 1980 amendment was made under a January 1, 1956 contract which has no application to State lands. Secondly, the Commission had not approved any increase in price reductions. The result of the error was a loss of royalty revenue.

- 3) With regard to the Isleton Non-Unit lands, gas sales are governed by the gas sales contract dated May 15, 1940. Beginning in July 1978, Chevron erroneously applied a load factor from a January 1, 1961 contract with P G & E. This latter contract was not, by its terms, applicable to State lands. While the error was corrected in January 1985, the State suffered a loss of royalty.

After the audit was issued, Commission staff met several times with Chevron to resolve the audit exceptions. Chevron conceded the errors in the Rio Vista Unit and Isleton Non-Unit. However, it contested the findings for the Rio Vista Non-Unit (Peco Zones). In the end, Chevron acknowledged a deficiency in production and made a settlement offer, but denied any harm to the State because of its failure to calculate reserves. The production formula and reserve estimate aspects were resolved in Calendar Item 23, July 24, 1986, when the Commission approved a new production formula of one-third deliverability. This calendar item deals solely with monetary damages. After much research and discussion by Commission staff, it was concluded that it was in the best interests of the State that a recommendation be made to accept Chevron's settlement offer of \$351,087 plus penalty and interest to resolve the audit exceptions and compensate the State for lost royalty. On April 15, 1987, Chevron tendered \$727,663 including principal, penalty and interest.

AB 884: N/A.

OTHER PERTINENT INFORMATION:

1. Pursuant to the Commission's delegation of authority and the State CEQA Guidelines (14 Cal. Adm. Code 15061), the staff has determined that this activity is exempt from the requirements of the CEQA because the activity is not a "project" as defined by CEQA and the State CEQA Guidelines.

Authority: P.R.C. 21065 and 14 Cal. Adm. Code 15378.

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IT IS RECOMMENDED THAT THE COMMISSION:

1. FIND THAT THE ACTIVITY IS EXEMPT FROM THE REQUIREMENTS OF THE CEQA PURSUANT TO 14 CAL. ADM. CODE 15061 BECAUSE THE ACTIVITY IS NOT A PROJECT AS DEFINED BY P.R.C. 21065 AND 14 CAL. ADM. CODE 15378.
2. ACCEPT CHEVRON'S OFFER OF \$727,663 IN SETTLEMENT OF AUDIT EXCEPTIONS CONTAINED IN THE COMMISSION'S AUDIT OF STATE OIL AND GAS LEASE E415 DATED JUNE 21, 1985.