CALENDAR ITEM
C130

A 8, 11, 15 | 06/23/2011
PRC E-415.1
M. Le Clair
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CONSIDER APPROVAL OF A LEASE AMENDMENT AND ASSIGNMENT, AS PROVIDED FOR IN THE ASSIGNMENT CONSENT AGREEMENT, FROM ROSETTA RESOURCES OPERATING LP'S 100 PERCENT INTEREST IN OIL AND GAS LEASE NO. PRC E-415.1 TO VINTAGE PETROLEUM, LLC, RIO VISTA GAS FIELD, CONTRA COSTA, SAN JOAQUIN, SACRAMENTO AND SOLANO COUNTIES

ASSIGNOR:
Rosetta Resources Operating LP
Attn.: Mr. Michael J. Rosinski
717 Texas, Suite 2800
Houston, TX 77002

ASSIGNEE:
Vintage Petroleum, LLC
Attn.: Mr. Michael D. Gooding
9600 Ming Avenue, Suite 300
Bakersfield, CA 93311

AREA, LAND TYPE, AND LOCATION:
Oil and Gas Lease No. PRC E-415.1 contains approximately 2,827 acres, more or less, of State land that encompasses portions of the beds of the Sacramento, San Joaquin, Mokelumne, Old, and False Rivers and other tide and submerged lands within the area designated by Agreement for Easement No. 415 dated June 3, 1940 (Location Map attached as Exhibit A).

BACKGROUND:
Agreement for Easement No. 415 was issued to Standard Oil Company of California ("Standard," presently Chevron Corporation) on June 3, 1940. On December 20, 1963, the California State Lands Commission (Commission)

approved Standard's request for a new lease designated as PRC E-415.1 (Lease) in exchange for Agreement for Easement No. 415. Calpine Corporation eventually succeeded to the lessee's interest under the Lease. Calpine and its affiliated entities entered into a Purchase and Sale Agreement (PSA) dated July 7, 2005, with Rosetta Resources, Inc. and its affiliates. The Commission approved the assignment of, and amendment to, the lease to Rosetta Resources Operating LP (Rosetta), a Delaware limited partnership on October 30, 2007. On February 24, 2011, Rosetta entered into a Purchase and Sale Agreement with Vintage Petroleum, LLC (Vintage), a Delaware limited liability corporation, and subsidiary of Occidental Petroleum Corporation, for all of its California assets including Lease No. PRC E-415.1.

Commission staff received a letter dated March 1, 2011, containing an application for Commission approval of the assignment of Rosetta's interest in the Lease to Vintage. As part of the assignment review process, staff performed a financial review of Vintage's assets to ensure its performance of the terms of the Lease. Staff determined that, in addition to a performance bond, Vintage's parent, Occidental Oil and Gas Holding Corporation (OOGHC), a California Corporation, would be required to sign a parental guarantee (in a form substantially similar to that set forth in Exhibit C) and take financial responsibility for the Lease obligations.

Staff determined that the original 1940 easement as amended by the current Lease entered into on December 20, 1963, and by an amendment entered into on October 30, 2007, should be further amended to provide additional protection of the State's interests in the leased lands. Staff also believes that verification of the accuracy of the cost allocations within the complex net profits provisions had become too expensive and too burdensome to manage.

The parties agreed that changing the existing 30 percent royalty plus a percentage of net profits to a flat royalty would be mutually beneficial, provided that the State would remain whole. In furtherance of that goal, staff and Vintage agreed to amend the Lease to provide for a flat royalty rate of 35 percent of the production of gas substances from the State's interest in all wells in the Rio Vista Gas Unit (RVGU), which is contained within the lease boundary, and from all current non-unit wells within State sovereign land below the RVGU, for the remaining economic life of the Lease. Staff and Vintage also agreed to a flat 25 percent royalty on gas substances produced from new wells drilled outside the boundaries of, or below, the RVGU into State sovereign land. These are the highest royalty rates in the area.

The amendments and agreements between the parties are contained in the Assignment Consent Agreement on file with the Commission in a form substantially similar to the document attached as Exhibit B.

Some of the more significant new terms are:

1. Changing the current fixed royalty rate plus net profits to a higher fixed royalty rate;

2. A requirement that Vintage develop offset wells to protect State lands from drainage or, alternatively, provide a compensatory royalty for any drainage that is occurring. Vintage is, under certain circumstance, to quitclaim particular areas the Lease so that the State may enter into a lease with the other operators;

3. A requirement that Vintage provide compensation for any well it drills through State land that does not produce from the State land (known as a “pass-through” provision);

4. An increase in the rental rate for the leased land, the bond and the insurance provisions, with a five-year review of each of these terms;

5. A requirement that Vintage, within three years of the date of the approval of the assignment, provide to the State a development plan and a description of all the surface leases Vintage has or will acquire and quitclaim any land it does not intend or have the ability to develop, and that it develop or quitclaim three distinct non-unit areas within the lease boundaries;

6. A requirement that Vintage adhere to all current regulations and any regulations promulgated during the remaining life of the Lease; and

7. A requirement that Vintage submit an annual report of Lease activity and projection for the continued development of the Lease.

Having a flat royalty rate instead of the current complicated net profits arrangement, which has resulted in payment of only the minimum 30 percent royalty since 2006, will simplify the accounting and auditing functions associated with the Lease.

Staff and Vintage have also agreed to increase the bonding requirement from the current amount of $1.5 million to $2.0 million. The rental rate for the 2,827 acres will increase from the $1,500 annual rental that is credited against subsequent royalties to a minimum annual rental of $20.00 per acre (amounting to $56,540.00), which will be in addition to any royalties. Both the bond amount and the annual rental are subject to review every five years.

In order to protect the State's resources from drainage and to allow leasing to other operators, staff has also added to the lease a term which would require the lessee to review and identify its surface holdings and a development plan within the boundaries of the lease within 36 months. Vintage will be required to quitclaim back to the State any sovereign land that is not included as part of the development plan, or in which it cannot protect the State's interest, so that the State may lease these areas to other interested parties.

STATUTORY AND OTHER REFERENCES:

A. Section 2 (o) and Section 8 of the Lease.

B. Public Resources Code section 6804

OTHER PERTINENT INFORMATION

1. Pursuant to the Commission's delegation of authority and 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 CEQA because it is not a "project" as defined by CEQA and State CEQA Guidelines.

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

2. Assignment forms have been provided and prerequisite filing fees have been paid by Rosetta.

3. This activity involves lands identified as possessing significant environmental values pursuant to Public Resources Code section 6370 et seq., but such activity will not affect those significant lands.

4. Upon approval of the transfer, Lease No. PRC E-415.1 shall be amended pursuant to the Assignment Consent Agreement in a form and substantially similar to the document attached as Exhibit B.

5. Performance bonds totaling $2.0 million are on file at the Commission's Long Beach office.

6. Occidental Oil and Gas Holding Corporation has executed an irrevocable and unconditional guaranty of Vintage Petroleum, LLC's performance of the terms of the Lease. Occidental Oil and Gas Holding Corporation has submitted corporate and financial data which were reviewed by Commission staff. Based on the results of the reviews and the fact that Occidental Oil and Gas Holding Corporation has other entities with leases with the State, Commission staff has determined that Occidental Oil and Gas Holding Corporation possesses the financial resources to meet the requirements and obligations under the terms of Lease No. PRC E-415.1

7. Staff will conduct an exit audit to ensure that all amounts due from the prior lessee, Rosetta, have been paid. Rosetta has agreed to increase its lease performance bond to four million dollars in order to secure payment of any amount found by the audit to be owed to the State. In addition, Rosetta has agreed to pay up to one hundred and fifty thousand dollars of the State's audit costs.

EXHIBITS:

A. Location Map
B. Proposed Assignment Consent Agreement
C. Proposed "Parental" Guarantee of Occidental Oil and Gas Holding Corporation

PERMIT STREAMLINING ACT DEADLINE:

N/A

RECOMMENDED ACTION:

It is recommended 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 this activity is consistent with the use classification designated by the Commission for land pursuant to Public Resources Code Sections 6370, et seq.

AUTHORIZATION:

1. Approve the Assignment Consent Agreement of Oil and Gas Lease No. PRC E-415.1, in a form substantially similar to that set forth in Exhibit B of this calendar item.

2. Approve the Parental Guarantee of Occidental Oil and Gas Holding Corporation, in a form substantially similar to that set forth in Exhibit C of this calendar item.

3. Consent to the assignment of 100 percent interest in Oil and Gas Lease No. PRC E-415.1 from Rosetta Resources Operating LP to Vintage Petroleum, LLC, effective upon execution of all implementing documents, with the assignee to be bound by all the terms and conditions of the Lease as amended.

4. Authorize the Executive Officer or his designee to execute any documents necessary to implement this assignment.