

**CALENDAR ITEM  
C71**

A 57, 58

04/26/05

W 11107

PRC 3455

D. Mercier

S 29

**CONSIDER A NEW GAS AGREEMENT BETWEEN  
CALIFORNIA STATE LANDS COMMISSION, CITY OF LONG BEACH,  
AND OCCIDENTAL LONG BEACH, INC.,  
LONG BEACH UNIT, WILMINGTON OIL FIELD,  
LOS ANGELES COUNTY**

**APPLICANT:**

California State Lands Commission  
100 Howe Avenue, Suite 100-South  
Sacramento, CA 9825-8202

**AREA, LAND TYPE, AND LOCATION**

The Long Beach tidelands include a large portion of the Wilmington Oil Field, a major oil field in the United States. The East Wilmington portion of this field includes tidelands granted in trust to the City of Long Beach (City), a small parcel in which the State retained the mineral interest, and an uplands area consisting of much of downtown Long Beach. These areas are combined into the Long Beach Unit for unitized oil production operations, with the City tidelands area being Tract 1, the State tidelands parcel being Tract 2 and the uplands area being the Townlot.

**BACKGROUND:**

Currently, neither the contractor (Occidental Long Beach, Inc.) nor the unit operator (City of Long Beach) has the financial incentive to explore for natural gas within the Long Beach tidelands Tract 1 area because, contractually, the State receives 100 percent (100%) of the gas revenue. State Assembly Members Lowenthal and Oropeza (Coauthor: Senator Karnette) introduced Assembly Bill No. 27 to authorize the California State Lands Commission (Commission) to negotiate and execute, on behalf of the State, an agreement with the City and any contractor (Occidental Long Beach, Inc. is the current contractor) that will provide a financial incentive for that contractor to explore for

CALENDAR ITEM NO. C71 (CONT'D)

and develop additional gas reserves in the Long Beach tidelands. Nothing in this legislation or any agreement made pursuant to this legislation supersedes or amends the contracts and agreements governing the drilling, developing, extracting, processing, taking, or removal of oil, gas, and other hydrocarbons from the Long Beach tidelands. The assembly bill became Chapter 1, Statutes of 2001, Second Extraordinary Session, on August 9, 2002 (Exhibit A, attached hereto).

Pursuant to this legislation, the State, the City and Occidental Long Beach, Inc., may enter into an agreement to develop new gas in the Long Beach Unit. The contractor and the City, either directly or indirectly, shall bear the costs of the exploration and development of additional gas reserves in the Long Beach tidelands. The State shall not pay any abandonment costs with respect to those exploration and development activities. A royalty will be paid to the State in lieu of a share of net profits, thus reducing risk to the State.

Additional gas reserves being contemplated for development as a result of this bill are characterized as "shallow gas" which lies above the oil and gas reserves presently developed as the Long Beach Unit Waterflood, and the "deep gas" which are possible reserves below the Long Beach Unit Waterflood horizon.

**STAFF RECOMMENDATIONS**

Commission staff has negotiated with the City (the unit operator) and Occidental Long Beach, Inc., (OLBI) (the field contractor) a Financial Incentive Agreement for new gas development and recommends that the Commission authorize the Executive Officer to execute the Agreement. Its major provisions are:

For shallow gas:

1. OLBI shall pay to the State an expense-free royalty on all dry gas produced from the shallow gas reserves and allocated to Tract 1 and the royalty shall be calculated using a gas price-sensitive sliding scale formula. The State's royalty rate shall vary with the reasonable wholesale market value of Long Beach tidelands dry gas under the current gas sales agreement between the City and the State. In no event shall the State's royalty rate be less than 35 percent (35%) or higher than 55 percent (55%) based on a low price of \$3 per MMBtu and a high price of \$8 per MMBtu (Exhibit B, attached hereto).

CALENDAR ITEM NO. C71 (CONT'D)

2. As compensation to the City for dry gas produced from the shallow gas reserves and allocated to Tract 1, the City shall receive a fixed expense-free royalty of 15 percent (15%) of the State's royalty share attributable to Tract 1, all of which shall be payable from the State's royalty share.

For deep gas:

3. The State's royalty rate shall be a fixed 25 percent (25%).
4. As compensation to the City for dry gas produced from the deep zone gas reserves and allocated to Tract 1, the City shall receive a fixed expense-free royalty of 8 percent (8%) of the State's royalty share attributable to Tract 1, all of which shall be payable from the State's royalty share.
5. OLBI shall drill at least one deep zone well for the purpose of exploring for gas. OLBI shall commence drilling the first deep zone well no later than February 1, 2008. The costs to the State could be nothing or shared depending upon whether oil and/or gas is discovered.

**PROJECT BENEFITS**

The State's expected cumulative revenue for this project, over a 10-year period, is over \$7.0 million. Oxy, the City, and the Townlot owners are expected to receive over \$3.0 million, \$1.0 million, and \$0.75 million respectively. If the deep zone exploratory well is successful, there is a chance this project could generate for the State millions of dollars of additional revenues.

**STATUTORY AND OTHER REFERENCES:**

Chapter 29, Statutes of 1956, First Extraordinary Session; Chapter 138, Statutes of 1964, First Extraordinary Session; Chapter 1, Statutes of 2001, Second Extraordinary Session

**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 this activity 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.

CALENDAR ITEM NO. C71 (CONT'D)

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

**EXHIBITS:**

- A. Chapter 1, Statutes of 2001, Second Extraordinary Session
- B. Agreement Providing Financial Incentive for Development of Shallow Gas  
and Additional Deep Gas Reserves in the Long Beach Unit

**PERMIT STREAMLINING ACT DEADLINE:**

N/A

**RECOMMENDED ACTION:**

**IT IS RECOMMENDED THAT THE COMMISSION:**

**CEQA FINDINGS**

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.

**AUTHORIZATION:**

AUTHORIZE THE EXECUTIVE OFFICER OR HIS DESIGNEE TO  
EXECUTE THE FINANCIAL INCENTIVE AGREEMENT ON BEHALF OF  
THE COMMISSION.

## Exhibit A

### Assembly Bill No. 27

#### CHAPTER 1

An act relating to energy, and declaring the urgency thereof, to take effect immediately.

[Approved by Governor August 8, 2001.  
Filed with Secretary of State August 9, 2001.]

#### LEGISLATIVE COUNSEL'S DIGEST

AB 27, Lowenthal. Long Beach tidelands: gas reserves: exploration and development.

(1) Existing law grants to the City of Long Beach certain tidelands and submerged lands in trust under prescribed conditions.

This bill would authorize the State Lands Commission to negotiate and execute, on behalf of the state, a contract or agreement with the City of Long Beach and any contractor operating under an oil operating contract with the City of Long Beach, that will provide a financial incentive for that contractor to explore for, and develop, additional gas reserves in the Long Beach tidelands, but would provide that nothing in the bill or any contract or agreement that may be entered into pursuant to provisions of the bill shall supersede or amend, in any respect, specified contracts and agreements governing the drilling, developing, extracting, processing, taking, or removal of oil, gas, and other hydrocarbons from the Long Beach tidelands, as defined. The bill would require that any contract or agreement so authorized pursuant to those provisions of the bill specify that the contractor and the City of Long Beach, either directly or indirectly, shall bear the costs of the exploration and development of additional gas reserves in the Long Beach tidelands, as specified. The bill would provide that the state would not bear any of the cost associated with the exploration and development of those additional gas reserves, nor would it pay any abandonment costs with respect to those exploration and development activities.

The bill would require all net revenue derived by the City of Long Beach from the disposition of its allocated share of the additional gas reserves that are a product of the exploration and development undertaken pursuant to a contract or agreement to be used by the City of Long Beach for specified purposes.

000345

CALENDAR PAGE

000591

MINUTE PAGE

(2) The California Constitution requires the state to reimburse local agencies and school districts for certain costs mandated by the state. Statutory provisions establish procedures for making that reimbursement.

This bill would provide that no reimbursement is required by this act for a specified reason.

(3) The bill would declare that it is to take effect immediately as an urgency statute.

*The people of the State of California do enact as follows:*

SECTION 1. The Legislature finds and declares all of the following:

(a) The State of California is in the midst of a severe energy crisis and increased production of natural gas reserves in the state will help to alleviate this crisis.

(b) There may be untapped natural gas reserves in the Long Beach tidelands, but contractors operating under existing oil operating contracts with the City of Long Beach need financial incentives to explore for and develop those reserves.

(c) There are currently no financial incentives provided for by existing laws governing oil operations in the Long Beach tidelands.

SEC. 2. (a) The State Lands Commission may, on behalf of the state, negotiate contracts or agreements with the City of Long Beach, and any contractor operating under an oil operating contract with the City of Long Beach, that provide financial incentives for the contractor to explore for, and develop, additional gas reserves in the Long Beach tidelands, as defined in subdivision (a) of Section 1 of Chapter 138 of the Statutes of 1964, First Extraordinary Session. Neither this act nor any contract or agreement entered into pursuant to this section shall supersede or amend, in any respect, the existing contractors' agreements for Tracts 1 and 2 of the Long Beach Unit, the Agreement for Implementation of an Optimized Waterflood Program for the Long Beach Unit, the Long Beach Unit Agreement, the Long Beach Unit Operating Agreement, the Long Beach Harbor Tidelands Parcel and Parcel "A" Oil Contract, the Fault Block Unit Agreements, and Unit Operating Agreements, or any other existing contract covering the drilling, developing, extracting, processing, taking, or removal of oil, gas, and other hydrocarbons from the Long Beach tidelands.

(b) Any contract or agreement entered into pursuant to subdivision (a) shall contain a provision specifying that the contractor and the City of Long Beach, either directly or indirectly, shall jointly bear the costs incurred in connection with the exploration and development of additional gas reserves in the Long Beach tidelands. The composition of those additional gas reserves to be developed in the Long Beach tidelands shall be prescribed in any contract or agreement entered into by the State Lands Commission, the City of Long Beach, and the contractor. The state shall not bear any of the cost incurred in connection

000346

CALENDAR PAGE

000692

MINUTE PAGE

with the exploration and development of those additional gas reserves, nor shall it pay any abandonment costs related to that gas exploration or development. The state shall receive an expense-free royalty, in cash or in kind, that is payable monthly on all gas produced as a result of this new exploration and development. The City of Long Beach and any contractor entering into a contract or agreement for the exploration or development of gas reserves with the City of Long Beach may determine, in the course of negotiations, how the exploration and development costs will be apportioned between the parties to the contract or agreement, and how the gas produced from this exploration and development will be allocated between or among each party, provided that the City of Long Beach shall have the right, but not the obligation, to purchase all gas produced at a negotiated price that is no greater than the reasonable wholesale commodity market price of dry gas sold for residential consumption in the Los Angeles Basin. The state shall receive its royalty in cash so long as the City of Long Beach is exercising its right to purchase all the gas, but may elect to receive its royalty either in cash or in kind whenever the City of Long Beach is not exercising this right. All oil produced in connection with the development and production of these additional gas reserves shall be allocated and accounted for as normal oil production under existing and applicable contracts or agreements governing oil production in the Long Beach tidelands.

(c) The provisions of Chapter 29 of the Statutes of 1956, First Extraordinary Session, and of Chapter 138 of the Statutes of 1964, First Extraordinary Session, relating to the allocation and disposition of Long Beach tidelands dry gas, shall remain in effect and continue to be fully applicable to all dry gas produced from the Long Beach tidelands that is not a product of the exploration and development undertaken pursuant to a contract or agreement authorized by subdivision (a).

(d) All net revenue derived by the City of Long Beach from the disposition of its allocated share of the additional gas reserves that are a product of the exploration and development undertaken pursuant to a contract or agreement authorized by subdivision (a) shall be used by the City of Long Beach for the purposes of, and in the manner set forth in, Section 6 of Chapter 138 of the Statutes of 1964, First Extraordinary Session.

SEC. 3. No reimbursement is required by this act pursuant to Section 6 of Article XIII B of the California Constitution because a local agency or school district has the authority to levy service charges, fees, or assessments sufficient to pay for the program or level of service mandated by this act, within the meaning of Section 17556 of the Government Code.

000347

CALENDAR PAGE

000693

MINUTE PAGE

SEC. 4. This act is an urgency statute necessary for the immediate preservation of the public peace, health, or safety within the meaning of Article IV of the Constitution and shall go into immediate effect. The facts constituting the necessity are:  
In order for the residents of the state to benefit from the potential for more natural gas as soon as possible, it is necessary that this act take effect immediately.

4/26/05  
W 11107  
PRC 3455  
D. Mercier

## Exhibit B

AGREEMENT PROVIDING FINANCIAL INCENTIVE FOR DEVELOPMENT OF  
SHALLOW GAS AND ADDITIONAL DEEP GAS RESERVES  
IN THE LONG BEACH UNIT

This Agreement Providing Financial Incentive for Development of Shallow Gas and Additional Deep Gas Reserves in the Long Beach Unit (Financial Incentive Agreement) is entered into by and among the City of Long Beach, a municipal corporation, acting as trustee of the Long Beach tidelands and as Unit Operator of the Long Beach Unit (City), Oxy Long Beach, Inc., a Delaware corporation, as the holder of the Field Contractor and Nonoperating Contractor interests in Tracts 1 and 2 of the Long Beach Unit (OLBI), and the California State Lands Commission (State).

Under the Long Beach tidelands granting statutes, specifically Chapter 29, Statutes of 1956, 1<sup>st</sup> E. S. and Chapter 138, Statutes of 1964, 1<sup>st</sup> E. S., the State is entitled to 100% of the dry gas revenue from the Long Beach tidelands, which include Tract 1. As a result of the substantial portions of dry gas revenue from Tract 1 that must be paid to the State by statute, there is not a sufficient financial incentive for OLBI, as Contractor, to undertake exploration for and development of additional gas reserves in the Long

Beach Unit (LBU). As a consequence, any additional gas reserves likely will not be developed.

In order to provide a financial incentive for the Long Beach tidelands oil contractors, working with the City, to undertake exploration and development of the additional gas reserves in the Long Beach tidelands, the Legislature enacted Chapter 1, Statutes of 2001, 2<sup>nd</sup> E. S. (AB 27). This legislation authorizes the State to negotiate agreements with the City and its tidelands oil contractors that provide financial incentives for the contractors to explore for and develop additional gas reserves and imposes certain requirements for and limitations on these agreements. These requirements and limitations include provisions that the contractor and the City, either directly or indirectly, shall bear the costs of the exploration and development and that the State shall bear none of this risk but shall receive an expense-free royalty on all gas produced as a result of this exploration and development.

Acting pursuant to the provisions in AB 27, the City, OLBI and the State agree as follows:

1. OLBI's Obligation to Explore for and Develop Shallow Gas Reserves.

OLBI shall undertake the exploration for and development of shallow gas reserves in the LBU. Shallow gas reserves are defined as all gas reserves above the Tar Zone. All the costs for the exploration, development and production of these shallow gas reserves allocated to Tract 1 shall be borne exclusively by OLBI. None of these costs shall be charged by OLBI to any net profits account under the Contractors' Agreement. LBU facilities operating costs associated with shallow gas production (Shallow Gas Processing Costs) shall be determined using the methodology in paragraph 18. Within 90 days of

execution of this agreement by all parties, the City shall submit a Unit Determination to the LBU Voting Parties to drill a shallow gas well or recomplete an existing well in the shallow gas zone. If commercial quantities of shallow gas are discovered, OLBI shall diligently continue development of the economic shallow gas reserves until they are fully developed. OLBI shall have the right and the obligation to take all dry gas and gas condensate produced from the shallow gas reserves and allocated to Tract 1.

2. Shallow Gas Royalty Payable to State. OLBI shall pay to the State an expense-free royalty on all dry gas produced from the shallow gas reserves and allocated to Tract 1. The royalty shall be calculated using the price-sensitive sliding scale formula in Exhibit A. Under this formula, the State's royalty rate shall vary with the reasonable wholesale market value of tidelands dry gas, in dollars per MMBtu, as defined in the 2003 Long Beach Tidelands Dry Gas Price Agreement between the City and the State or any successor agreement ("Long Beach Tidelands Dry Gas Price Agreement"). In no event shall the State's royalty rate be less than 35% or higher than 55% based on a low price of \$3 per MMBtu and a high price of \$8 per MMBtu.

3. Shallow Gas Royalty Payable to City from State's Royalty Share. As compensation to the City for dry gas produced from the shallow gas reserves and allocated to Tract 1, the City shall receive a fixed expense-free royalty of 15% of the State's royalty share, all of which shall be payable from the State's royalty share.

4. Shallow Gas Royalty Valuation. The royalty payable to the State, and the share from the State's royalty to be paid to the City, shall be paid monthly in accordance with standard LBU accounting practices and shall be valued at the reasonable wholesale market value of tidelands dry gas, in dollars per MMBtu, as defined in the

Long Beach Tidelands Dry Gas Price Agreement in effect at the time the gas is delivered by OLBI to its purchaser or consumed as fuel in the LBU power plant. This purchaser may be either the purchaser under the Long Beach Tidelands Dry Gas Agreement or the purchaser under a separate contract for the sale by OLBI of the dry gas from the shallow gas reserves in accordance with the LBU Unit Agreement and Unit Operating Agreement and applicable legislation.

5. Plugging and Abandonment of Shallow Gas Wells and Abandonment of Related Facilities. Except as expressly set forth herein, this Agreement shall not in any way affect the responsibility for plugging and abandoning any Unit Wells or Unit Facilities, which responsibility shall remain as set forth in the LBU Unit Agreement and Unit Operating Agreement and the Agreement for Implementation of an Optimized Waterflood Program for the Long Beach Unit (OWPA). The responsibility for the payment of all plugging and abandonment costs allocated to Tract 1 for the wells drilled or recompleted and the facilities used exclusively for the purposes of exploring for, developing and producing the shallow gas reserves pursuant to this Financial Incentive Agreement, shall be OLBI's exclusively, regardless of when these wells are plugged and abandoned and the facilities are removed. The shallow gas facilities abandonment responsibility shall not include any facilities downstream of the point where shallow gas production is blended or commingled with other LBU produced gas. None of these costs shall be charged by OLBI to any net profits account under the Contractors' Agreement nor shall the Tract 1 share of plugging and abandonment of these wells or the abandonment of these facilities in any other way become the burden of the City or the State.

6. Tract 2 and Townlot Shares of Shallow Gas. The costs for exploration and development of the shallow gas reserves, including the costs for well plugging and abandonment, and the produced dry gas from the shallow gas reserves allocable to Tract 2 and the Townlot tracts shall be accounted for under the LBU Unit Agreement and Unit Operating Agreement.

7. OLBI's Obligation to Drill Deep Zone Well. In addition to exploring for and developing the shallow gas reserves, OLBI shall drill at least one deep zone well (a well completed in a zone or zones below the Union Pacific/Ford Zone or below the upper level of the Union Pacific/Ford Zone if the Union Pacific/Ford Zone repeats itself under subthrust conditions) for the purpose of exploring for gas. OLBI shall commence drilling the first well no later than February 1, 2008. The drilling program (including target location, completion interval, and testing method) shall be prepared by OLBI and shall be subject to the approval process for plans of operation provided in the LBU Unit Agreement and Unit Operating Agreement, the Contractors' Agreement and the OWPA. OLBI shall have the right and the obligation to take all hydrocarbons produced from the deep zone well and allocated to Tract 1.

8. Cost and Proceeds Sharing if Well is Completed in a Deep Zone and is a Gas Well. OLBI shall initially pay the costs allocated to Tract 1 for drilling the first deep zone well. If the well is completed in a deep zone and is a gas well, OLBI shall bear the entire burden of the costs allocated to Tract 1 for drilling and producing this well. OLBI shall not charge any of these costs to any net profits account under the Contractors' Agreement. LBU facilities operating costs associated with deep gas production (Deep Gas Processing Costs) shall be determined using the methodology in paragraph 18. If the

well is completed in a deep zone and is a gas well, OLBI shall pay to the State a fixed expense-free royalty of 25% on all dry gas produced and sold from the deep zone well and allocated to Tract 1. As compensation to the City for dry gas produced from the deep zone well and allocated to Tract 1, the City shall receive a fixed expense-free royalty of 8% of the State's 25% royalty share, all of which shall be payable from the State's 25% royalty share. The State's royalty, and the share from the State's royalty to be paid to the City, shall be paid monthly in accordance with standard LBU accounting practices and shall be valued at the reasonable wholesale market value of tidelands dry gas, in dollars per MMBtu, as defined in the Long Beach Tidelands Dry Gas Price Agreement in effect at the time the gas is delivered by OLBI to the purchaser of the gas. All Tract 1 allocated costs for plugging and abandoning the well and abandoning related facilities used exclusively for the production of a deep zone gas well, if the well is completed in a deep zone and is a gas well, shall be borne by OLBI. The Tract 2 and Townlot shares of costs and production from this well shall be allocated to Tract 2 and the Townlot tracts, respectively, as provided in the LBU Unit Agreement and Unit Operating Agreement.

9. Cost and Proceeds Sharing if Well is Completed in a Deep Zone and is an Oil Well. If the first well is completed in a deep zone and is an oil well, the State shall receive a fixed expense-free royalty of 25% on all associated gas produced and sold from the well and allocated to Tract 1, and the City shall receive a fixed expense-free royalty of 8% of the State's 25% royalty share, which is payable from the State's 25% royalty share, for associated gas produced and sold from the well and allocated to Tract 1. The State's royalty, and the share from the State's royalty to be paid to the City, shall be paid monthly in accordance with standard LBU accounting practices and shall be valued at the

wholesale market value of tidelands dry gas, in dollars per MMBtu, as defined in the Long Beach Tidelands Dry Gas Price Agreement in effect at the time the gas is delivered by OLBI to the purchaser of the gas. Prior to payout, as provided in paragraph 10, all investment, incremental operating and abandonment costs attributable to oil and allocated to Tract 1 shall be borne exclusively by OLBI (i.e., not charged to any net profits account under the Contractors' Agreement) and no revenue from the sale of produced oil from the well and allocated to Tract 1 shall be credited to the net profits account under the Contractors' Agreement. After payout is achieved, as provided in paragraph 10, all operating, abandonment, and potential investment costs attributable to oil production and allocated to Tract 1 shall be shared in accordance with OWPA (i.e., charged to the net profits account under the Contractors' Agreement) and the oil revenue from the sale of produced oil from the well and allocated to Tract 1 shall be credited to the net profits accounts under the Contractors' Agreement. The portion of all investment, operating and abandonment costs attributable to any associated gas produced by the well, however, shall continue to be borne exclusively by OLBI. OLBI shall not charge any of the costs associated with gas production to any net profits account under the Contractors' Agreement. LBU facilities operating costs associated with deep gas production (Deep Gas Processing Costs) shall be determined using the methodology in paragraph 18. The portion of the drilling, workover and plugging and abandonment costs attributable to oil and to associated gas production shall be determined on the basis of the ratio of oil production in barrels to associated gas production in barrels of oil equivalent (BOE) during the first four months the well is on production. BOE for associated gas is calculated by dividing the associated gas production in thousands of cubic feet (mcf) by

000355

7

000731

CALENDAR PAGE

MINUTE PAGE

six (6). The Tract 2 and Townlot shares of costs and production from this well shall be allocated to Tract 2 and the Townlot tracts, respectively, as provided in the LBU Unit Agreement and Unit Operating Agreement. Natural gas liquids (hydrocarbons found in natural gas that are extracted or isolated at the Broadway and Mitchell (B&M) refrigeration unit as liquefied petroleum gas or natural gasoline) and gas condensate (liquid hydrocarbons recovered at the surface and upstream of the B&M refrigeration unit that result from condensation of the hydrocarbons existing initially in the gaseous phase in the reservoir) shall be commingled with other LBU natural gas liquids and allocated and accounted for as oil production.

10. Cost Sharing if Well is Completed in a Deep Zone and is a Dry Hole.

In the event of a dry hole, OLB I commits that none of the dry hole costs associated with the first deep zone well and allocated to Tract 1 will be charged by OLB I to any net profits account under the Contractors' Agreement. A dry hole is a well that does not achieve payout during its operating life. Payout is achieved when the revenue from the sale of the oil and gas produced from the well, net of royalty, is equal to 100% of the drilling, completion and incremental operating costs for the well. Dry hole costs include all investment costs and incremental operating costs associated with the well, but do not include the gas royalty paid to the State and the City.

11. Cost and Proceeds Sharing if Well is Drilled to a Deep Zone and is Recompleted above the Deep Zone. If the first well drilled to a deep zone is a dry hole and then is recompleted as an Economically Successful Well in a zone above the deep zone to which it was drilled, all costs associated with the continued operation of the recompleted well and all production from this well shall be shared as provided in the

OWPA. OLBI, however, shall not charge any of the dry hole cost as defined in paragraph 10, plus the plug back and up-hole recompletion costs, minus the "Uphole Recompletion Value" (the equivalent cost to drill and complete an oil well in known up-hole economic intervals penetrated by the exploratory well, provided that the borehole actually penetrates a known up-hole economic interval or intervals) allocated to Tract 1, to any net profits account under the Contractors' Agreement. An Economically Successful Well is a well that generates revenue during its operating life, calculated on a present value basis using an annual discount rate of 12%, that exceeds 100% of the of the "Uphole Recompletion Value" and operating costs associated with the recompleted well.. If OLBI chooses to recomplete the deep zone well to a higher zone and that well is not an Economically Successful Well, that well shall be considered a dry hole completed in a deep zone for purposes of allocating costs. If the well is drilled to the deep zone and then plugged back and recompleted to a shallow gas zone, none of the costs allocated to Tract 1 will be charged by OLBI to any net profits account under the Contractors' Agreement. The Tract 2 and Townlot shares of costs and production from this well shall be allocated to Tract 2 and the Townlot tracts, respectively, as provided in the LBU Unit Agreement and Unit Operating Agreement.

12. Additional Deep Zone Wells. The methods and formulae for allocating and sharing costs, revenues, and production associated with each deep zone well drilled after the first deep zone well by OLBI under this Financial Incentive Agreement shall be either as provided in paragraphs 8 through 11 above or pursuant to the OWPA, based upon the mutual agreement of the State, the City and OLBI before the well is drilled.

13. Allocation of Certain Well Plugging and Abandonment and Facilities Abandonment Costs. Notwithstanding the provisions in paragraphs 5 and 8 relating to OLBI's exclusive responsibility for well plugging and abandonment and facilities abandonment that are used exclusively for the purposes set forth in this Agreement, the following well abandonment costs related to known oil reserves shall be accounted for and paid under the LBU Unit Agreement and Unit Operating Agreement, the Contractors' Agreement and the OWPA: (1) Plug back of existing oil wells in preparation for shallow gas recompletions; (2) plug back of existing oil wells in preparation for kicking off for deep zone exploration and development; and (3) plugging and abandonment of all wells completed in the Tar, Ranger, Terminal and Union Pacific/Ford Zones.

14. Reservoir Characterization. A newly discovered reservoir will be defined as oil or gas based on the reservoir temperature and pressure position on a phase diagram of the reservoir fluid. OLBI shall bear the entire burden of the costs allocated to Tract 1 for drilling, producing and plugging and abandoning any well completed in a gas reservoir, pursuant to paragraph 8. OLBI shall not charge any of these costs to any net profits account under the Contractors' Agreement.

15. Gas for Field Use. If gas is required for field use other than the power plant, the gas for which a royalty to the State is not paid will be used first. If any gas for which a royalty is paid is required for field use other than the power plant, payment of the portion of the royalty to the State that would include such gas shall be suspended during the time the gas is taken for such use.

16. Gas Measurement. Gas production volumes from gas wells will be measured using properly calibrated gas meters. Monthly associated gas production volumes from wells completed in oil reservoirs may be calculated by multiplying monthly oil production volumes as reported in the LBU Monthly Report filed with the Department of Oil Properties and estimated GORs. Estimated GORs shall be based on oil and gas production tests from a representative sample of wells determined by OLBI as Field Contractor.

17. No Effect on Oil Production or Gas Production from Middle Zones. Nothing in this Financial Incentive Agreement is intended to change the parties' interest in or share of oil and gas produced from Middle Zones. Middle Zones are all zones below the top of the Tar Zone and above the bottom of the Union Pacific/Ford Zone or the upper level of the Union Pacific Ford Zone if the Union Pacific/Ford Zone repeats itself under subthrust conditions.

18. Shallow and Deep Gas Processing Costs. Shallow and Deep Gas Processing Costs are all LBU facilities-related operating costs associated with shallow and deep well gas production. Gas processing costs allocated to a given volume of gas from a shallow or deep well shall be determined by multiplying the volume of gas, in mcf, by the Gas Plant Cost Index. The initial Gas Plant Cost Index is the ratio of the total costs to operate the B&M gas plant to the total volume of gas processed in the B&M gas plant, in mcf, using the 12-month period immediately preceding the month that shallow gas production commences. Subsequent Gas Plant Cost Indices shall be calculated annually thereafter, using the data from the immediately preceding 12-month period. Each 12-month Gas Plant Cost Index will be used to calculate (1) Monthly Estimated Gas

Processing Costs associated with gas production for all months in the 12-month period following the period on which the Gas Plant Cost Index is based and (2) an Annual Gas Processing Cost Adjustment to reflect actual facilities operating costs associated with gas production for the 12-month period on which the Gas Plant Cost Index is based. As part of providing the State and the City with an expense-free royalty, the Monthly Estimated Gas Processing Costs and Annual Gas Processing Cost Adjustments for shallow and deep gas processing will be credited to the net profits accounts under the Contractors' Agreement on a monthly and annual basis, respectively.

19. Force Majeure. A delay or failure of performance under this Financial Incentive Agreement by any party shall be excused to the extent it is caused by Force Majeure, as defined below, provided that the excuse shall not relieve the party claiming it from using reasonable efforts to overcome or remove the Force Majeure. Force Majeure means acts, events, occurrences and conditions beyond the reasonable control of the party claiming Force Majeure, but not limited to acts of God, riots, terrorists, labor disputes, sudden actions of the elements, the effect of changes in applicable laws or regulations, actions by federal, state or municipal agencies, actions of legislative, judicial, or regulatory agencies or denial, lapse or revocation of any permit, license or regulatory approval necessary in connection with operation of the LBU. A party claiming delay or failure of performance shall give prompt notice of the Force Majeure upon which it bases its claim and a description of its efforts to overcome the Force Majeure.

20. Notices. All notices to be sent under this Financial Incentive Agreement shall be in writing and shall be deemed given when deposited with the United

States Postal Service as first class mail, with postage pre-paid, or when sent by telephonic facsimile to the parties at the following addresses and phone numbers:

Oxy Long Beach, Inc.  
Mr. Fred Boepple  
P. O. Box 2900  
Long Beach, CA 90801  
Phone: 562-624-3304  
Fax: 562-624-3299

City of Long Beach  
Department of Oil Properties  
Mr. Chris Garner  
211 East Ocean Boulevard, Suite 500  
Long Beach, CA 90802  
Phone: 562-570-3947  
Fax: 562-570-2008

California State Lands Commission  
Mr. Paul Mount  
200 Oceangate, 12<sup>th</sup> Floor  
Long Beach, CA 90802  
Phone: 562-590-5205  
Fax: 562-590-5210

21. Term. This Financial Incentive Agreement shall be coextensive with the LBU Unit Agreement, Unit Operating Agreement and the Contractors' Agreement.

22. Successors and Assigns. This Financial Incentive Agreement shall be binding upon the successor and assigns of the parties.

23. Time of the Essence. Time is of the essence in the performance of the rights and obligations under this Financial Incentive Agreement.

24. Governing Law. This Financial Incentive Agreement shall be governed by and construed in accordance with the laws of the State of California.

25. Counterparts. This Financial Incentive Agreement may be executed in any number of counterparts, each of which shall be an original, but all of which shall together constitute one and the same instrument.

Dated: \_\_\_\_\_, 2005

OXY LONG BEACH, INC.

By \_\_\_\_\_  
FRANK KOMIN  
General Manager - OLBI

Dated: \_\_\_\_\_, 2005

CITY OF LONG BEACH, a municipal corporation,  
in its capacities as a municipality, as Unit  
Operator of the Long Beach Unit and as  
tidelands trustee

By \_\_\_\_\_  
GERALD R. MILLER  
City Manager

Dated: \_\_\_\_\_, 2005

STATE OF CALIFORNIA, acting through  
the California State Lands Commission

By \_\_\_\_\_  
PAUL D. THAYER  
Executive Officer

**Exhibit "A"**

SHALLOW GAS  
SLIDING SCALE ROYALTY SCHEDULE

<u>*Gas Price (\$/MMBtu)</u> <u>Greater</u> <u>Than or Equal To</u>	<u>But Less Than</u>	<u>Royalty Rate, %</u>
\$0.00	\$3.00	35.00
\$3.00	\$8.00	$[4.0 * (\text{Gas Price}) + 23.0]$
\$8.00		55.00