CITY OF LONG BEACH

Memorandum

Date: July 14, 2020

To: Thomas B. Modica, City Manager

From: Robert Dowell, Director of Energy Resources

For: Mayor and Members of the City Council

Subject: **Response on the Potential Bankruptcy by California Resources Corporation – June 16, 2020 City Council Meeting, Item NB 18**

At its June 16, 2020 meeting, the City Council requested the City Manager to report back on the impact to the City of Long Beach (City) of a potential bankruptcy filing by its oil contractor California Resources Corporation (CRC). The City Council requested information in five key areas:

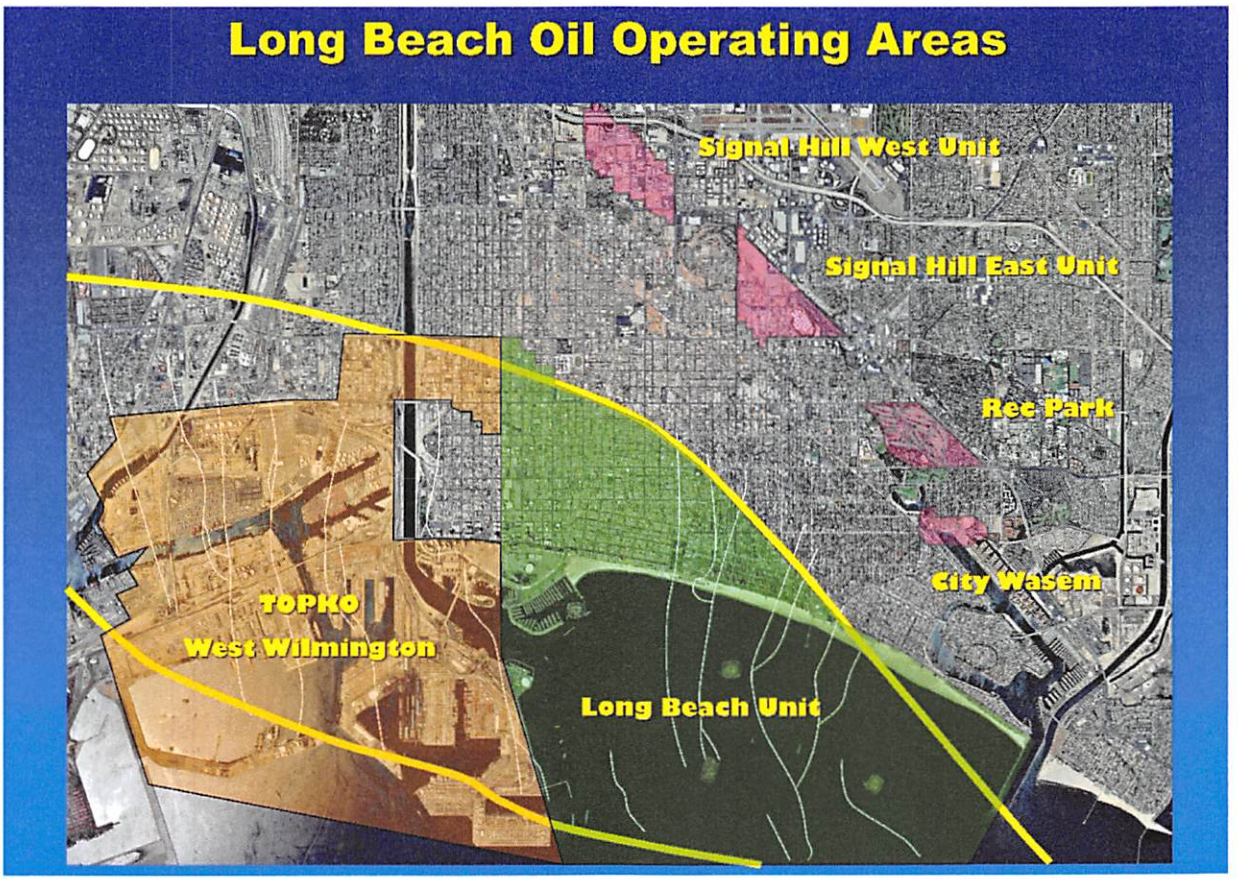
1. The City's plans to manage CRC's potential bankruptcy filing.
2. Unfunded liabilities if the field contractor dissolves and potential impacts to Tidelands and Upland funded projects and initiatives.
3. Report on oil revenues to the City's individual funds, revenues, and reserves for the last three fiscal years.
4. Inventory of public expenditures from oil revenues in the Tidelands zone and projects at risk if CRC files for bankruptcy or because of the current low oil prices.
5. Inventory of the offshore THUMS oil islands and Tidelands onshore infrastructure and facilities.

In these unprecedented times, oil prices have experienced lows not seen in over 20 years. While oil prices have recently rebounded, the volatile oil prices have placed the City's contractor, CRC, into a financial situation where their only recourse may be to declare financial bankruptcy. CRC is a publicly traded company and, thus, is prohibited from discussing this matter with the City. Regardless of the status of CRC, the City will continue to invest in operations that will protect the environment, ensure the safety of workers, ensure meeting regulatory obligations, and maintain critical infrastructure. The City will also continue to manage subsidence and monitor ground elevations.

INTRODUCTION

The City, through its Energy Resources Department (ER), manages oil and gas assets located within the Wilmington Oil Field. The majority of the Wilmington Oil Field resides in the State of California (State) Tidelands and is comprised of the Long Beach Unit (LBU) and the West Wilmington operations (Figure 1). The State granted the tidelands to the City in the early 1900s for development and the City, therefore, became the trustee for the State in the Wilmington Oil Field when it was discovered in the early 1930s.

Figure 1



ER's staff oversees oil production from the Wilmington Oil Field, which currently exceeds 9 million barrels per year, and the management of approximately 2,000 active producing and injection wells. As the operator of the Wilmington Oil Field, ER works closely with its contractor, CRC, the California State Lands Commission (SLC), the California Department of Conservation's Division of Geologic Energy Management (CalGEM), and, on occasion, the California Coastal Commission (CCC).

ER also works closely with the City's Financial Management Department to develop revenue projections from oil operations that are factored into the City's budget. The revenue projections are highly dependent on the price of oil, and, to a lesser extent, the level of activities taking place in the oil field. Other than paying staff expenses and determining how much net revenue should be reserved for future well and facility abandonment, ER does not manage how the oil revenue profit is invested throughout the City.

City's Plan to Manage CRC's Potential Bankruptcy Filing

There are many agreements, contracts and State legislative actions that determine how the Wilmington Oil Field is operated. Legislative actions designated the City as trustee for the State in the Long Beach Tidelands, established the City the responsible party to manage subsidence and determined how the State's revenues are distributed. The Unit Agreements

established the City as the Unit Operator and unitized the Wilmington Oil Field to allow for the management of subsidence. The City has a contractor's agreement with CRC for both the LBU and West Wilmington oil operations.

CRC is more than just the City's contractor; they are also a partner in operating the Wilmington Oil Field. The State and City review and approve all major investments and the THUMS operating budget is also approved each year by the public partners. The State and City are carried working interest owners, which means that CRC will carry any negative cash flow from the operations. In return, CRC is allowed a percentage of the profits from the operation of the oil field. This arrangement insulates the State and City from the financial risk and volatility of investing in oil operations.

The COVID-19 pandemic and the subsequent drop in demand for oil have led to a very volatile oil price market. In April of this year, oil prices traded below zero for the first time in history. The market price volatility has placed CRC into a financial situation where their only recourse may be to declare bankruptcy. The staff speculates that if CRC were to declare bankruptcy, it would seek relief from their debtors through a debt restructuring effort, not by liquidating the company. This would be a Chapter 11 bankruptcy where the goal would be to remain in operation while CRC restructured its debt. Other than some possible organizational restructuring, we do not anticipate any significant changes to how they currently operate for the City. It is ER's recommendation that the City continues to work with CRC and not terminate the contract if they choose to file for bankruptcy.

Unfunded Liabilities if the Field Contractor Dissolves and Potential Impacts to Tidelands and Upland Funded Projects and initiatives

Being a prudent operator of oil production involves the responsibility for abandoning wells and associated facilities no longer in use. The City and CRC adhere to CalGEM's regulations that require eliminating a percentage of long-term idle wells on an annual basis. However, CRC has a limited abandonment liability in the Wilmington Oil Field. The State and City are responsible for the majority of the abandonment expense and the cost to abandon wells each year reduces the net oil revenue that the State and City receive. CRC's abandonment liability in the Wilmington Oil Field is estimated to be $61 million. There is no contractual requirement for CRC to disclose to the City how it will fund their abandonment liability. Oil companies similar to CRC have a diverse portfolio of assets that can fund abandonments. A new State law will soon require bonding for the cost to abandon offshore oil and gas assets in California State Waters by operators such as CRC. By comparison, the State has an estimated abandonment liability of $902 million and the City an estimated abandonment liability of $141 million for the oil operations located in the Wilmington Oil Field.

The City currently has a reserve of $34.0 million in the Tidelands Fund and another $9.3 million in the Uplands Oil Fund to cover future abandonment costs. However, the City's expected future abandonment needs are far exceed the current set aside amounts with approximately $85 million in unfunded abandonment costs remaining for Tidelands operations and $13 million remaining in Uplands operations. The City has recently been funding this unfunded liability at approximately $6.0 million a year from Tidelands revenues and $1.3 million a year from

Uplands revenues. Assembly Bill 2687 proposes increasing the funding for the State's Oil Trust Fund. The Oil Trust Fund will be used by the State to exclusively pay for their share of abandonment liability in the Wilmington Oil Field. The City is a sponsor of AB 2687 and if passed will increase the Oil Trust Fund beyond the current funding of $300 million.

	Total Abandonment Liability	Current Reserve for Abandonment	Unfunded Liability
City Tidelands Operating Fund	$118,600,000	$34,000,000	$84,600,000
City Uplands Oil Fund	$22,400,000	$9,300,000	$13,100,000
State	$902,000,000	$300,000,000	$602,000,000
CRC	$61,000,000	NA	NA

Another liability is the cost of managing subsidence once the oil field has reached the end of its economic life. The City annually spends money on subsidence prevention as part of normal oil operations, which includes injecting produced water, shutting in oil wells when necessary, conducting ground elevation surveys, and measuring downhole reservoir pressures. The annual costs are absorbed as part of normal oil operations and paid by all the Unit participants. When the oil operations are shutdown at the end of field life, the City has $186 million set aside for subsidence management costs in the future. City staff believes this subsidence reserve is sufficient to prevent ground elevation loss after the oil production operations cease. CRC does not have any financial responsibility for post-production subsidence management.

As stated above, the price of oil is the dominate factor that determines the profits of the oil operations. The City does not anticipate any major change to oil revenues if CRC were to file bankruptcy. The current activity levels in the oil field will remain unchanged. Therefore, the City does not believe there will be any impacts to Tidelands and Upland funded projects and initiatives because of a CRC bankruptcy.

Oil Revenues to the City's Individual Funds, Revenues, and Reserves for the Last Three Fiscal Years

The table below summarizes the revenue generated from oil operations for the Uplands and Tidelands fund for the past three fiscal years. In FY 18 and FY 19, the price of oil averaged over $60 per barrel, which allowed for approximately $16 million to be reserved for the City's future abandonment liability.

Structural Transfers from Oil Revenue Funds

	FY 2017	FY 2018	FY 2019	FY 2020 Budgeted
General Fund (from Uplands Oil)	$8,871,570	$11,121,982	$10,623,733	$8,816,761
Tidelands (from Tidelends Oil Revenues - TORF)	$15,349,016	$17,001,595	$15,357,877	$12,613,628

In addition to the City's mineral interests, the City also receives a barrel tax for oil produced within the City limits. There are two components to the barrel tax, one portion is received in the General Fund and another part of the tax flows to a special fund designated for public

safety. The combined barrel tax has averaged about $5 million per year for the past three years. Each year the oil production declines in the City and therefore, the barrel tax revenue also decreases each year. Currently, CRC operations account for approximately 94 percent of the total tax collected.

The City has been reserving approximately $7.3 million a year for future abandonment costs however due to the current COVID-19 pandemic and low oil prices, ER is recommending not doing so in FY 20 or FY 21. This likely means higher payments to the City's abandonment reserve will be necessary in the future to make up for two years of not reserving any funds. The City is currently assuming the economic life of the Wilmington Oil Field will be reached by the mid 2030's. Actual oil market conditions could increase or decrease the economic field life estimate. If oil prices significantly increase, the economic life of the field could be extended, but it is important to note that oil production generally declines 8 to 10 percent per year, absent spikes in production caused by significant investment in new wells.

Inventory of Public Expenditures from Oil Revenue Projects and Operations Funded in the Tidelands Zone and Projects at Risk Because of the Current Lower Oil Prices

Tidelands Oil

Tidelands operations and capital projects are significantly funded from Tidelands oil revenues. The other main source of Tidelands revenue is a 5 percent gross revenue transfer from the Port of Long Beach (by Charter). At current oil price levels, the total available Tidelands revenue may or may not be enough to sustain the current level of operations in Tidelands with no or little money available for capital or one-time costs. A significant increase in oil revenues is anticipated within a few years due to the application of a revenue sharing formula that CRC agreed to several years ago. However, that anticipated increase will not last long and may be enough only to cover current Tidelands operations and minimal capital investment. Unless the situation materially changes, it would not be surprising if by the end of the decade, or sooner, Tidelands oil revenues are needed exclusively to fund abandonment costs and a shrinking level of oil operations. However, if oil prices dramatically increase, the Tidelands fund could become healthier for a period of time. Nonetheless, planning should begin for when oil revenues are not sufficient to maintain operations or provide for any significant capital investments within 10 years or less.

The Tidelands fund supports all beach operations, the Convention Center, major capital improvements along the beach (Tidelands area), and is a backstop for bonds supporting Rainbow Harbor improvements, the Aquarium and its Pacific Visions expansion, capital improvements for the Queen Mary, and parking garages located in Tidelands. Additional details on specific capital projects in the Tidelands are included in Attachment A.

Uplands Oil

Recently, Uplands oil revenues have only been used to transfer to the General Fund to support general City operations. As with Tidelands, it should be assumed these revenues to the General Fund will be decreasing in the future due to decreasing oil production levels. However, it is important to remember that less than 50 percent of Uplands oil revenue actually comes from produced oil sales. Over half is essentially a fee on oil production costs in the Tidelands.

Therefore, if there is significant investment in new wells, Uplands revenue will increase, regardless of whether oil production is enhanced. Similarly, if production costs are decreased, Uplands revenue may decrease regardless of the price of oil.

Inventory of the Offshore THUMS Oil Islands and Tidelands Onshore Infrastructure and Facilities

The LBU and West Wilmington operations own all the wells, infrastructure, and facilities located in the Wilmington Oil Field for its existing oil operations. The State, being the largest stakeholder, owns and, therefore, has the largest abandonment responsibility for the existing wells, infrastructure, and facilities. At end of field life, the City may choose to repurpose the four existing oil islands for another use by the City. If the City were to require the existing oil islands to be removed, that abandonment liability would entirely be the State's obligation at an estimated cost of over $400 million.

CRC owns none of the equipment, infrastructure, or facilities currently utilized to operate the oil field. If CRC were to terminate the existing contractor's agreement with the City, the City would rebid the contract and the new contractor would utilize the existing equipment for continued oil operations. Attachment B provides a high-level overview of the current THUMS Oil Islands and Tidelands Onshore infrastructure and facilities.

Summary

As of the date of this memorandum, CRC has not declared bankruptcy. ER expects new information on this matter will be announced shortly. It is predicted the bankruptcy will have minimal impact to oil operations and no impact on the City's oil revenues. ER anticipates the Wilmington Oil Field has future economic potential for many years to come. It is unfortunate that its contractor, CRC, is struggling with debt obligations caused by the recent volatile oil price market. However, ER is confident the City and its partners will successfully navigate the turbulent oil price environment and continue to operate its existing world class oil and gas operations. ER and CRC remain fully committed to continuing to protect the City's environmental landscape and ensuring no adverse conditions arise.

If you have any questions, please contact me at (562) 570-2001.

ATTACHMENTS

cc: CHARLES PARKIN, CITY ATTORNEY
DOUGLAS P. HAUBERT, CITY PROSECUTOR
LAURA L. DOUD, CITY AUDITOR
LINDA F. TATUM, ASSISTANT CITY MANAGER
KEVIN JACKSON, DEPUTY CITY MANAGER
TERESA CHANDLER, DEPUTY CITY MANAGER
REBECCA G. GARNER, ADMINISTRATIVE DEPUTY CITY MANAGER
MONIQUE DE LA GARZA, CITY CLERK (REF. FILE #20-0570)
DEPARTMENT HEADS

TIDELANDS CAPITAL IMPROVEMENTS

On June 16, 2015 the City Council received a report on the Tidelands Capital Budget and approved a 5-Year Tidelands Capital Plan (Plan) and prioritization of projects. The Plan was necessary at the time because of a decline in oil revenue, which serves as the primary source for funding capital improvements within the City's Tidelands area. The Plan prioritized a total 35 projects, of which 24 are fully completed, and an additional 6 will be completed in the current fiscal year (2020). Of the remaining 5 projects, 3 are ongoing including the Belmont Pool, East San Pedro Bay Ecosystem Restoration, and the Junior Lifeguard Facility Rebuild, while the other 2 projects have been postponed for different reasons. The prioritization criteria was reviewed by the City Council and included, among others: maintaining/improving public health and safety, high number of users impacted, urgency, poor condition/high need, and quality of life.

Prioritized projects completed to date include: Ocean Blvd. Bluff Erosion and Enhancement Phase 2, Colorado Lagoon Dredging and Restoration Phase 1, Seaside Way Pedestrian Bridge, Rainbow Harbor Commercial Sewer Pump-out System Replacement, Beach Maintenance Yard Clarifier System, Marina Vista Park Restroom, Bayshore Lifeguard Facility Rebuild, 11th Place Beach Stairway, Leeway Sailing Center Pier, Gangway, and Deck House Replacement, Parking Lot Improvements at Granada and Leeway Sailing Center, Concessions Stand Improvements at Bayshore, and renovation of the Marine Stadium Judging Stand. Prioritized Tidelands projects currently in construction include: Beach Playgrounds and Concessions Stand Improvements at Junipero and Granada, Naples Seawalls Phase 2, and the Alamitos Beach Concessions Stand Rebuild, Playground and New Beach Restrooms.

The June 2015 Plan also included a list of additional projects totaling over $137 million, which includes the Belmont Pool, Naples Seawalls Phase 3, Lifeguard Headquarters Facility Rehabilitation, Rainbow Lagoon Improvements, various public restrooms, Leeway Sailing Center Facility Rebuild, Belmont Pier Rebuild, new Lifeguard Towers, Rainbow Lagoon Rebuild, and additional beach parking lot improvements. These projects remain unfunded or in additional need of significant funding.

On February 6, 2018, the City Council identified the following "8 by 28" projects and requested that staff prioritize and brand these projects as Olympic priority developments for future funding opportunities:

- Belmont/Veterans Pier Rebuild (Funding Needed: $25-$35 million)
- Belmont Pool (Funding Needed: $25 million)
- Lifeguard Towers (Funding Needed: $1.5 million)
- Beach Concession Stands (Completed in FY 2020)
- Arena Improvements (Funding Needed: $24 million)
- Convention Center Hotel (Private Project)
- Airport Improvements (Funded)
- Blue Line Improvements (Completed in FY 2020)

Of these, the Beach Concessions Stands are currently in construction and expected to be completed this fiscal year. The Blue Line Improvements were completed earlier this fiscal year, and Belmont Pool is pending final review and approval by the Coastal Commission. The Belmont Pier Visioning and Planning process also started this year and will culminate in the release of the project's schematic design and cost estimate.

Attachment B

THUMS Oil Islands and Tidelands Onshore infrastructure and Facilities

Major equipment is listed below. Total count of all assets is approximately 1 million.

- Over 2,500 production and injection wells
- 36 vehicles
- 2 crew boats
- 2 barges
- 4 oil islands
- 2 drilling rigs
- 10 field offices
- 7 diesel powered engines
- 8 gasoline powered engines
- 3 natural gas-powered engines
- 69 heat exchangers
- 4 flares
- 7 emergency generators
- 4 lease custody transfer stations
- 67 flow meters
- 690 motors to power various equipment in the processing facilities
- Subsea pipelines and numerous pipelines throughout the operations
- 11 uninterruptible power units
- 1 - 40 megawatt powerplant
- 1 - Gas compression and refrigeration plant
- 665 pumps
- 255 tanks of various capacity
- 67 power transformers
- 24 emergency shut down valves
- 623 Vessels of various capacity
- 177 Compressors (air, vapor recovery, etc.)
- 2 Water fall systems
- 1000's of palm trees and other drought resistant landscaping