BAKER & O'BRIEN
INCORPORATED
12001 N. CENTRAL EXPRESSWAY, SUITE 1200
DALLAS, TEXAS 75243
214/368-7626

DONALD L. FLESSNER don.flessner@bakerobrien.com

June 8, 2021

To: Ms. Heather S. Baker
Assistant City Attorney
City of Culver City
9770 Culver Boulevard
Culver City, CA 90230-0507

Subject: **Response to Technical Comments to the *Capital Investment Amortization Study for the City of Culver City Portion of the Inglewood Oil Field***

Baker & O'Brien, Inc., ("Baker & O'Brien") prepared its *Capital Investment Amortization ACI Study for the City of Culver City Portion of the Inglewood Oil Field* (the "ACI Study"), dated May 29, 2020, on behalf of the City of Culver City (the "City"). Baker & O'Brien presented the ACI Study at two public meetings, which included the Oil Drilling Subcommittee Community Meeting held June 4, 2020, and the City Council Special Meeting held August 13, 2020.

During these public meetings, Baker & O'Brien consultants responded to questions from members of the City Council and the public. In addition to receiving more than 100 oral and written comments during the two public meetings, the City received two comment letters that specifically address the technical merits of the ACI Study. The purpose of this Memorandum is to respond to these written technical comments in order to clarify the analysis and conclusions presented in the ACI Study. In summary, none of the written comments provide evidence or raise issues that change the conclusions of the ACI Study, which remain valid and relevant.

Written comment letters were received from The Termo Company ("Termo") and Sentinel Peak Resources California LLC ("SPR"), and are on file with the City. Termo's

written comments were provided in a letter dated August 11, 2020, and are referred to in this Memorandum as the "Termo Comments". Termo is an independent oil and gas exploration and production company located in Long Beach, California. SPR's written comments were provided through its legal representative, Alston & Bird LLP, in a letter and a consultant report dated August 13, 2020, which are referred to in this Memorandum as the "SPR Comments". SPR is the operator of the Inglewood Oil Field and it retained Mr. Robert Lang to prepare its comments, who is a managing director of Alvarez & Marsal that purports to be knowledgeable in financial matters related to the oil and gas industry.

Baker & O'Brien has prepared this Memorandum for the sole benefit of the City. Any reproduction, distribution, or use of this information for other purposes requires Baker & O'Brien's written consent. Baker & O'Brien expressly disclaims all liability for the use, reproduction, or disclosure of this information to, or distribution by, any third party. This Memorandum is subject to the same Legal Notice that is presented at page 1 of the ACI Study. In addition, this Memorandum uses various terms and abbreviations for which definitions are provided in Exhibit A of the ACI Study.

INTRODUCTION

The ACI Study notes that the Inglewood Oil Field ("IOF") was developed and operated through multiple owners over a period of nearly 100 years. The 78-acre City portion of the IOF (the "City IOF") is operated together with the other facilities in the IOF, contains less than 10% of producing wells in the IOF, and produce less than 5% of the crude oil produced from the IOF. SPR has reported that it has drilled no new producing wells in the IOF since it became the operator in 2017. In the City IOF, only six production wells were drilled between 1977 and 2002 and no new wells have been drilled in nearly 20 years.

The income analysis presented in the ACI Study offsets capital investment with receipt of income to determine the time required for amortization of capital investment. In other words, income produced by a property is accumulated until it exceeds the original capital investment and a rate of return on investment, at which time ACI is achieved. The ACI Study evaluated two capital investment scenarios. The first

scenario evaluates amortization of the initial or original capital investment in wells located in the City IOF. The second scenario substitutes SPR's acquisition cost for the City IOF for original capital investment in drilling wells in the analysis.

The ACI Study evaluates amortization of original capital investment to drill and complete wells in the City IOF in two ways. For wells drilled since 1977, the income analysis is based upon historical information about capital investment and well performance, which results in a time to achieve ACI of less than five years. For wells drilled prior to 1977, the ACI Study determines aggregate production economics for wells drilled in different periods, which are compared to the same economic factors for the six wells completed since 1977. In both cases, production economics based upon original investment achieve ACI within five years of the original capital investment. These results are consistent with payback periods of three to five years that have been reported for various oil and gas developments.

The ACI Study also develops a secondary income analysis for comparison purposes that evaluates SPR's investment to acquire the City IOF in 2017. The City IOF is a small portion of the IOF, and a much smaller portion of the portfolio of California properties that SPR purchased in 2017. For this purpose, it was necessary to determine a fair market value for SPR's acquisition of the City IOF using standard indications of value as a proxy for original capital investment. Revenues and costs were projected for 10 years from 2017 based upon public records and information available at the time of the acquisition. The time to achieve ACI occurred within four years of SPR's acquisition of the City IOF.

The ACI Study relies mainly upon public information to determine capital investment, revenues, and operating costs. Key public information includes historical data for production of oil, gas, and water from individual wells in the City IOF that were reported by various operators of the IOF and available through the California Geological Energy Management ("CalGEM") portal. These historical data were also used to develop reasonable projections of production rates for individual wells in the City IOF. Although SPR comments that the ACI Study should rely on its proprietary data, SPR provided no proprietary information about the City IOF for use in the ACI Study in

response to the City's detailed data request. However, sufficient historical data is available about the wells in the IOF so that SPR's proprietary information was not necessary to complete the ACI Study. If SPR records were available that extended prior to its ownership, this information would have been used to validate the historical information that was already available and to supplement historical data prior to 1977, to the extent possible.

The ACI Study tested the sensitivity of its conclusions to key assumptions used in the income model. The sensitivity analysis was used to test the extent to which changes to certain factors would impact the time to achieve ACI, including SPR's acquisition cost, crude oil prices, and return on capital. The sensitivity analysis demonstrated that reasonable changes in these factors had little or no impact on the conclusions. In general, the data and assumptions used in the income analysis result in conservative conclusions regarding the time to achieve ACI. In other words, the income analysis generally calculates a longer time to achieve ACI than would be expected if actual records of expenditures and income were available.

The Termo Comments address two technical issues: 1) the relevance of other operators' production costs to operation of the IOF; and 2) the crude oil prices used to calculate revenues. The SPR Comments address a wide range of technical issues, as well as issues that are outside the scope of the ACI Study. None of the written comments provides evidence that any factors used in the ACI Study are incorrect or unreasonable. The technical comments are considered below as they relate to: 1) the income model; 2) analysis of original capital investment; and 3) analysis of the SPR acquisition.

INCOME MODEL

METHODOLOGY

In determining the time to achieve ACI, historical or projected cash flows can be used, depending upon the timing of the capital investment. SPR comments: "*A calculation of ACI first establishes the amount of capital investment as of a certain date and then projects cash flows forward from that date*." See SPR Comment Attachment

B, ¶16. However, SPR's comment that cash flows were projected is incorrect when ACI is evaluated for historical capital investments and income streams. For example, the ACI Study determines the time to achieve ACI for capital investments between 1977 and 2017 using historical capital investment, historical production rates, and historical commodity prices.

The income model prepares an annual cash flow analysis that calculates revenues and operating expenses based upon historical production volumes of oil, natural gas, and water. Oil and gas production volumes after 2017 are projected based upon trends in historical production rates. In order to produce income from an oil field, oil and gas must be extracted from the reservoir, separated from water, treated to market quality, and sold to customers. SPR comments that other factors should be considered in the income analysis, including the "diminishing asset doctrine," financial derivatives that SPR acquired with its California portfolio, and allocation of maintenance capital and other costs from the IOF to the City IOF. See SPR Comment Att. B, ¶53. However, these factors are: 1) not relevant to the income produced by the City IOF; nor 2) could they be considered without SPR's comprehensive records. SPR's comment suggests that it does not understand the basic mechanics of the income analysis, while it continues to withhold information about its financial derivatives and operating costs that it claims are relevant to the ACI Study.

PRODUCTION AND REVENUES

The income model determines revenues from historical and projected volumes of crude oil and natural gas produced by individual wells located in the City IOF. These production volumes are multiplied by the netback prices received at the IOF for crude oil and natural gas to calculate revenues from the City IOF.

In preparing the ACI Study, Baker & O'Brien reviewed the City IOF production history as represented by CalGEM and SPR's public drilling plans that it submitted to the Baldwin Hills Community Standards District ("CSD"). Information from these records informed the income analysis with regards to historical and projected oil and gas production from the City IOF. SPR comments that "*…reserve reports and expected drilling plans…*" should have been considered "*…to estimate production from future*

wells." See SPR Comment Att. B, ¶54. However, SPR's annual submissions to the CSD reveal: 1) SPR does not plan to drill new wells in the IOF; 2) SPR has drilled no new wells in the IOF since 2017; and 3) the most recent well drilled in the IOF was completed in 2014. Based upon the drilling plans reviewed to date, SPR's suggestion that there is a plan to develop the City IOF to increase oil and gas production is not credible, since: 1) no production wells have been drilled in the City IOF since 2002; 2) SPR has shared no development plan with the City since its 2017 acquisition; and 3) the wells in the City IOF produce little oil and natural gas but produce large amounts of water.

Independent reviews of IOF reserves do not support significant prospective oil and gas development in the IOF. SPR comments: "*With technological advances in the oil and gas industry, engineers estimate that as much as 50% of the field's oil resources remain in place in producing zones and can be readily accessed through drilling and production activities. [Footnote omitted] Considering there is possibly 400 million barrels of oil still in the ground, which would include reserves within the City IOF, SPR would certainly consider drilling new wells and/or work over current wells to continue production in the City IOF*." See SPR Comment Att. B, ¶30. SPR references its own website for this information and suggests that it has reserve reports and drilling plans that project a bright outlook for development of the IOF. This outlook is much different than the drilling plans that SPR has actually presented and made publicly available to the CSD. Baker & O'Brien would have considered SPR's internal drilling plans and the potential impact on the ACI Study had this information been provided. However, SPR's estimate of 400 million barrels of reserves also differs markedly from a report prepared in late 2018 that estimates 13 million barrels of recoverable oil from the IOF. See *Recoverable Petroleum Beneath the City of Los Angeles*, Donald L. Gautier Ph.D., December 3, 2018. The Gautier report estimates original oil in place in the IOF of less than 200 million barrels (half of what SPR claims to remain in place) with low recovery efficiencies of about 2%, around one-tenth of the average recovery efficiency for other oil fields in the Los Angeles basin and much less than optimal recoveries of 30% to 60%. The Gautier assessment also indicates that recoverable oil from the IOF is less than 1% of the total amount of 1,628 million barrels of oil estimated to be recoverable

from various fields located in the Los Angeles basin. Based upon this public information and SPR's actual development activity in the IOF to date, its assertion that it would "*certainly consider drilling new wells*" in the City IOF is not credible.

The income model relies on historical production volumes of oil and gas through 2017 and projections of volumes after 2017 that are based on historical volumes. SPR comments that: "…*the [ACI Study] underestimates expected future production volumes (and capital expenditures) which severely underestimated the time that SPR could achieve ACI…*" See SPR Comment Att. B, ¶54. SPR provides no evidence of its project economics that would indicate the time required to achieve ACI for future capital investment. In addition, SPR provides no evidence to support its comment that the time to achieve ACI is underestimated. First, SPR presents no evidence that the historical information available from CalGEM is incorrect. Second, SPR provides no evidence that oil and gas production rates are overestimated. Third, SPR provides no evidence that capital investment required to sustain production rates is underestimated. Fourth, SPR proposes that the ACI Study should include speculative capital investment for new wells that are not planned or permitted. Fifth, SPR proposes that the ACI Study should consider potential revenues from wells that have not been drilled. SPR's comment misrepresents the purposes of the ACI Study, which is intended to consider amortization of original capital investment in the City IOF. The ACI Study is not intended to consider amortization of speculative new investment or production of oil and natural gas that could potentially result from new investment.

The income model prices Inglewood crude oil competitively with other crudes available to Los Angeles area refineries, including adjustments for quality and transportation costs. The income model values Inglewood crude oil based upon the benchmark market price of Line 63 crude oil delivered to Los Angeles, with discounts of around $1.75/B for quality and $0.25/B for transportation costs. Termo and SPR challenge the values for Inglewood crude oil used in the ACI Study, but neither provides evidence that: 1) Inglewood crude is not priced in competition with Line 63 crude; 2) that the quality adjustment is unreasonable; or 3) that the transportation cost adjustment is unreasonable. SPR makes reference to prices for Brent crude oil between 2017 and

2019. See SPR Comment Att. B, ¶55. Brent prices are generally useful to benchmark prices for crudes that are imported into California. However, Inglewood crude does not generally trade at prices competitive with Brent crude or other crudes imported by Los Angeles area refineries and SPR presents no evidence that this is the case.

The income model prices Inglewood natural gas at the Southern California Natural Gas Co. City Gate price. For projected natural gas prices, the ACI Study uses a U.S. Department of Energy forecast for Henry Hub natural gas, which is localized to Southern California. Termo and SPR appear to accept this market price relationship for Inglewood natural gas.

OPERATING COSTS

The income model deducts operating costs from revenues in order to calculate operating income. The income model includes operating costs directly related to operation of wells in the City IOF, including costs for operation, maintenance, and workovers. The income model calculates operating costs based upon operations conducted in the City IOF and uses costs that are significantly higher than costs reported by other California operators.

The income model calculates operating costs by multiplying production rates of oil, natural gas, and water for each individual well by the operating cost per barrel of crude oil, per oil equivalent barrel of natural gas, and per barrel of water. These operating costs include costs to separate well fluids into oil, gas, and water, as well as to treat crude oil and natural gas to market quality. Termo comments that a mistaken assumption is the "*…application of another, larger operator's (CRC) production costs as a proxy for the cost per barrel of production in the Inglewood Oil Field*." See Termo Comments. SPR comments that: "*[Baker & O'Brien] has underestimated operating costs [because]…it used operating cost information related to fields owned by CRC…*" See SPR Comment Att. B, ¶63. However, neither Termo or SPR provide any evidence of actual operating costs for the IOF or any evidence that the operating costs used in the ACI Study are incorrect or unreasonable.

In any case, Termo's and SPR's comments that CRC operating costs are applied

to the IOF in the ACI Study are simply incorrect. The operating costs used in the income model are based upon independent assessments of costs to produce crude oil, natural gas, and water from wells using waterflood operations. These operating costs were validated for California operations by comparison to costs reported by CRC for similar waterflood operations. The operating costs used in the income model are about 25% higher than operating costs reported by CRC and are sufficiently above costs reported by CRC to adjust for the location and the type of oil field operations conducted at the IOF. These conservative operating costs generally result in a longer time to achieve ACI than would be expected if SPR's actual operating costs were used in the income model.

SPR raises two further issues with respect to the operating costs used in the ACI Study. First: "*…the majority of CRC fields are not in heavily urbanized metro areas like the IOF meaning costs associated with development of the fields are lower due to the lack of having to work around existing city infrastructure*." See SPR Comment Att. B, ¶63. SPR's focus on field development is misplaced since the IOF already exists and there are limitations on any future development that are imposed by the CSD and the City. In any case, development costs are not operating costs and should not be considered in the income model. Second, SPR speculates that "*…the CRC fields may have access to an aquifer that supplies the necessary pressure rather than having to inject water to provide the necessary pressure, decreasing costs*." See SPR Comment Att. B, ¶63. The technical basis for SPR's comment is not clear since most oil and gas operations are designed to segregate aquifers from oil and gas operations in order to prevent contamination of the aquifer. However, SPR misses the point that both CRC and IOF must dispose of large quantities of water produced with crude oil and natural gas by reinjecting the water into the respective reservoirs, which represents a significant operating cost to both operators.

The income model deducts income taxes from revenues produced from the City IOF based on the highest marginal federal and California corporate income tax rates. SPR comments: "*…as a limited liability company…SPR does not realize corporate tax rates. [Limited liability companies] are pass through entities where the profits and losses*

are passed on to the owners and these amounts are then taxed on the individuals." See SPR Comment Att. B, ¶66. However, SPR presents no evidence of income tax rates paid by its general or limited partners and has not identified these partners. What is known through public records and presented in the ACI Study is that SPR, with headquarters in Colorado, is owned by Quantum Energy Partners ("QEP"), a private equity investor located in Texas. With respect to federal income taxes, income realized by SPR would be passed to QEP, which lists 30 companies in its portfolio and has its own tax obligations before it performs distributions to investors. Details of SPR's or QEP's income tax situation, or that of other companies in QEP's portfolio are not publicly available and would not be considered as a basis for deducting taxes on income produced by the IOF.

The income model uses marginal federal and state income tax rates for California corporations for the following reasons: First, there is no public information that identifies investors in QEP, whether its investors are located in California, or whether its investors are subject to personal income tax rates. Second, the deduction of state and federal income taxes in the income model is conservative since private equity owners often have more favorable income tax treatment than corporations. Third, the intent of the ACI Study is to provide a reasonable estimate of the operator's tax situation, not that of its investors. SPR admits that its tax situation as a pass-through entity is more advantageous than if it were a California corporation because it does not pay corporate income taxes. Therefore, the deduction of federal and California income taxes in the income model results in a conservative assessment of the time to achieve ACI. SPR also refers to personal income tax rates in the state of California that exceed corporate tax rates. See SPR Comment Att. B, ¶66. However, SPR presents no information about where its investors are domiciled or where QEP investors are domiciled to support its assertion that California personal income tax rates should be used in the income model. SPR also fails to note that QEP is organized in Texas, which has no personal income tax. Although Baker & O'Brien considers the deduction for income taxes in the income model to be conservative, we would have considered SPR's actual tax obligations and the impact on the time to achieve ACI if its records had been made available.

The ACI Study does not consider allocation of maintenance capital or general and administrative costs from the IOF to the City IOF. SPR correctly comments: "*…[Baker & O'Brien] makes no consideration for maintenance capital required to sustain facilities and offices that support the City IOF… or…general and administrative costs relating to the operation…*" See SPR Comment Att. B, ¶62 and ¶65. However, it would not be appropriate to deduct indirect costs for the IOF from City IOF revenues in the income model. First, the income model already includes sustaining capital expenditures directly related to workovers of producing wells in the City IOF. Second, SPR overhead costs are unlikely to be reduced if the wells in the City IOF were shut-in and the remaining wells in the IOF continue to operate. In other words, SPR's overhead costs and sustaining capital expenditures for facilities and buildings outside of the City IOF would still be required to support production of crude oil and natural gas from the IOF.

RATE OF RETURN

The ACI Study evaluates the time to achieve ACI as the time at which the internal rate of return produced by after-tax cash flows equals or exceeds a rate of return on capital investment. SPR comments that "*…the time to ACI is significantly affected by the selection of the discount rate*." See SPR Comment Att. B, ¶67. SPR's comment is incorrect since the ACI Study demonstrates little or no sensitivity of the time to achieve ACI within a reasonable range of returns on capital investment.

The ACI Study uses a weighted average cost of capital ("WACC") for the oil and gas industry to represent a reasonable rate of return for capital investment in the City IOF. SPR provides "*…a non-exhaustive list of project specific risk factors that would require upward adjustments to the discount rate…*" See SPR Comment Att. B, ¶69. However, SPR confuses the WACC with a discount rate for a project and presents no evidence that the market risks associated with the IOF are different than indicated by an industry WACC. In addition, SPR's proposal to include "*project specific risk factors*" in the discount rate misrepresents how these risks are accounted for in the income model. In accordance with financial theory, the income model distinguishes between two general types of risks: 1) market risks are reflected in the WACC and 2) risks specific to

the City IOF are reflected in cash flows. The WACC provides for returns on equity that compensate investors for market risks. The income model accounts for risks specific to the City IOF in the cash flow analysis, including risks related to production rates, commodity prices, and operating costs. For these reasons, the ACI Study does not apply inappropriate project-specific risk adjustments to the WACC. Setting aside the inapplicable adjustments proffered by SPR, the WACC is a reasonable rate of return to use in the ACI Study because it accounts for industry market risks. In any case, the sensitivity analysis confirms that the time to achieve ACI is not sensitive to reasonable changes in the rate of return.

Risks related specifically to the City IOF are accounted for in the cash flows developed in the income model and no further adjustment is warranted. As one example, SPR lists regulatory risk as a risk specific to the City IOF. See SPR Comment Att. B, ¶69. The industry WACC compensates investors for regulatory risks that are generally applicable to oil and gas companies, including those with operations in California. The income model makes no adjustment to cash flows for regulatory risks specific to the City IOF because no material regulatory risk was identified. In another example, SPR cites political risks unique to California as a project-specific risk, including the City's purpose for the ACI Study. See SPR Comment Att. B, ¶69. However, the ACI Study does not adjust the cash flow for SPR's continuing use of the City IOF for oil field operations because SPR and its predecessors were aware of all restricted uses when the property was acquired, including the status of nonconforming oil uses in the City IOF. In fact, the ACI Study assumes that oil field operations in the City IOF will continue without further development for 10 years after SPR's acquisition. In a third example, SPR lists a project-specific risk of "*Environmental related costs associated with running complex water flood wells*." See SPR Comment Att. B, ¶69. While it is true that water-flood operations have specific risks, the ACI Study accounts for these risks in its estimates of operating costs, which are in excess of CRC's reported operating costs for waterflood wells. In one more example, SPR comments that "*…private equity owned companies generally require a rate of return in excess of 20% to reflect the risk inherent in their investments*." See SPR Comment Att. B, ¶69. While SPR provides no evidence that this is the case, its assertion is incorrect. There is

extensive public information, which demonstrates that pass-through oil and gas entities, including LLCs and MLPs, generally have lower WACCs than corporations. By using a corporate WACC instead of a WACC for pass-through entities, the ACI Study is conservative in evaluating the time to achieve ACI.

ORIGINAL INVESTMENT ANALYSIS

In the Original Investment scenario, the ACI Study determines the time to achieve ACI for the original capital investment to drill and complete wells located in the City IOF that were drilled between 1925 and 2002 and were in operation or available to operate as of 2017. SPR refers to this scenario as the "*All Owners ACI Model*" and asserts that it determines "*…how long it would take the various oil and gas operators that drilled and completed wells within the City IOF since 1977 to achieve ACI*." See SPR Comment Att. B, ¶19. SPR also comments: "*[This] approach utilizes historical transaction data relating to all owners dating back to 1977 and attempts to estimate time to ACI related to those historical capital investments*." See SPR Comment Att. B, ¶17. However, SPR's characterization of the original investment analysis is incorrect. The ACI Study simply determines the time to achieve ACI by offsetting capital investment for the drilling and completion of the wells located within the City IOF with income. The ACI Study does not consider historical ownership interests, it does not use "transaction data" as original costs, and it extends the analysis well before 1977 to the original field development. Transactional data is irrelevant because the income model only considers capital investment and offsetting income from operating oil and gas wells to determine the time to achieve ACI.

The ACI Study considers wells drilled after 1977 differently than wells drilled before 1977. For the six production wells that were drilled after 1977, historical production data is available to develop the cash flow analysis beginning with completion of each of the wells. SPR mischaracterizes the ACI Study as concluding that: "*…the string of investors drilling and completing wells since 1977 achieved ACI 'well before 2016.*'" See SPR Comment Att. B, ¶20. In fact, the ACI Study determines the time to achieve ACI for each of the individual wells and for all of these wells together, without regard to ownership or investors. Based on this analysis, the ACI Study concludes that

four of the six wells achieved ACI within three years, while two other wells achieved returns of 5.0% and 6.5% by 2016. This analysis demonstrated that wells vary in performance, but achieved ACI within five years when considered together.

For wells drilled prior to 1977, historical production data are generally incomplete or unavailable. However, the ACI Study determines reasonable estimates of initial production rates from wells drilled in the City IOF by using a common petroleum engineering method that develops "type curves" from actual production rates for wells drilled in the City IOF after 1977. A type curve represents the typical production profile for an oil well drilled in a reservoir from the beginning of production and for more than ten years of operation. The type curve typically demonstrates high initial production rates, which decline over the first few years to a long-term trend. See *CRC: Value Driven* corporate presentation, November 2018, p. 53. The ACI Study developed a type curve characteristic of the City IOF using historical data for production wells drilled in the City IOF between 1977 and 2017.

To determine initial production rates for individual wells drilled in the City IOF between 1925 and 1977, the long-term trend for the City IOF type curve was matched to the historical production rates available from CalGEM. SPR comments: "*[Baker & O'Brien] still made broad brushed assumptions for wells drilled from 1925-1976 based on only 6 wells drilled from 1977 to 2002*." See SPR Comment Att. B, ¶73. Although SPR should be familiar with reservoir analysis using type curves in managing its field developments, it appears to misunderstand the application of this analysis in the ACI Study. First, the City IOF type curve specifically represents the typical performance of new wells drilled in the City IOF and no "broad brushed" assumptions were used. Second, the City IOF type curve is reliable because it uses actual production data for wells drilled in the City IOF between 1977 and 2002. Third, the City IOF type curve is baselined to match the actual long-term production rates of each well that is available after 1977. Fourth, production estimates from the City IOF type curve are conservative since reservoirs typically have higher production rates during early years of field development than in later years of in-fill drilling. In other words, wells drilled in the IOF during the 1920s and 1930s had much higher initial production rates than wells drilled in

the 1970s or later. For these reasons, the production rates used in the ACI Study for wells drilled prior to 1977 are reasonable and conservative.

For wells drilled prior to 1977, the ACI Study does not determine the time to achieve ACI, but compares production economics, including the internal rate of return, the ratio of oil price to total expense, and the simple payback period, to that of wells drilled after 1977. SPR comments: "*[Baker & O'Brien] has performed some various analytics to try and support their apparent conclusion that all wells, in the aggregate, have achieved ACI by 1976, but there are too many data inputs with very little support to reasonably conclude that this occurred*." SPR also refers to "*…two world wars, increase in number of light vehicles, changes in technology, changes in environmental laws, oil embargos, etc*." See SPR Comment Att. B, ¶75. SPR's comment is incorrect and mischaracterizes the conclusions of the ACI Study. SPR is incorrect that there are "*too many data inputs…to reasonably conclude that this occurred*." There are four relevant data inputs in the ACI Study: production rates beginning with well completion; oil prices; operating costs; and capital investment. The other factors have been considered but do not represent assumptions used in the income model to determine cash flow. First, production rates in the income model are characteristic of the City IOF and are based on the type curve analysis, which SPR incorrectly characterizes as "broad brushed". Second, historical oil prices are available since 1950, and oil prices moved within a narrow range between 1925 and 1970. Third, operating costs are estimated based upon production rates for individual wells. Fourth, capital investment in drilling and completion of wells is estimated for each well at the time it was drilled. The income model uses conservative estimates for each of these four data inputs to determine production economics for wells drilled in the City IOF between 1925 and 1977. SPR has provided no records or other evidence that the production rates, oil prices, operating costs, or original capital investment in wells drilled prior to 1977 are incorrect or unreasonable. The ACI Study concludes that production economics for wells drilled before 1977 are similar to those drilled between 1977 and 2002. This comparison confirms that the original investment in all of the wells in the City IOF achieved ACI prior to 2016.

The ACI Study aggregates capital investment and income for wells drilled in separate periods to determine production economics and the typical time to achieve ACI. SPR comments: "*While aggregating may give one the answer they are looking for, trying to use this data to apply it to other wells drilled in the previous 50 years is inappropriate and speculative*." See SPR Comment Att. B, ¶75. SPR is incorrect that aggregating capital investment and income was done to get "*the answer they are looking for*" or that this approach is either inappropriate or speculative. The ACI Study evaluates individual wells in the City IOF and demonstrates fundamental facts about the performance of oil wells in the City IOF that are true of any oil field: 1) some wells perform better than others; 2) productive wells generate high returns and achieve ACI quickly; and 3) unproductive wells produce lower returns. Aggregating capital investment and income within certain periods is appropriate to normalize these factors, since basing a determination of time to achieve ACI on the best wells or the worst wells would be an inappropriate measure of the overall field. The use of the City IOF type curve to estimate initial production rates for wells drilled before 1977 applies an average performance trend to individual wells. Since this analysis begins with average well performance, it is appropriate to aggregate capital investment and income within certain periods to determine average production economics for wells drilled in the City IOF. SPR's comment mischaracterizes the analysis of original investment, and SPR presents no records or analysis to dispute the accuracy or reasonableness of the income model in determining the time to achieve ACI for original investment.

SPR ACQUISITION ANALYSIS

In the SPR Acquisition scenario, the ACI Study determines the time to achieve ACI for SPR's acquisition of the City IOF in 2017. This analysis of SPR's recent acquisition is evaluated as a secondary scenario for comparison purposes and uses the acquisition price as a proxy for original capital investment. It is important to note that the acquisition price is not the same as an original capital investment, since an acquisition price often includes consideration for value that is not directly related to income, including intangible value, permits, potential for development, market access, and other factors. SPR's acquisition cost for the City IOF is a further complicated because the City IOF was a small portion of the IOF, which itself was a portion of the

much larger portfolio of California properties that SPR acquired in 2017. While SPR has not provided the terms of its acquisition, its comments suggest that it paid for facilities, cashflow, undeveloped reserves, financial derivatives, and other assets when it purchased its portfolio of California properties. However, only original capital investment and cashflow are relevant to ACI, and it is inappropriate to consider other factors in this scenario that are speculative or do not directly impact capital investment or income from the City IOF.

The ACI Study uses the fair market value of the City IOF at the time of SPR's acquisition as a proxy for SPR's original cost. Since there is no public allocation of SPR's acquisition price to the City IOF, the ACI Study determined a fair market value by considering the three standard indications of value: 1) income; 2) cost; and 3) market transactions. The income indication of value evaluates the present value of income from the City IOF, taking into account the market value of production, the costs of water flood operations, sustaining capital investment, and a return on capital. The cost indication of value evaluates the present value of physical assets in the City IOF, taking into account the age and condition of the wells in the City IOF and the remaining economic life of these wells with routine maintenance. The market indication of value evaluates what buyers would likely pay for the City IOF, taking into account the sales price paid by SPR for its portfolio of California properties. This analysis considers the outlook for the oil and gas industry at the time of SPR's announced acquisition in late 2016, which predated the onset of the COVID pandemic in 2020 by more than three years.

After evaluating each of the indications of value, the ACI Study weights them to determine a conclusion of value. SPR challenges the weighting used in the ACI Study: "*Typically in fair market valuation calculations, one will choose one method over another…just averaging the three methods to determine the value is inappropriate and unusual*." See SPR Comment Att. B, ¶51. However, SPR's comment is incorrect. Under California appraisal standards, it is appropriate to use those indications of value that inform the market value of the City IOF. The ACI Study considers all three indications of value and finds that no indication of value is superior to the others. For purposes of determining a proxy for original capital investment, the income indication of

value explicitly accounts for risks specific to the City IOF, while the cost indication of value represents the value of the remaining useful life of the aging wells and ancillary equipment in the City IOF. The market indication of value is less indicative of original capital investment since this indication includes the value of developed reserves in various producing oil fields, the potential for new development in these fields, and other intangible value. The ACI Study concludes that equal weighting of all three indications of value is appropriate in determining a proxy for SPR's original cost. The sensitivity analysis demonstrates that the time to achieve ACI would increase by one year within a reasonable range of fair market value.

With respect to the income indication of value for the SPR acquisition, the ACI Study utilizes a 10-year cash flow from the time of the acquisition. SPR comments that: "*…all of these wells have lifespans greater than a ten-year period*." See SPR Comment Att. B, ¶44. However, the ACI Study evaluates trends in production rates for wells in the City IOF and demonstrates that SPR's assertion is not true. Decline trends for individual wells were estimated based upon actual production data prior to 2018. These trends revealed that some of the wells operating in 2017 will no longer be economical to operate by 2026. Even for the remainder, historical production data confirms that oil production from the City IOF was expected to decline from approximately 200 barrels per day in 2017, while producing in excess of 9,800 barrels per day of water. Historical data confirm these trends since 16% of the wells operating in 2013 had been shut-in by 2017. In any case, extending the income analysis beyond 10 years would have no impact on the time to achieve ACI in this scenario, which is less than four years.

With respect to the cost indication of value for the SPR acquisition, the ACI Study determines a deferred replacement value ("DRV") for the property. The DRV is the value to a buyer of deferring capital investment in new facilities until the service life of existing facilities is exhausted. The DRV is calculated as the present value of the remaining service life of facilities, with adjustments for obsolescence and sustaining capital investment. For the City IOF, the DRV is a fraction of the functional replacement value ("FRV") due to the age of the operating wells. The FRV is the capital investment required to replace the functionality of the existing equipment with current technology

and construction practices. For example, the FRV represents today's cost to drill a well that performs the same function as a well drilled in 1925. SPR comments that: "*[Baker & O'Brien]…did not provide a description of what it considers functional replacement value…or why it chose DRV as it[s] cost indication of value*." See SPR Comment Att. B, ¶45. It appears that SPR's consultant is accredited in business valuation but is unfamiliar with these engineering valuation concepts, which are developed in *Engineering Valuation and Depreciation*, Marston, Winfrey, and Hempstead, 1953.

With respect to the market indication of value for the SPR acquisition, Baker & O'Brien allocated the reported SPR transaction price based on actual oil production from the City IOF as a portion of the total oil production that was reported for the portfolio of California properties that SPR acquired. This assumption is reasonable since oil production generates income, and reserves are valued based upon expectations for future income. SPR states that the ACI Study: "*…only addressed PDPs and did not address PDNPs, PUDs, probable reserves and possible reserves and these related costs*." See SPR Comment Att. B, ¶50. However, SPR is incorrect since its purchase price for the California properties includes value for all reserves at the time of the acquisition in 2017. Allocation of the purchase price to wells in the City IOF further assumes that the condition and performance of wells in the City IOF are near the average of the portfolio acquired by SPR. However, the wells in the City IOF appear to be generally less productive based on age and production characteristics and, therefore, less valuable than the average of the wells that SPR acquired in 2017. Therefore, the market indication of value for the City IOF used in the ACI Study is higher and more conservative than if it had been: 1) adjusted to remove the value of reserves included in SPR's acquisition; and 2) adjusted for the age and performance of the wells in the City IOF.

While the ACI Study gives credit to reserves in the market indication of SPR's acquisition value, the income model only considers wells that produce oil and gas from the City IOF in determining the time to achieve ACI. SPR comments: "*Because it is only interested in determining the sunk capital costs and how long it would take to recover those costs, [the] ACI ignores the consideration given and value of the other categories*

of reserves such as PDNPs and PUDs, or probable or possible reserves. This serves to significantly understate the value of the City IOF and the diminishing asset." See SPR Comment Att. B, ¶29 and ¶43. While SPR is correct that the ACI Study determines the time to ACI by offsetting initial capital investment with income from the City IOF, its assertion that the ACI Study does not consider PDNP reserves is incorrect. The income model includes production and revenues from returning wells that were idle in 2017 to service if they are reasonably expected to be economical. SPR is also incorrect that PUD, probable, or possible reserves should be considered in determining the time to achieve ACI. First, field development requires capital investment to drill new wells, which has not occurred in the City IOF since 2002. Second, SPR has not proposed any field development plan to the City or to the CSD since 2017 that would add permitted and producing wells in the IOF. Third, SPR provides no evidence that probable or possible reserves can be economically developed in the City IOF. In fact, SPR admits that it has not followed even the limited drilling plans provided to the CSD since 2017 because it was not economical to drill new wells when oil prices were between $55/B and $75/B. See SPR Comment Att. B, ¶35-36. SPR continues to withhold information that would indicate price levels at which it would find it economical to drill new wells in the City IOF.

The ACI Study gives credit to the package of financial derivatives that SPR acquired with the IOF in the market indication of SPR's acquisition value. However, these financial derivatives are not considered in the income model. SPR comments: "*It does not appear that B&O considered the financial derivates that limited the actual cash [SPR] would ultimately receive, which severely decreases the time ACI would be achieved."* See SPR Comment Att. B, ¶59. However, SPR provides no details of the financial derivatives program, including the "fixed-rate swaps" and "costless collars" disclosed in the referenced Freeport McMoRan 10-K report, or evidence that these derivatives relate to sales of Inglewood crude oil. For example, SPR has not provided evidence of futures contracts or other financial derivatives for Inglewood crude oil. Since this package of financial derivatives was included in the transaction, any impact on future cash flows would have been reflected in the reported transaction price. The ACI Study correctly ignores these financial derivatives because they are a set of

transactions that are completely separate from the physical sales of crude oil and natural gas produced at the IOF and do not limit prices received for sales in physical markets. In addition, California appraisal standards require petroleum properties to be valued at market prices without adjustment for contract or hedged prices.

BAKER & O'BRIEN, INC.

Donald L. Flessner
President