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VIA ELECTRONIC MAIL MMILLS@STOEL.COM & U.S. MAIL

Michael Mills, Esq.
Stoel Rives, LLP
500 Capitol Mall, Suite 500
Sacramento, California 95814

Re: City of Seal Beach - California Resources Corporation

Dear Mr. Mills:

This responds to your most recent letter to me on behalf of California Resources Corporation ("CRC") with the latest set of arguments as to why CRC is not required to obtain a City of Seal Beach business license. Despite the City's lawful demand that CRC license its business and pay taxes, penalties and costs, CRC continues to extract oil from oil wells that are drilled from City-owned property located in the City of Long Beach and bottomed within the territorial boundaries of the City of Seal Beach, without a City business license.

I will respond herein to the basic points you make on behalf of CRC in your most recent letter, some of which are now inconsistent with arguments made in previous communications. Any decision not to respond to a particular issue, or to not call out an inconsistency with your prior arguments is not to be read as a concession of any point. It is merely a recognition that you apparently have been directed by your client to continue to make any argument you can think of so that CRC can continue to avoid paying taxes it owes to Seal Beach; the same taxes CRC regularly pays to other municipalities. That is an unfortunate and wasteful tactic.

1. CRC's wells are **not** "located **and** bottomed on state owned tide and leased land."

Your letters have repeatedly pointed out that Seal Beach Municipal Code ("SBMC") Section 5.10.005 states, in relevant part, "[N]or shall the provisions of this Chapter apply to the drilling and production of oil where wells are located and bottomed on state owned tide and leased land." CRC claims, incorrectly, that this creates some kind of "state exemption." You asserted in a previous letter that CRC's wells are "bottomed" in State Lands Lease PRC 186 (PRC 186). For that reason alone, CRC previously claimed, the City's business license tax does not apply to

CRC's production bottomed in PRC 186. More recently, and inconsistently, CRC seems to argue that the wells are actually "located" in PRC 186.

It is apparent from the plain text of the above-quoted sentence from SBMC Section 5.10.005 that the concepts of "bottomed" and "located" are two different things. For the City's requirements to **not** apply, both facts must be true. If "located" and "bottomed" mean the same thing, which apparently is CRC's current argument, there would have been no reason for the City Council to have included both words in the ordinance. Further, there would have been no reason to couple the two terms with the all-important word "and." CRC cannot pick and choose individual words of an applicable law and ignore the others to avoid paying lawfully imposed taxes.

As I noted in my previous letter to you, the "plain meaning rule" of statutory interpretation means that every word of the law at issue must be given meaning. *See, e.g., City of Pasadena v. AT&T* (2002) 103 Cal.App.4th 981. In your letter to City Manager Jill Ingram dated October 11, 2018, you conceded that CRC's wells are "bottomed in State-owned lands." A case you cited in that letter stated conclusively that the "State-owned lands" in question are located within the Seal Beach city limits. Your letter did not then address the issue of where the wells are "located," and took the position that the existence of the "bottom" of the wells in PRC 186, by itself, meant that CRC did not need to obtain a business license. After I pointed out in my April 19, 2019 letter that the wells, rather obviously, are not both located **and** bottomed in state-owned tide and leased land, CRC has now decided to create a new definition of where an oil well is "located" that is inconsistent with existing definitions of the term in applicable law, including the section of the Seal Beach Municipal Code you cited in your letter.

As you noted in your most recent letter, Seal Beach Municipal Code Section 5.55.010 defines the term "Oil Well" as:

> "*Any well or hole already drilled, being drilled, or to be drilled from the surface into the earth, which well or hole is used or intended to be used in connection with the drilling for, prospecting for, or production of oil, natural gas, or other hydrocarbon substances. "Oil well" shall also include a well or hole used for the subsurface injection into the earth of oil field waste, gases, water, or liquid substances, including any well or hole that has not been abandoned and is now in existence.*"

The oil "well" is the hole drilled into the ground in connection with drilling oil, natural gas and other hydrocarbons. The location of a "well" is self-evident, since the "hole" and the related drilling apparatus are located on the surface of the land at an identifiable location. In this case, it is undisputed that CRC operates 36 "oil wells" that are "located" on property owned by the City of Long Beach and not on any state owned tide and leased land. We note that that the California Division of Oil, Gas and Geothermal Resources confirms that CRC's wells are "located" on City-owned property in Long Beach. The interactive map available on the "DOGGR" website

shows the Long Beach location of those wells, and there is no reference to the **wells** being "located" in Seal Beach. Once the "hole" is drilled from its surface location, the exploration must stop somewhere, and the stopping point is referred to in the oil industry as the "bottom." As you confirmed in the October 2018 letter to City Manager Ingram, each of CRC's wells located in Long Beach is "bottomed" in PRC 186, which is located entirely within the City limits of Seal Beach.

CRC's new argument seems to be that where the pool or reservoir of oil sits under the surface of the ground establishes where the "well" is "located." This new argument ignores the actual text of the Seal Beach Municipal Code. This argument is also rebutted by Seal Beach Municipal Code Section 5.55.015(A)(6) which states that the location of a well in the City is determined by the surface location of the well itself, or the surface location of the wellhead, "irrespective" of the subsurface locations of producing intervals or where the well may be "bottomed." It defies to logic to think that the City would use this definition of the "location" of a well in one context, and another, unspecified definition for the purposes of determining that other wells are located elsewhere.

CRC's theory about the location and bottom of its wells both being in State lands is not just unsupported by any authority, it has been debunked by an impartial and authoritative source. In the letter to Mr. Kirste from State Lands Commission Senior Attorney Joseph Fabel dated March 19, 2019, a copy of which was sent to CRC, Mr. Fabel stated:

> *"After a preliminary document review by Commission staff of the City's boundaries, as established November 1, 1915, and publicly available records, it does appear that the wells are bottom holed within the described City boundaries and surface in Los Angeles County."*

The above-quoted opinion of counsel for the State Lands Commission establishes that CRC is required to obtain a business license under the applicable provisions of the SBMC. In the same letter, Mr. Fabel confirmed that the State Lands Commission has no constitutional objection to cities' collection of local taxes from its offshore lessees like CRC. CRC knows this, because it pays hundreds of thousands of dollars in local business license taxes elsewhere in the State.

At the end of the day, you have failed to address the basic question of statutory construction that lies at the heart of this issue. If the word "located" means the same thing as "bottomed," why do both words, connected by the word "and" appear in the same sentence? The answer is, of course, that these provisions of the Seal Beach Municipal Code were drafted with the intent of taxing exactly the type of operation your clients are carrying out here - conducting the business of extracting oil located within the limits of the City of Seal Beach by slant drilling from another city. We recognize that the City cannot **regulate** oil production in State Lands leases and do not attempt to do so. However, a complete and accurate reading of the Municipal Code

confirms that it has been the City's practice for many years to exercise its constitutional authority to **tax** - not regulate - oil that is extracted in the exact manner that your client is operating.

CRC has cited no authority to support the theory that a well is "located" wherever the reservoir of oil lies. It does not appear that CRC applies this theory in other jurisdictions and, I am informed, this theory is contrary to common oil industry interpretation.

2. CRC's wells extract oil from a location bottomed in the City of Seal Beach.

It is unclear to me why you alternately claim in your recent letter that CRC's wells extracting oil from PRC 186 do not "pass through and are not bottomed under any real property in the City." I had thought that the basic fact of the bottom of the wells, which has been verified in multiple ways, was not be worth wasting each other's time and our clients' money on. PRC 186 - where the wells are bottomed - is located within the City limits of the City of Seal Beach. That basic fact has been confirmed by the State Lands Commission in the March 19, 2019 letter from State Lands Commission Counsel Fabel. The location of PRC 186 in Seal Beach is easily established through the use of public records going back decades. You admitted in the October 11, 2018 letter to Ms. Ingram that CRC's wells are "bottomed" in PRC 186. Yet despite this undisputable fact, your letter claims to devine some intent that the City never meant to require a business license for a business producing oil from PRC 186. This is contrary to history, since a predecessor producer from PRC 186 paid taxes to the City for many years.

In your latest letter, you mentioned a desire to continue to try to resolve this matter amicably, which the City shares. The way to do that is for CRC to acknowledge that it needs a business license, and pay the full tax amounts, penalties and costs assessed by the City. But if CRC is going to continue to push back on fundamental and indisputable facts like whether PRC 186 is located in the City, there may be no way to resolve this dispute without the authority of a court. I would remind you that additional taxes, penalties and delinquency charges continue to mount as we send letters back and forth.

3. The "math" has been repeatedly detailed; yet CRC refused to meet with the City's agent to discuss it.

Seal Beach Municipal Code Section 5.10.065 states that when a business operator has failed to obtain a required business license, the City's tax collector may determine the amount of tax to be paid. Sections 5.10.085 and 5.50.035 further provide for the automatic imposition of additional penalties when taxes owed become delinquent. The City's tax collector has made the determinations permitted by the Municipal Code and appointed Mr. Kirste as the City's agent for collection. Mr. Kirste wrote to Marshall Smith of CRC on September 26, 2018 detailing all of the amounts due, penalties and collection costs due. That letter fully described

the methodology and "math," which was not contested by CRC. Mr. Kirste offered, in writing and through telephone calls, to meet with representatives of CRC on multiple occasions. Rather than agreeing to timely meet and discuss any objections CRC might have to the appropriateness of any of the amounts assessed, CRC just flatly refused to meet with Mr. Kirste.

If CRC had objections to the amount of taxes, penalties and reimbursable costs assessed or the methodology behind the City's estimates and determinations, CRC should have agreed to meet with the official and agent who made those decisions, rather than continuing to spend money on lawyers in the hope that bluster alone will scare the City off.

4. The "delayed discovery rule" has significantly extended any statute of limitations, to the extent any applies in the case of a complete failure to pay taxes.

We appreciate, and agree with, your acknowledgement that the "delayed discovery rule" would postpone the calculation of any statute of limitations applicable to the City's action to collect these taxes from CRC. Because this is a case where CRC has failed to pay any City taxes since commencing its operations, we do not concede that any statute of limitations limits the City in collecting back taxes. The City was not even aware that CRC was conducting a business in its jurisdiction until early in 2018. This is because CRC apparently intentionally failed to comply with the terms of its applicable State lease, which requires CRC to timely obtain all local permits and licenses. Attorney Fabel from State Lands Commission stated in his March 19, 2019 letter that this is a basic requirement of State Lands leases, and that the Commission has no statutory or constitutional objection to local business licensing requirements. The purpose of this State Lands lease requirement is to avoid exactly the type of controversy the City and CRC are embroiled in now. CRC was the only party that knew it was drilling into the City limits of the City of Seal Beach, and it has known it was doing so since 2005. Had CRC complied with its lease and obtained a business license in Seal Beach, the City would have had the ability to pursue the business license taxes to which it is lawfully entitled. Further, it must be noted that CRC's tax liability would have been significantly lower had it just complied with the law and the terms of its lease from the beginning.

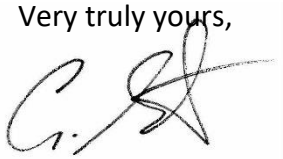
The argument that the City somehow had the obligation of discovering CRC's business operations in Seal Beach earlier simply because public records existed within the bowels of some state agency is not compelling. The discovery rule postpones the time in which a party has to file a lawsuit when that party is justifiably "ignorant of their right to sue." (Seelenfreund v. Terminix of N. Cal., Inc. (1978) 84 Cal.App.3d 133, 138; *see* Leaf v. City of San Mateo (1980) 104 CA3d 398, 406 [discovery rule applies "where it is manifestly unjust to deprive plaintiffs of a cause of action before they are aware that they have been injured"].) For the rule to apply, a party must conduct a reasonable investigation **after** becoming aware of an injury and the party is charged with knowledge of information that would have been revealed by such an investigation. Whatever you imagine Mr. Kirste may have learned in prior work, there is no

doubt that **the City** first became aware of CRC's failure to pay business license taxes in 2018, and has diligently pursued the matter since then. There is no factual basis to contend that because the City previously hired an oil consultant, the City should have been able to figure out that CRC was breaking the law and the terms of its lease by not obtaining a business license in Seal Beach.

It would be manifestly unjust to the taxpayers of the City, and create a corresponding unjust windfall to CRC, if the City was barred from collecting the taxes that CRC owes because CRC failed to give the City notice that it was extracting oil from Seal Beach, and has been doing so for many years without paying taxes. CRC knew that it was liable to pay business license taxes in the cities from which it extracts oil, including Huntington Beach and Long Beach. CRC also knew, or should have known, that it has been required to obtain a business license in Seal Beach as well.

Additional business license taxes are coming due, and unpaid taxes will continue to be delinquent shortly after that if unpaid again. The penalties and costs of CRC's failure to pay the taxes it owes continue to mount. This letter is the City's final demand that CRC obtain a City business license for its operations immediately and pay in full all delinquent taxes, penalties and costs, along with currently due taxes.

Very truly yours,



Craig A. Steele

cc: Jill R. Ingram, City Manager
Victoria Beatley, City Treasurer and Finance Director
Greg Kirste

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