

Agenda Report



Date: October 28, 2008
To: Stephen W. Helvey, City Manager
From: David A. Pelsler, Director of Public Works
Subject: Whittier Main 2008 Mineral Extraction Lease – Award

RECOMMENDATION

It is recommended the City Council:

1. Award the bid for the Whittier Main 2008 Mineral Extraction Lease to Matrix Oil Corporation of Santa Barbara, California; and
2. Approve and authorize the City Manager to sign the Whittier Main 2008 Mineral Extraction Lease and the Whittier Main 2008 Short Form Lease.

BACKGROUND

On August 26, 2008, the City Council adopted a Resolution of Intention (ROI) to lease property for the production of oil, gas and other hydrocarbons. A proposed Oil, Gas, and Mineral Lease Agreement form was also approved by the Council at that time. The ROI served as a type of request for proposals for the lease. In compliance with State law, the ROI was published four consecutive weeks in the Daily News prior to bid opening. On October 2, 2008 at 2:00 p.m. in the Council Chamber, proposals were publicly opened. The City Clerk received one proposal from Matrix Oil Corporation of Santa Barbara, California with Clayton Williams Energy, Inc. of Midland, Texas as Project Guarantor. This proposal was reviewed by the City's staff and a team of consultants for compliance with requirements of the ROI.

The remaining paragraphs of this Background Section essentially repeats the information provided in the August 26 staff report.

The City owns approximately 1300 acres of former oil fields in the hills north of the developed areas of the City (see Exhibit A to the Resolution of Intention). This was commonly known as the Whittier Main Field which was in oil production for over 100 years. The majority of this land was purchased from Chevron and Unocal with Measure A funds in order to preserve this land as open space and wildlife habitat. This land is managed for the City by the Puente Hills Landfill Native Habitat Preservation Authority (Habitat Authority), a joint powers agency with members including the City of Whittier, County of Lo Angeles, Los Angeles County Sanitation Districts, and Hacienda Heights Improvement Association. When oil production stopped, the oil was worth about \$12 per barrel. Today, the oil is valued at approximately \$100 per barrel. If the oil could be successfully extracted now, the City could receive a new source of revenue for its General Fund in the form of royalty payments from an oil company. In addition to the change in value of the remaining oil deposits, technology has also changed. New methods of drilling and pumping are much less invasive to the surface land uses and

the environment. We estimate the same 1300 acres of oil deposits could now be developed from approximately three surface sites of 2-3 acres each (less than half of 1% of the land). Furthermore, most of the drilling and pumping equipment can be placed in soundproof underground vaults that would not be visible. Therefore, it now appears feasible to access the valuable oil and gas resources while continuing to preserve our precious open space and wildlife habitat.

Project Concept

Extracting oil and natural gas will require an experienced oil company to partner with the City. The relationship with the oil company will be in the form of a mineral lease in which with the City will lease its mineral rights to the land and the oil company will pay the city royalties on the oil and natural gas produced. Under State law, the City must use a competitive process to solicit bids for the mineral lease. The highest qualified bidder will then have the opportunity to explore and extract the oil and natural gas. The request for bids is accomplished in the form of a resolution of intention. Attached is a proposed RESOLUTION OF INTENTION TO LEASE PROPERTY FOR PRODUCTION OF OIL, GAS AND OTHER HYDROCARBONS and a proposed OIL, GAS AND MINERAL LEASE.

The successful bidder on the mineral lease must still apply to the City for a Conditional Use Permit (CUP) in order to do any work on the ground surface such as set up a drill rig, pumps, and other equipment required to actually extract the minerals. The CUP application will describe exactly what the oil company plans to do, and will define the "project" that will be subject to review under the California Environmental Quality Act (CEQA) which will require an Environmental Impact Report (EIR). The Draft EIR will be circulated for public comment. The proposed OIL, GAS AND MINERAL LEASE has no guarantee that the successful bidder will be able to obtain a CUP once the environmental impacts are presented in the EIR. Also, if a CUP is issued, it will contain many specific requirements and mitigation measures for the oil company to follow. City staff and the Habitat Authority have already given this much thought and cooperated to provide the attached List of Potential Mitigation Measures in order to inform potential bidders and the public of the extent of environmental protections expected to be include in any future CUP. While it is unusual to anticipate mitigation measures prior to preparing an EIR, staff wants the public and the bidders to be aware of the high value the City places on the open space and wildlife habitat uses of this land. The actual mitigation measures and CUP conditions will be determined later by the City Council following public review of potential environmental impacts disclosed in the EIR.

Public Involvement

The public will have multiple opportunities to be informed and to comment while the process unfolds. Already, the City Council has heard a staff report at its meeting on April 22, 2008 and a presentation by Mayor Pro Tem Bob Henderson on June 24, 2008. Information was posted on the City's web site to keep the public informed. Several front page articles appeared in the Whittier Daily News. The CEQA process including

the preparation of an EIR will include multiple opportunities for public review and comment, as will the consideration of issuing a CUP. All through this process, there will be several government agencies which will have permitting and oversight authority to impose additional project requirements. For example, the California Department of Conservation, Division of Oil, Gas, and Geothermal Resources (DOGGR) has multiple regulations related to oil and natural gas exploration and production.

City Project Team

The City Manager assembled a team of key staff and consultants to work together in assessing the feasibility of a project to extract minerals from City-owned land in the Whittier Hills area. Specific staff members involved will vary according to the needs of the project at any particular time. During the preparation of the proposed RESOLUTION OF INTENTION and OIL, GAS AND MINERAL LEASE and during the review of the proposal received the City team included the following:

Bob Henderson, City Councilman and Chairman of the Board of the Puente Hills
Landfill Native Habitat Authority
Steve Helvey, City Manager
Dick Jones, City Attorney
David Pelsler, Public Works Director
Jeff Collier, Community Development Director
Rod Hill, Controller
Jim Day, Partner with Day Carter Murphy, LLP law firm
Kyle Rhorer, Vice President of RW Beck (finance and procurement specialist)
Tom Walker, Vice Pres. of Evans and Walker Consulting Petroleum Engineers

Request for Bids

Also in compliance with State law, there was only one variable on which to bid – royalty payments to the City. The Royalty payments were set at a minimum bid of 20% initial royalty plus an additional increment as price or production increases. Bidders were allowed to bid a higher initial royalty, a higher incremental royalty, or both. The royalty is based on either published market price or gross proceeds of sale per month. Royalty payments are made when production begins, even if it occurs during the Primary Term of the lease while rent payments are also paid.

Bidders were required to submit a check for \$400,000 as initial deposit toward the City's costs including running the bid process and preparing an EIR. The deposit will be increased if City costs reach 90% (\$360,000) of the initial deposit. Alternatively, a refund will be made to the Bidder if the City costs total less than the amount on deposit.

To protect the City from wasting time with unqualified bidders, the ROI includes Exhibit "B" - "Minimum Qualifications and Submittal Requirements". The bidders were required to demonstrate their technical, financial, and experience qualifications. Only bidders

that meet the minimum qualifications will be considered for award of a lease. The same minimum qualifications will be required as a condition of assignment of the lease should the successful bidder desire to assign the lease to another company at a later date.

Proposition A Compliance

The City's purchase of the Whittier Hills land subject to the proposed mineral lease was funded by a grant of Proposition A funds. Conditions of this funding prevent the City from using the land for anything other than open space. In order to make available for drilling and pumping approximately 8 acres of the surface in the 1300 acre mineral lease area, the City will have to either reimburse a portion of the Proposition A funds, or provide an additional comparable area of land that can be used for open space to compensate for that area used for surface facilities in oil production. City staff is in contact with the Los Angeles County Proposition A District to determine the appropriate approach to compliance with this requirement. The proposed lease includes a provision that a CUP will not be issued by the City until a release from protected area status is obtained from the Proposition A District.

Limitations on Property Access

Prior to CEQA compliance and issuance of a CUP, the successful bidder will not be allowed to enter the property, except for visual inspections or surveys in support of preparing a CUP application.

Lease Payments During Primary Term

The Primary Term of the lease is three years, during which time CEQA compliance must be completed, a CUP issued, and drilling operations started. The first year's rental payment is \$10.00 per acre (approximately \$13,000) and is paid in advance with the proposal submittal. The rent for the next two years total is \$140.00 per acre, or approximately \$182,000.

Funding for Ecologist and Habitat Enhancement

The proposed lease requires the successful Bidder pay the Habitat Authority a monthly Management Fee of \$5,000, increasing to \$7,000 when drilling operations begin. The lease also requires payment to the Authority a Habitat Enhancement Fee of \$100,000 annually upon starting drilling operations. Both of these fees will be adjusted over time by a consumer price index.

Payment of Taxes

The proposed lease requires the successful bidder pay all taxes including property taxes.

Insurance

The proposed lease requires workers compensation coverage, \$1,000,000 in employer's liability insurance and \$5,000,000 in both auto and general liability

insurance. It also provides for naming the City and the Habitat Authority as an additional insured.

Potential Mitigation Measures and CUP Conditions

The successful Bidder will have to apply to the City for a Conditional Use Permit. The CUP application will provide the basis for a project description that will be subject to CEQA review. Most likely, a full EIR will be required. CEQA compliance is likely to require mitigation measures be included in the proposed project. In addition, the City will likely have a number of conditions in a CUP. City staff and the Habitat Authority have already given this much thought and cooperated to provide a List of Potential Mitigation Measures in order to inform potential bidders and the public of the extent of environmental protections expected to be included in any future CUP. While it is unusual to anticipate mitigation measures prior to preparing an EIR, staff wanted the public and the bidders to be aware of the high value the City places on the open space and wildlife habitat uses of this land. The actual mitigation measures and CUP conditions will be determined later by the City Council following public review of potential environmental impacts disclosed in the EIR. The actual conditions adopted may be even more extensive than this List. The List is intended to serve as a starting point for public discussion and review. The List was made available to potential bidders and was attached to the August 26, 2008 staff report.

Hazardous Substances, Pollution, Well Abandonment, Restoration

While there are many safeguards that will be in place in the lease, in State regulations, and in various permits to assure safe and environmentally responsible operations, the lease also holds the successful Bidder responsible for all hazardous substances, waste materials, spills, and environmental pollution that may occur. The Bidder will be responsible for any cleanup and restoration due spills, pollution, and the like. Furthermore, the lease agreement includes reference to anticipated CUP conditions for establishment of a fund that will have sufficient moneys to pay for well abandonments and restoration of surface conditions upon completion of oil production operations.

DISCUSSION

At the appointed time and place City staff publicly opened the one bid received from Matrix Oil Corporation with Clayton Williams as Project Guarantor. City staff and the team of project consultants reviewed the proposal (s) submitted and found that it complies with the submittal requirements. The royalty amount bid was 30% which is well above the minimum 20% required. The team also determined that the Matrix and Clayton Williams team meets the qualifications requirements. The bid package included the required check for \$400,000.00 (towards City costs) which was deposited and cleared by the bank.

FISCAL IMPACT

At this time, it is not possible to estimate with any certainty the fiscal impact of the proposed lease agreement. As described above the details of a proposed project to develop the mineral resources that are the subject of this lease will be included in an application for a Conditional Use Permit which is expected to result in preparation of an Environmental Impact Report. The \$400,000 deposit by the bidder is expected to cover the City's costs of processing a CUP application including the cost of a consultant to prepare an EIR. If Matrix is successful in obtaining the necessary CUP and other permits, and if their oil exploration is successful, the City could benefit greatly over many years as a result of royalty payments made pursuant to the terms of the proposed lease agreement. The potential future royalty revenue to the City could be as much as millions of dollars annually for many years.

Submitted by:



David A. Pelser
Director of Public Works

Attachments:

- A – Proposal Letter from Matrix Oil Corporation
- B – Project Guarantor Acknowledgement Form by Clayton Williams Energy, Inc.
- C – Whittier Main 2008 Mineral Extraction Lease Agreement
- D – Whittier Main 2008 Mineral Extraction Short Form Lease Agreement



101 W. Anapamu Street, Suite 100
Santa Barbara, CA 93101

Tele: 805 384-9000
Fax: 805 384-9000

October 2, 2008

VIA Hand Delivery
City of Whittier
13230 Penn St
Whittier, CA 90602

**RE: Bid for Oil and Gas Lease
City of Whittier Resolution No 8155 (the "Resolution")**

Ladies and Gentlemen:

Matrix Oil Corporation ("Matrix") as bidder and Clayton Williams Energy, Inc. ("Williams") as Project Guarantor hereby submit this bid for the Oil and Gas Lease described in the Resolution:

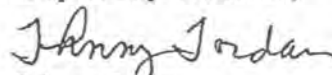
Bid:
Initial Royalty: 30%
Incremental Royalty: 1.25%
Highest Total Royalty not to exceed 50 %

Enclosed herewith is: (i) check in the amount of Four Hundred Thousand Dollars (\$400,000.00) for the initial deposit; (ii) the Project Guarantor Acknowledgement form executed by Williams; and (iii) a notebook of documentation as required and set forth in Exhibit "B" to the Resolution.

As evidenced in the attachments hereto, Matrix and Williams together meet all of the requirements of a qualified bidder. Matrix has operated the adjoining West Whittier field since 2000. In 2006 Matrix and Williams commenced a successful development program in this field which increased production 278%. We firmly believe that our understanding of the geology and our operations at the Rideout Heights and Honolulu Terrace facilities demonstrate that the Matrix/Williams team are not only a qualified bidder, but the most qualified bidder.

If you need any additional information, please do not hesitate to call. We look forward to working together with the City on this project.

Respectfully Submitted,


Johnny Jordan
President

ENCLOSURES



CLAYTON WILLIAMS ENERGY, INC.

PROJECT GUARANTOR ACKNOWLEDGEMENT

Matrix Oil Company ("Bidder") has submitted herewith a Bid in response to the City of Whittier, California ("City") to provide services under the Whittier Main 2008 Oil Extraction Project and the City's Oil, Gas, and Mineral Lease.

The Project Guarantor hereby certifies that it will irrevocably, absolutely and unconditionally guarantee the performance of all of the Bidder's obligations under the Oil, Gas, and Mineral Lease negotiated by the parties.

Name of Guarantor: Clayton Williams Energy, Inc

Name of Authorized Signatory:
T. Mark Tisdale

Signature: 

Title: Vice President

OIL, GAS AND MINERAL LEASE

THIS OIL, GAS AND MINERAL LEASE (hereinafter "Lease") is, made and entered into this 28th day of October, 2008, by and between the **CITY OF WHITTIER**, a charter municipality of the State of California with a mailing address at 13230 Penn Street, Whittier, CA 90602 (hereinafter called "Lessor"), and Matrix Oil Corporation, a California corporation (as to an undivided 25%), with a mailing address at 104 Anapamu, Santa Barbara, CA 93101 and Clayton Williams Energy, Inc., a Delaware corporation (as to an undivided 75%), with a mailing address at 6 Desta Drive, Suite 6500, Midland, TX 79705 (hereinafter called "Lessee").

WITNESSETH: Lessor, for and in consideration of the rental paid upon execution hereof, receipt of which is hereby acknowledged, and Lessee's covenants and agreements hereinafter contained, does hereby lease, let and demise unto Lessee the land hereinafter described (hereinafter called the "Leased Land"), subject to the covenants, conditions and limitations hereinafter set forth, for the purposes and with the exclusive right of exploring, prospecting, mining, drilling, and operating the Leased Land for oil, gas, other hydrocarbons, associated substances, sulfur, nitrogen, carbon dioxide, helium and other commercially valuable substances which may be produced through wells on the Leased Land, similar to the above-mentioned substances except for water (but not excepting water which may be produced in association with leased substances which may be used by Lessee in its operations on the Leased Land, but not sold) and geothermal resources (hereinafter collectively called "substances") and producing, extracting, taking, treating, storing of oil, removing and disposing of such substances from the Leased Land together with the right to construct, erect, maintain, operate, use, repair, replace and remove pipelines, telephone, telegraph and power lines, tanks, machinery, appliances, buildings, and other structures, useful, necessary or proper for carrying on its operation on the Leased Land, and rights-of-way for passage over, upon and across and ingress and egress to and from the leased land, or neighboring lands pooled therewith for any or all of the above-mentioned purposes. Lessor shall have the right to occupy and use the leased land in any manner and to any extent not inconsistent with Lessee's rights or in interference with Lessee's operations hereunder. The land hereby leased is situated in the County of Los Angeles, State of California, and described in Exhibit "A", attached hereto and incorporated herein by this reference, and containing 1.280 acres, more or less.

The parties hereby agree as follows:

1. **Term.** The term of this Lease shall be three (3) years from and after the date hereof ("Primary Term") and so long thereafter as Lessee shall conduct development operations (including, without limitation, drilling, re-drilling, deepening, repairing and reworking) or production is maintained in paying quantities on the Leased Land or on lands pooled or unitized therewith without cessation for more than one hundred eighty (180) consecutive days, or such operations are suspended or excused as hereinafter provided. Notwithstanding the foregoing, this Lease shall terminate if Lessee fails to submit a complete application for the issuance of a Conditional Use Permit as provided for in Paragraph 6.1., hereof, within a period of one hundred eighty days from the date of this Lease.

2. **Rental, Management Fee and Habitat Enhancement Fee.**

2.1 **Rental.** Lessee has paid to Lessor rental in full hereunder for the first twelve months of the term hereof. If Lessee has not commenced drilling operations on the leased land or terminated this lease within that time, Lessee, commencing with the earlier to occur of (i) the expiration thereof or (ii) Lessee's entry on the leased land to commence operations pursuant to any Conditional Use Permit which may be issued therefore by the City of Whittier shall pay or tender to Lessor in advance, as rental for the remaining two (2) years of the primary term hereof, the sum of One Hundred Forty Dollars (\$140.00) per acre for so much of the said land as may then still be held under this lease at the time of payment which payment or tender shall operate as rental and as consideration for deferring the commencement of drilling operations for a period of two (2) years from the expiration of that period for which and advance rental has been paid. The commencement of drilling operations may then be deferred for up to but not beyond the balance of the paid up primary term hereof.

2.2 **Management Fee and Habitat Enhancement Fee.** Lessee shall pay the following management fee and habitat enhancement fee to the Puente Hills Landfill Native Habitat Preservation Authority:

(a) **Management Fee.** The sum of Five Thousand Dollars (\$5,000.00) per month commencing on the date of acceptance in writing by Lessee of a Conditional Use Permit issued by the City of Whittier in accordance with the provisions of Paragraph 6.1, hereof, which management fee shall be increased to Seven Thousand Dollars (\$7,000.00) per month commencing on the commencement of drilling operations (as defined in Paragraph 17.(a), hereof), and continuing annually thereafter on or before each anniversary of such date.

(b) Habitat Enhancement Fee. The sum of One Hundred Thousand Dollars (\$100,000.00) per year commencing on the date of commencement of drilling operations (as defined in Paragraph 17.(a), hereof) on the Leased Land pursuant to an issued and accepted Conditional Use Permit and continuing annually thereafter on or before each next ensuing anniversary of the date of Lessee's acceptance of such Conditional Use Permit.

(c) CPI Adjustment of Management Fee and Habitat Enhancement Fee. The foregoing management and habitat enhancement fees shall be increased annually in a percentage equal to the percentage increase, if any, in the U.S. Department of Labor Consumer Price Index, All Goods-All Consumers, for the Los Angeles Metropolitan Area (or a reasonably equivalent replacement index to be selected by Lessor if such index is no longer published) commencing on the second anniversary of the date on which both such fees were paid.

(d) Credit for Portion of Incremental Royalty. If and to the extent that Lessee pays a portion of an incremental increase in royalty hereunder to the Puente Hills Landfill Native Habitat Preservation Authority pursuant to Paragraph 7.7, hereof, such incremental royalty amount paid each year to the Puente Hills Landfill Native Habitat Preservation Authority shall be a credit against the next ensuing management fee and habitat enhancement fee.

3. Payments and Notice.

3.1. Payments. The payments required to be paid by Lessee hereunder shall be made by check made payable to, and mailed to:

To the City of Whittier:

City of Whittier
ATTN: David Pelser
13230 Penn Street
Whittier, CA 90602

To the Puente Hills Landfill Native Habitat Preservation Authority:

Puente Hills Landfill Native Habitat Preservation Authority
ATTN: Andrea Gullo, Executive Director
7702 Walnut Street, Suite C
Whittier, CA 90602

3.2. Notice. Any notice to be given by either party to the other hereunder may be delivered in person or by registered or certified mail, postage prepaid, addressed to the party for whom intended as follows:

To Lessor at:

City of Whittier
ATTN: David Pelser
13230 Penn Street
Whittier, CA 90602

To Lessee at:

Matrix Oil Corporation
ATTN: Michael D. McCaskey,
Vice President
104 Anapamu
Santa Barbara, CA 93101

And to:

Clayton Williams Energy, Inc.
ATTN: T. Mark Tisdale,
Vice President and General Counsel
6 Desta Drive, Suite 6500
Midland, TX 79705

Either party may from time to time, by written notice to the other, designate a different address which shall be substituted for the one above specified. If any notice from one party to the other is given by registered or certified mail, service of notice will be considered made on the date of mailing if properly addressed and postage is fully prepaid.

4. Drilling Schedule.

4.1. **Drilling Within Primary Term.** Subject to the terms of Paragraph 2 above and Paragraph 6.1, below, Lessee shall, on or before the expiration of the Primary Term, commence and diligently prosecute the drilling of at least three wells to a depth adequate to test the Miocene Puente Formation, (the "Initial Test Wells") failing in which this Lease shall terminate, save and except for the Well Tract for such well theretofore drilled and completed as a well capable of producing in paying quantities, together with continuing nonexclusive rights to utilize the drill or well site and routes of ingress and egress and pipeline purposes therefor. Thereafter, Lessee shall engage in continuous drilling operations as provided in Paragraph 4.2, below.

4.2. **Continuous Operations.** If Lessee has complied with the drilling obligations set forth in Paragraph 4.1, then Lessee may at its option maintain this Lease as to all of the Leased Lands by conducting a continuous development program. For purposes hereof, a continuous development program shall mean that Lessee commences the drilling of a well and prosecutes the same with reasonable diligence until oil, gas or another of said substances is found in paying quantities, or until it is drilled to a depth at which further drilling would, in the judgment of Lessee, be unprofitable or impractical and said well is abandoned, on or before one hundred eighty (180) days from the later to occur of (i) expiration of the Primary Term or (ii) the completion of the last well commenced during the Primary Term. Thereafter, in a like manner Lessee shall within one hundred eighty (180) days after the completion or abandonment of the preceding well commence drilling operations for another well for oil and/or gas and prosecutes the same with reasonable diligence until oil, gas or another of said substances is found in paying quantities, or until it is drilled to a depth at which further drilling would, in the judgment of Lessee, be unprofitable or impractical and said well is abandoned; provided, however, in the event that Lessee has two or more wells drilling at any one time, the continuous development obligation shall not require subsequent wells for each of such wells, rather compliance shall require that no more than 180 days lapse in which there are no drilling operations being conducted on the Leased Lands. For the purpose of determining the commencement of a one hundred eighty (180) day continuous development period, a well shall be deemed completed at the earlier of 1) the date the official completion report is filed with the Division of Oil, Gas and Geothermal Resources or 2) the date the completion unit is released from the location. Upon the expiration of the continuous development program, the Lease shall expire, and Lessee shall quitclaim this Lease, as to all lands not then located in a Well Tract upon which there is a well that is producing, or is capable of producing and which is thereafter diligently returned to production.

Lessee may drill as many additional wells as it may elect in excess of the number required for the Leased Land to be considered fully drilled.

5. **Offset Wells.**

5.1. **Offset Distances.** If, after the date of this lease, a well is drilled and completed as a well capable of producing in paying quantities on adjoining property in which Lessor has no interest and the producing interval location thereof is at that time ascertainable and within 1320 feet of the exterior limits of any land embraced in this lease, or, if the producing interval location of such well is not ascertainable at that time, but the surface location thereof is within 1320 feet of the exterior limits of any land at the time embraced in this Lease, and gas (unassociated with oil) but not oil, is capable of being produced therefrom in paying quantities, or within 660 feet and oil is capable of being produced therefrom in paying quantities, unless a well offsetting the same has been completed or is being drilled by Lessee on the Leased Land, Lessee, subject to its right to quitclaim as herein provided, within forty-five (45) days after it is ascertained that the production of oil or gas from the well to be offset is occurring in paying quantities shall commence drilling operations at a suitable offset location, as hereinafter defined, to offset such well and drill and complete the same diligently to protect the Leased Land from drainage.

5.2. **Zonal Offset.** Lessee shall offset such outside well by drilling to the same producing formation or zone as the well to be offset, and no well existing or being drilled on the Leased Land shall satisfy this offset requirement unless drilled to the same producing formation or zone from which oil or gas is being produced by the well to be offset, and at a suitable offset location as hereinafter defined. The requirements of Paragraph 4 shall not relieve Lessee of this obligation to offset any producing well in a different strata or zone from that in which production is obtained on the Leased Land. For the purpose of satisfying obligations hereunder, an offset well or wells shall be considered as other wells required to be drilled hereunder.

5.3. **Additional Offset.** Notwithstanding anything in this Lease to the contrary, the offset requirements contained in Paragraph 5 shall constitute a minimum offset requirement only. Lessee shall drill and produce competitively offset wells at such times, to such depths, and at such locations upon the Leased Land as may be necessary to protect all zones remaining subject to this Lease from drainage by wells on other lands.

5.4 **Optional Compensatory Royalty in the Event of Lessee's Offset Default.** In addition to any other remedies available to Lessor under this Lease or under California law, should Lessee fail to quitclaim or drill and produce an offset well within the time provided in this Paragraph 5 or in the manner provided in this Paragraph 5, at Lessor's election to be exercised by written notice from Lessor to Lessee, Lessee shall be obligated to pay to Lessor a compensatory royalty in the royalty share provided in Paragraph 7.1 hereof, at the highest price being paid in the vicinity for substances being produced in the well to be offset, upon one-half of the production volume of the well to be offset until such time as Lessee has complied with the provisions of Paragraph 5 of this Lease. Provided, however, nothing contained in this Article 5 shall require the drilling of a well, or payment of compensatory royalties, to offset a well in which Lessee holds no interest whose reasonably anticipated production will not pay the actual costs of drilling, completing and producing of such well.

6. **Operations.**

6.1. **No Surface Entry Unless and Until Conditional Use Permit Obtained and CEQA Complied With.** Lessee shall not be entitled to make any surface entry on the Leased Land (other than for visual inspection or surveying purposes in support of an application for a Conditional Use Permit) unless and until: (i) a Conditional Use Permit has been applied for at the City of Whittier for up to three drill and well sites, for use for drilling and production support facilities including waste water reinjection, of not more than 7 acres in total, combined size and in reasonably compact shape and routes of ingress and egress thereto and for pipeline and utility purposes and, if desired by Lessee, for the conduct of a seismic survey, (ii) environmental review under the California Environmental Quality Act ("CEQA") has been conducted and paid for by Lessee, (iii) a Conditional Use Permit has been issued by the City of Whittier, in its sole and absolute discretion; and accepted in writing by Lessee within a period of ten (10) days of the date of its issuance, and (iv) no Conditional Use Permit will be issued by the City of Whittier until Lessor has obtained a release from protected area status of that portion of the Leased Land upon which surface operations are allowed under an issued Conditional Use Permit from the Los Angeles County Proposition A District. The terms and conditions of any Conditional Use Permit which may be issued by the City of Whittier, including any mitigation measures and monitoring plans which may arise in the cause of any CEQA review thereunder, shall be deemed incorporated into this Lease as terms and conditions thereof.

6.2. **Lessee to Use Good Oil Field Practice.** Except as herein otherwise provided, Lessee shall drill and operate each well in accordance with good oil field practice, and in material compliance with any conservation or curtailment programs imposed by law or governmental agency with jurisdiction over operations on the Leased Lands. Lessee shall comply in all material respects with all state, federal and local laws and with the rules, regulations and orders of any federal, state or other governmental agency having jurisdiction in the Leased Land with respect to the spacing, drilling or producing of wells, or other operations for oil or gas, and if there be any conflict between the same and provisions of this lease, such laws, rules, regulations and orders shall modify or supersede, as the case may be, the relevant provisions of this lease.

6.3 **Protection of Leased Land From Liens/Indemnification.** Lessee shall at its own risk and expense provide and promptly pay for all labor, equipment and supervision of whatever kind or nature that may be needed to carry on the operations hereunder and to perform the requirements of this Lease, and nothing herein contained shall obligate Lessor to reimburse Lessee for any costs incurred by it hereunder or to return to or repay to Lessee at any time any sums paid to Lessor pursuant to the provisions of this Lease. Lessee agrees to pay all damages, losses and expenses incurred by Lessor and to defend, indemnify and to hold Lessor and the Leased Land free and harmless of and from all damages, losses, expenses (including attorneys' fees in any action arising out of matters herein set forth), liens, liability to or claims of others (including, but not limited to, surface owners, if other than Lessor, surface tenants and other oil and gas lessees) or injury to the Leased Land which result from or, in anyway arise out of or in connection with (a) any of the operations of Lessee on said lands, (b) the exercise by Lessee of any of its rights hereunder, (c) the doing of any labor or the furnishing of any materials or supplies to or for Lessee, (d) any act or failure to act on the part of Lessee or of any contractor engaged in doing work for Lessee, (e) any breach by any contractor engaged in doing work for Lessee, (f) any breach by Lessee or its contractors of any of the provisions of this Lease, or (g) the Lessee's release or threatened release of pollutants, contaminants, hazardous substances, gas or petroleum on, under, about or from the Leased Land. This obligation to defend and indemnify shall not be subject to, reduced or barred by any theory of consent, assumption of the risk, contributory or comparative negligence, not amounting to gross negligence on the part of Lessor or its agents, employees, contractors, or invitees (but not including any commercial lessees of Lessor hereunder), or any other risk or loss shifting theory at law or in equity. This obligation to defend and indemnify and hold harmless shall survive any termination or expiration of the lease or assignment of the Lease by Lessee, without limitation, and shall not be limited in any manner by the insurance requested in Paragraph 10., hereof.

6.4. **Enhanced Recovery Operations.** Lessee shall not engage or participate in any steam injection or or tertiary recovery operation upon or affecting the Leased Land without first submitting a detailed plan of the proposed operation to Lessor and obtaining Lessor's written consent thereto, which consent may be granted, withheld or conditioned at Lessor's sole discretion. With respect to any secondary recovery operations such as waterflood or pressure maintenance operations, Lessee shall submit a detailed plan of the proposed operation to Lessor and obtain Lessor's written consent thereto, which consent shall not be unreasonably withheld; provided, however, that if it is determined that a Conditional Use Permit is required for such flood, pressure maintenance or other enhanced recovery operation, such Conditional Use Permit must be applied for and obtained and Lessor's discretion as to the issuance of such Conditional Use Permit shall not be limited in such manner.

6.5 **Plugging and Abandonment and Site Restoration Fund or Bond.** The cost of plugging and abandoning any well drilled by Lessee and the cost of abandoning a well site which may be permitted by issuance of a Conditional Use Permit, together with the cost of site restoration and revegetation and habitat restoration shall be established to the reasonable satisfaction of the City of Whittier through the Conditional Use Permit issuance process, and, if a Conditional Use Permit is issued, Lessee shall establish out of Lessee's share of production of leased substances, without impact on Lessor's royalty share, a segregated sinking fund to cover the costs thereof, or in lieu thereof a bond reasonably acceptable to the City of Whittier, in accordance with the terms and conditions of any such issued Conditional Use Permit.

6.6 **Request for Additional Sites.** In the event that Lessee has drilled six wells on the Leased Lands, then Lessee shall have the right to request from Lessor one or more additional drillsites, subject to Lessee applying for and obtaining a Conditional Use Permit therefor and obtaining a release of any such additional sites from protected area status from the Los Angeles County Proposition A District. Lessor may in its sole discretion and for any reason deny or grant Lessee the right to construct any such additional site.

7. **Royalty.**

7.1. **Royalty Share.** The term "royalty share" as used herein means:

Thirty percent (30%) on the first \$1,500,000.00 in market price (if leased substances are produced but not sold) or gross proceeds of sale of leased substances produced in any calendar month, plus an additional One and One-Quarter percent of One Hundred percent (1.25% of 100%) on each incremental \$250,000.00 in market price (if leased substances are produced but not sold) or gross proceeds of sale of leased substances produced in any calendar month; provided, however, that the highest total royalty to be paid shall not exceed Fifty percent (50%).

7.2. **Royalty on Oil.** Lessee shall pay Lessor as royalty on oil the market price of said royalty share of all oil produced or lost from the Leased Land after making customary adjustment or deductions for temperature, water and sediment. In computing royalties all gravities shall be taken on the basis of oil containing not in excess of three percent (3%) water and other basic sediment. If Lessee sells said oil to an unaffiliated third party, market price shall be deemed and said royalty shall be paid on the basis of the gross proceeds thereof.

7.3. **Royalty on Gas.** Lessee shall pay to Lessor the royalty share of the gross proceeds received from the sale of any gas (excluding residual dry gas from extraction of casinghead gasoline), while the same is being sold off said land, or from any payment pursuant to a gas contract for gas not actually taken, but nothing herein contained shall require Lessee to save or market gas from said land unless there shall be surplus above fuel requirements and a market at the well for the same. Where the Lessee utilizes gas off the Leased Land, or where, due to Lessee's operations, gas shall be lost from the said lands in volumes that would have been marketable had such volumes been captured, the royalty share shall be based upon the market price of such gas at the wellhead.

If casinghead gasoline is extracted from the Leased Land or lands pooled or unitized therewith by Lessee from the natural gas produced from wells on said lands, then Lessee shall pay to Lessor as royalty 50% of Lessor's royalty share of the market price of the gasoline and 50% of the market price of other hydrocarbons (including residual dry gas) credited to this lease from the gas so treated.

7.4. **Royalty on Other Substances.** Lessee shall pay Lessor as royalty the market price on the Leased Land, in the condition as produced, of the royalty share of any substance covered by this Lease, other than oil and/or gas and the products thereof, which Lessee may elect to produce and save or market or utilize from the Leased Land.

7.5. **Royalty to be Free of Certain Costs.** Notwithstanding anything herein to the contrary, all royalties herein shall be computed without any deduction or charge on account of any tax, cost or expense of exploration, development, extraction or production, cleaning, dehydration, treatment, processing, extraction, compression, transportation or delivery, or any other deduction or charge whatsoever, whether of the same or a different character but shall bear its proportionate part of any ad valorem real property tax or possessory interest tax which may be levied against the mineral rights leased to Lessee hereunder.

7.6. **Payment of Royalties.** Within one hundred twenty (120) days following the first sale of oil and/or gas from the lands described herein or lands pooled therewith, but in no event more than two hundred forty (240) days after the date of first production or loss of marketable quantities of any such substances from said lands, Lessee shall pay, or cause to be paid, to Lessor such sums as shall have accrued to Lessor as royalties under this lease and thereafter such payments shall be made monthly, on or before the last day of the month following the month of production thereto for oil and on or before the last day of the second month following production for gas, without the necessity of the execution by Lessor, or any other party, of a division or transfer order. Notwithstanding anything herein to the contrary, in the event such amounts accruing to Lessor as royalty total less than one hundred dollars (\$100.00) such amounts may be remitted the earlier of annually or when such amounts shall exceed one hundred dollars (\$100.00). All sums not paid timely shall bear interest at the highest lawful rate from the date they are due until the date payment is received by Lessor. Lessee shall reimburse Lessor for all reasonable attorneys' fees, court costs, filing fees, and other costs or expenses incurred in connection with any legal action or other collection effort initiated by Lessor due to Lessee's failure to pay royalties hereunder in a timely manner in which Lessor is found to be entitled to recover any royalties and/or interest. In the event of a conflict between the terms and conditions of any division or transfer order as Lessor may execute and this Lease, the latter shall prevail and shall not be amended thereby. Lessee shall furnish Lessor monthly statements showing the computation of royalties.

7.7. **Payment of a Portion of Incremental Increased Royalties to the Puente Hills Landfill Native Habitat Preservation Authority.** If and to the extent that an incremental increased royalty becomes payable to Lessor hereunder, Lessor may direct Lessee by written notice to Lessee, to pay a portion thereof directly to the Puente Hills Landfill Native habitat Preservation Authority.

7.8. **Minimum Royalty.** To the extent contemplated in the following sentence, upon completion of a well or wells on the Leased Land capable of producing gas or oil in paying quantities, Lessee shall pay Lessor a minimum royalty hereunder of an amount equal to, and not less than, fifty dollars (\$50.00) (minimum royalty) per acre annually for the total acreage held subject to this lease irrespective of the operation or suspension of operations of any such well or wells, or the curtailment of production therefrom. If at the expiration of any full calendar year following the Primary Term hereof, Lessor shall not have received royalties above an amount equal to the minimum royalty per acre as aforesaid, Lessee shall on or before the twenty-fifth (25th) day of January next succeeding pay to Lessor an amount equal to the difference between said royalties paid during the preceding calendar year and such minimum royalty per acre.

The minimum royalty payments provided for herein shall be deemed the equivalent of production and shall constitute performance under this Lease if Lessee shall make a diligent effort to obtain commencement of production from any gas and/or oil well completed on the Leased Land; provided, however, that Lessee shall not be privileged, in any event, to hold this Lease by actual production plus adjustment to minimum royalty, or by payment of minimum royalty alone, for more than three (3) years, cumulatively.

8. **Ownership.**

8.1. **No Warranty of Title.** This Lease is made without warranty of any kind as to title. Lessee accepts as satisfactory to itself the title of Lessor in the Leased Land and agrees that Lessor shall not be liable or responsible to Lessee in damages or otherwise by reason of any defects in or any liens or encumbrances on Lessor's title or any want of title in Lessor to the Leased Land, or any portion thereof, or to any hydrocarbons therein contained or found or produced thereon or taken therefrom. If any third party asserts any claim against Lessor on account of Lessee's extraction or removal of hydrocarbons from the Leased Land or other operations of Lessee thereon

(including, without limiting the generality of the foregoing, any governmental or other action or proceeding for the abatement of a nuisance or the cleanup, removal or other protection against a hazardous waste as now or hereafter defined), Lessee will defend and indemnify and hold Lessor harmless from all such claims except such portion thereof as represents a claim to Lessor's royalty, provided that upon receiving notice thereof, Lessor shall notify Lessee with reasonable promptness of the bringing of any action or the assertion of any such claim and shall allow Lessee to have Lessee's attorneys appear therein, either alone or in association with Lessor's attorneys (as Lessor may elect), in defending any such action on behalf of Lessor, each party paying the expenses of its own attorneys. Lessee shall promptly notify Lessor in writing of any judicial proceeding brought to the attention of Lessee, and affecting or purporting to affect, Lessee's possession or rights hereunder.

8.2. **Proportionate Reduction.** If Lessor owns a lesser interest in the oil, gas and other hydrocarbons in the Leased Land than the entire undivided fee simple estate therein, then any royalties, rentals and other payments herein provided for shall be paid to Lessor only in the proportion which Lessor's interest bears to the whole and undivided fee; provided, however, that Lessor shall have no obligation to reimburse Lessee, retroactively, for any payments already made by Lessee to Lessor.

9. **Taxes.**

9.1. **Payment by Lessee.** Lessee shall at its own expense and without any reimbursement by Lessor pay and discharge before delinquency (a) all taxes, assessments and other governmental charges which, during the term of this Lease, shall be levied upon or assessed or charged against (1) the improvements and personal property constructed or placed upon the Leased Land by or for Lessee under this Lease; and (2) the Leased Land or any part thereof or any minerals or mineral rights or other rights therein; (b) all other taxes, assessments and other governmental charges upon or referable to any operations or acts of Lessee or on its behalf on the Leased Land; (c) all other assessments, charges and obligations of any kind whatever that by reason of any operation of Lessee may be or might become a lien upon or charge against the Leased Land, or any part thereof, or any well thereon, and that are created by or shall arise under or by reason of any present or future law, ordinance, regulation or order whatever; and (d) all taxes, assessments and governmental charges levied by or arising under any present or future law, ordinance, or regulation upon or with respect to this Lease, the execution or delivery hereof, or the leasing of the Leased Land hereunder.

Lessee shall, and hereby agrees that after hydrocarbons are discovered in paying quantities hereunder it will pay, to Lessor promptly upon demand, as supplemental royalty hereunder, an amount equal to each such tax, assessment and other governmental charge so paid by Lessor (including the portion thereof for the unexpired part of the fiscal year in which the discovery is made, prorated as of the completion date of the discovery well), except any portion of any such charge which is referable to personal property or major improvements of Lessor or to minerals not then subject to this Lease and being produced by Lessor or any third party.

9.2. **Tax Liens.** If any tax lien for taxes of the nature referenced in paragraph 9.1., above, is filed against the Leased Land and is not removed or released within thirty (30) days of the date the tax lien is recorded in the Official Records of the relevant County, this Lease, without notice or demand by Lessor, shall automatically terminate in its entirety.

10. **Insurance.** Lessee shall maintain in full force and effect, at its own expense, a policy or policies of worker's compensation insurance as required by the State of California, a policy or policy of Employer's Liability with limits of at least \$1,000,000.00 per occurrence, a policy or policies of Automobile Liability covering all owned, non-owned and hired vehicles, with limits of at least \$5,000,000.00 per occurrence, and a policy or policies of commercial general liability insurance insuring Lessee and Lessor as an additional insured (and such other persons, firms or corporations as are designated by Lessor as having an interest in the Leased Land) against any liability for death, personal injury or property damage arising out of or resulting from Lessee's operations hereunder. Such general liability insurance shall have an initial combined single event coverage of not less than Five Million Dollars (\$5,000,000.00).

Upon request Lessee will furnish Lessor valid certificates of insurance certifying the above coverage or evidence satisfactory to Lessor that Lessee is qualified to self-insure. In the event Lessor should determine that Lessee is qualified to self-insure, it is agreed between Lessee and Lessor that the intent of the provisions noted above concerning additional insured and waiver of subrogation shall apply to such self-insurance.

Lessee agrees that the insurance required by this Agreement shall not be materially changed, cancelled, or allowed to lapse for any reason, without thirty (30) days advance written notice to Lessor. As long as the respective insurers so

permit, each insurance policy obtained shall provide that issuing insurance company waives all right of recovery by way of subrogation against Lessor. Lessee's failure to acquire and/or maintain the required insurance coverages with at least the specified limits, or failure to provide any requested certification thereof within thirty (30) days following receipt of a written request from Lessor, or any successor, shall be grounds to withhold or deny any assignment and/or terminate this Agreement as to all of the said lands not then assigned to Lessee at Lessor's election.

11. Surrender and Forfeiture.

11.1. **Removal of Equipment and Restoration.** Lessee shall have the right at any time to remove from the Leased Land any machinery, rigs, piping, casing and other property and improvements belonging to or furnished by Lessee, including that installed in wells or otherwise affixed to the land; provided that, if this Lease terminates in its entirety, such removal shall be completed within one hundred twenty (120) days thereafter and, in the event of the termination of this Lease as to a portion of the Leased Land, all such property not needed by Lessee for its operations on land retained under this Lease shall be removed from the land as to which this Lease is terminated within one hundred twenty (120) days after such partial termination and the remainder shall be removed within one hundred twenty (120) days after the termination of this Lease in its entirety. Lessee, after termination of this Lease, shall drain and fill all sump holes and other excavations made by it on the Leased Land and in all other respects restore the Leased Land as nearly to its condition existing on the date hereof as is reasonably practical and in accordance with the terms and conditions of any Conditional Use Permit issued therefore (including, without limitation, any revegetation and habitat restoration therein required), but Lessee shall not be obligated to restore anything for which it may theretofore have made payment acceptable to Lessor for damages. The obligation of Lessee to restore the Leased Land (set forth above) shall include the obligation to remediate any contamination arising from Lessee's exercise of any rights granted hereunder.

11.2. **Lessee's Right to Surrender.** Lessee, at its option, may at any time quitclaim and surrender all of the Leased Land, in which event this Lease shall terminate and Lessee shall be relieved of all obligations hereunder save and except the obligation to pay rents and royalties theretofore accrued and any obligation hereby imposed for removal of equipment and restoration or remediation of the Leased Land, and any tax or assessment which Lessee would be obligated otherwise to pay under Paragraph 9, hereof, prorated for any of the tax or assessment year for which Lessee held the Leased Land. Lessee, at its option, may at any time after drilling on the Leased Land or on land properly pooled with all or a portion of the Leased Land and from time to time thereafter, quitclaim and surrender any part of the Leased Land not desired by it (but only to all depths and strata in the surrendered acreage), and in such event the amount of any rental or minimum royalty provided for in this Lease shall thereafter accrue only on the basis of the land not so quitclaimed, and the number of wells to be drilled before the land may be deemed fully drilled shall be determined by the acreage retained. Land so quitclaimed, and any portion of the Leased Lands released pursuant to the partial termination provisions of this lease, shall remain subject to the easements and rights-of-way herein provided for so long as necessary to accommodate operations by Lessee on the retained part of the Leased Land or lands pooled therewith, including the right to dispose of produced water through Disposal Wells. Anything to the contrary herein notwithstanding, Lessee prior to drilling may make no partial release or quitclaim as provided under this Paragraph comprising less than forty (40) acres.

Lessee may at any time with respect to all of the Leased Land or, at any time or from time to time after drilling with respect to a designated part of the Leased Land subject to the acreage limitation provided herein, (a) surrender its right to produce oil, or (b) surrender its right to produce gas. A surrender of the right to produce oil shall include a surrender of the right to produce the gas that may be produced therewith. A surrender of the right to produce gas shall include a surrender of the right to produce associated liquids which may be produced therewith. A surrender of oil or gas rights in all the Leased Land will relieve Lessee of further obligation to drill wells for the released substance. A surrender of oil or gas rights in a part only of the Leased Land will reduce the number of required oil or gas wells to a number determined by the acreage as to which oil or gas rights are retained by Lessee. A surrender of oil rights shall have no effect on obligations to drill for the substance for which Lessee has retained its rights.

11.3. **Lessee's Obligation to Release Deep Rights.** One year following the later of the expiration of the primary term or the termination of the continuous development program, this lease shall terminate for all depths 100 feet and more below the stratigraphic equivalent of the deepest horizon from which a well drilled in the Leased Lands is then capable (without further drilling operations) of producing oil and/or gas, or either of them, in paying quantities.

11.4. **Lessee's Obligation to Surrender Undeveloped or Non-Producing Acreage.** One year following the later of the date on which the Leased Land is fully developed or Lessee has completed or abandoned its

continuous development program under Paragraph 4, Lessee shall surrender and quitclaim to Lessor all of the Leased Land except as to Well Tracts surrounding (i) oil and gas wells then producing or capable of producing and on which reworking operations are timely performed and (ii) Injection Wells. Thereafter as to producing wells, if production ceases and there shall have been no production of hydrocarbons in paying quantities hereunder from a Well Tract retained by Lessee for a continuous period of one hundred eighty (180) days and in such time Lessee has not commenced and diligently prosecutes operations to convert such producing well into an Injection Well, this lease as to the subject Well Tract shall terminate and Lessee shall promptly surrender each such Well Tract to Lessor. With respect to Well Tracts held by an Injection Well, such Well Tract shall terminate at such time as Lessee permanently abandons injection operations at such well.

11.5 Joint Use of Drill and Well Sites, Production Support Site, Access and Pipeline and Utility Routes Upon Partial Surrender or Termination of Lease. In the event of the partial surrender or termination of this Lease, Lessee agrees that its rights to use of such drill and well sites and access and pipeline and utility routes as may be permitted by issuance of one or more Conditional Use Permits issued by the City of Whittier shall be nonexclusive, and that such sites and routes will be available for use by any oil and gas lessee obtaining an oil and gas lease from the City of Whittier or its successor for the exploration for and development of oil, gas or other hydrocarbons in the lands so released from this Lease, provided that: (i) such joint use would not unreasonably interfere with the remaining operations of Lessee under this Lease; (ii) that any such subsequent oil and gas lessee applies for and obtains a Conditional Use Permit therefore from the City of Whittier; and (iii) that any such subsequent oil and gas lessee shall not be entitled to utilize any tanks, pipelines or other production, transportation, marketing, treatment or sales physical facilities installed by Lessee unless there is adequate surplus capacity to the needs of Lessee and any such subsequent oil and gas lessee pays to Lessee fair value for such joint use of physical facilities of Lessee, including value for a proportionate part of the abandonment obligations hereunder.

12. Force Majeure.

12.1. Suspension of Obligations During Force Majeure. Performance of covenants and conditions imposed upon Lessee hereunder shall be excused while, and to the extent that, Lessee is hindered in or prevented from complying therewith, in whole or in part, by war, riots, strikes, lockouts, natural disasters, accidents, inability (after a thirty (30) day attempt) to obtain materials or services in the open market or to obtain transportation therefor, laws, rules, and regulations of any federal, state, municipal or other governmental agency or any other cause beyond the control of the Lessee, whether similar or dissimilar to those herein specifically enumerated and without regard to whether such cause exists at the date hereof or hereafter arises; provided, however, that (i) Lessee shall provide written notice to Lessor of any claim of suspension or excuse of Lessee's obligations under this Paragraph, specifying with particularity the act, event, or condition giving rise to such claim of suspension or excuse and specifying the date on which such act, event, or condition arose; and (ii) in the case of any governmental approval, Lessee shall have applied for such approval sufficiently in advance to reasonably obtain such approval prior to Lessee's obligation to perform under the covenants and conditions herein. The obligations of Lessee under this Lease shall not be suspended or excused pursuant to this Paragraph unless and until such written notice to Lessor is given and shall not be suspended or excused by any act, event, or condition as to which Lessor has not been so notified. Lessee shall diligently pursue the removal or lifting of such act, event, or condition in such manner as may be reasonably practicable throughout the course of its existence. Notwithstanding anything herein contained to the contrary, the obligations of Lessee hereunder shall not be suspended or excused by reason of failure to obtain any permit for the drilling of the initial well unless such permit shall have been applied for at least six (6) months prior to the expiration of primary term hereof, and such application shall have been diligently pursued. The failure to obtain any other governmental permit or entitlement shall not be deemed an event of force majeure unless Lessee shall have submitted a timely and complete application therefor and such application shall have been diligently pursued; in which event Lessee's obligations shall not be suspended hereunder for a period of longer than one (1) year from the date a completed application was filed.

13. Default. In addition to all other rights and remedies of Lessor under this Lease or the law, if Lessee shall be in default in the performance of any of Lessee's covenants under this Lease, and if for a period of fifteen (15) business days as to the payment of undisputed (not challenged in court by Lessee) royalties (or fifteen (15) days after resolution of any dispute thereafter), including minimum royalties or thirty (30) days as to other undisputed defaults (or thirty (30) days after resolution of any dispute thereafter), after written notice by Lessor of such default except for Lessee's failure to give a notice under Paragraph 20, hereof (for which Lessee shall pay to Lessor \$100.00 for each day or portion thereof such notice is not given), Lessee shall fail to commence and thereafter diligently and in good faith to prosecute the remedying of such default then, at the option of Lessor this Lease shall forthwith cease and terminate and all rights of Lessee in and to the Leased Land shall be at an end, save and except as to any wells

theretofore drilled or being drilled and in respect to which Lessee is not in default and the applicable Well Tracts and appurtenances therefore. Upon termination of this Lease by default, Lessor, without notice or demand, may reenter the Leased Land or any part thereof, and expel, remove and put out Lessee or any person or persons occupying the Leased Land, and, if not removed by Lessee under the provisions of Paragraph 11 hereof, Lessor may (i) remove all property therefrom using such force as may be necessary to again repossess and enjoy the Leased Land as before this demise, and (ii) to restore and remediate the Leased Land or affected portion thereof to return it to as near as original condition as practical, without prejudice to any other remedies to which Lessor might be entitled and without liability to Lessee or any third party for damages sustained by reason of such removal, provided that no default in the performance of any of the conditions or provisions hereof as to any well or wells shall affect the right of Lessee to continue Lessee's possession and operation of any other well or wells (to depths and portions of the Leased Land earned) in regard to which Lessee is not in default, together with the Well Tract earned and the surface well site parcel for each such drilling or producing oil or gas well, and rights-of-way and easements necessary for Lessee's operation thereof. In the event that Lessor properly exercises the above right to expel Lessee, remove equipment, or restore and remediate the Leased Land or any portion thereof, Lessee shall protect, defend, indemnify and hold Lessor harmless from any cost, risk, expense or other liability associated with the exercise of such rights. In order for the written notice required herein for termination of this Lease to be effective, such notice shall be delivered by certified mail, set forth the specific allegations of the breach and contain in bold, conspicuous print that failure to take action will result in termination of the lease. The time periods set forth above shall be calculated from the date of receipt of such notice.

In addition, without limiting in any way Lessor's remedies upon default, any amount due under this Lease which is not paid when due, unless excused pursuant to Paragraph 12 hereof, shall bear interest at the highest lawful rate for debts of that kind and character from the date said amount became due until the date payment in full shall be received by Lessor.

14. Assignment. This Lease and each and all of its provisions shall be binding upon and shall inure to the benefit of the heirs, administrators, executors, successors and assigns of the respective parties hereto. Lessee shall not, however, sublet the demised premises or any part thereof, or assign, transfer, or otherwise convey this Lease or any of its rights hereunder or any of its interest in or to the demised premises, or enter into any partnership overriding royalty or participation agreement with respect to rights of Lessee hereunder, without the prior written consent of Lessor which may be granted, withheld or conditioned at Lessor's sole discretion up until the expiration of the Primary Term. Thereafter such consent shall not be unreasonably withheld by Lessor. Without limiting the generality of the foregoing, Lessor may withhold such consent if the proposed assignee or transferee does not demonstrate to the reasonable satisfaction of Lessor that it meets the Minimum Qualifications for Bidders which was attached as Exhibit "B" to the Resolution of Intention to Lease adopted by the City Council of the City of Whittier on August 26, 2008. In the event that Lessee shall sublet, assign, transfer, otherwise convey the Leased Land or its rights and interest hereunder, or any part thereof, or enter into any partnership, overriding royalty or participation agreement with respect to rights of Lessee hereunder, or attempt to do so, in violation of the foregoing provision and if after the primary term Lessee has not contested the reasonableness of Lessor's withholding of consent and thereafter established that the withholding of such consent was unreasonable, to assign by Lessor consent would be reasonable, then, in addition to any and all other rights and remedies available to it, Lessor may at its option, by written notice to Lessee within ninety (90) days after receiving actual knowledge of such event, declare such sublease, assignment, transfer, mortgage, conveyance, encumbrance or agreement void. Notwithstanding the foregoing, assignment of overriding royalty interest(s) in the leasehold in an amount not to exceed in the aggregate 10% of 8/8ths of production and lease shall be permitted under the terms hereof without the consent of Lessor. In the event that Lessee shall file a voluntary petition in bankruptcy or shall be adjudged a bankrupt in any involuntary bankruptcy proceeding, or in the event that any voluntary or involuntary proceeding for the reorganization of Lessee shall be instituted by anyone other than Lessor under any of the provisions of the bankruptcy laws of the United States, or in the event that (except in proceedings instituted by Lessor) a receiver or judicial trustee or custodian shall be appointed for, or any lien or any writ of attachment, garnishment, execution or distraint shall be levied upon, any of Lessee's rights or interest under this Lease, or in the event that there shall be any assignment of any of Lessee's rights or interest under this Lease by operation of law, then, in addition to any and all other rights and remedies available to it, Lessor may at its option, by written notice to Lessee within ninety (90) days after receiving actual knowledge of such event, terminate this Lease and all rights and interest of Lessee and all other persons under this Lease. Lessee shall be entitled to enter into financing arrangements whereby its interest is conveyed into a partnership or other entity controlled by Lessee and otherwise entitled to encumber all but Lessor's royalty share of production, or the proceeds of sale thereof, from the Leased Land without the prior written consent of Lessor for the purpose of financing its operations on the Leased Land, but not otherwise without Lessor's prior written consent, which shall not be unreasonably withheld. Any consent of Lessor to any sublease, assignment, transfer, conveyance,

encumbrance or agreement shall not be or be deemed or construed as a consent to any other, different or subsequent sublease, assignment, transfer, mortgage, conveyance, encumbrance or agreement, nor as a waiver or exhaustion of any of the provisions of this Paragraph. The provisions and agreements contained in this Paragraph with respect to Lessee shall be applicable to any and all subleases, assignees, transferees, mortgagees and other persons holding or claiming any of the rights or interest of Lessee under this Lease as well as to Lessee originally named herein. The term "Lessee" as used in this article includes any individual, partnership or corporation who is a lessee hereunder even though several individuals, partnerships or corporations are such and includes each partner of any partnership which is a lessee hereunder. Notwithstanding the foregoing, Lessee may assign all or part of its interests in the lease to an affiliate (defined as an entity owned or controlled by Lessee) thereof without the consent of Lessor.

15. Pooling and Unitization. Lessee shall have the right at its option, at any time, either before or after the discovery of oil, gas or other substances on the Leased Land to present to Lessor a specific proposal to combine and pool all or any part of the Leased Land or interest therein into one or more operating units with any other lands or interests therein (whether held by Lessee or others and whether or not the surface of such other land may be used for oil or gas development purposes). Lessor may, at its sole discretion, either consent in writing to the formation of such pool or operating unit, or withhold its consent, and no pool or operating unit may be formed without the prior specific written consent of Lessor. Each operating unit created hereunder with the consent of Lessor shall be created by and shall become effective upon the execution by Lessee and the recording in the office of the appropriate County Recorder of a Declaration of Pooling setting forth the exterior boundaries of the unit so created and describing the lands pooled thereunder, followed by the prompt mailing of a copy thereof to Lessor. If there are any lands or interests in lands within the exterior boundaries of any operating unit which are not pooled therein, Lessee may, with Lessor's prior written consent which may be withheld for any reason, at any time after creation of such unit, add any or all such additional lands or interest to such unit by executing a Supplemental Declaration of Pooling, but no retroactive adjustment of royalties shall be made. Promptly after execution of each Declaration of Pooling and each Supplemental Declaration of Pooling, Lessee shall give written notice thereof to Lessor. Any operating unit may include land upon which a well has theretofore been completed or upon which operations for drilling have theretofore been commenced, and within the meaning of the requirements of the Lease any such well or operations, if off the Leased Land, shall be considered as having been commenced immediately after the effective date of such pooling. Production, drilling or reworking operations anywhere on the operating unit created hereunder shall be treated as production, drilling or reworking operations on that portion of the Leased Land properly included in such operating unit. Any portion of the Leased Land included in an operating unit pursuant to this Lease shall thereafter during the term of such operating unit be deemed to be segregated from the balance of the Leased Land and any portion of the Leased Land not included within such unit shall be subject to further rental, development or release in accordance with the terms of this Lease, and Lessee shall not be entitled to hold any land not so included by virtue of drilling upon or production from land included in such unit. There shall be allocated to the Leased Land the proportion of the pooled production from any such operating unit (whether or not such production is from the Leased Land) that the number of surface acres covered by this Lease and included in such unit bears to the total number of surface acres in such unit; royalties shall be paid hereunder only upon that portion of such production so allocated, and as to pooled production from land in such unit such royalties shall be in lieu of any other royalties. Lessee may at any time quitclaim to the persons entitled thereto all or any part of the land in any such operating unit and no owner of land in such unit not owning any interest in quitclaimed land, except by virtue of such pooling, shall have any interest in such quitclaimed land after the quitclaim is delivered or recorded. Allocation of production as aforesaid from any such operating unit, whether to the Leased Land or in like manner to other lands therein, shall continue notwithstanding any quitclaim or other termination, either in whole or in part, of this or any other lease covering lands in such unit until such time as the owner of such land shall (or shall give others the right to) drill for or produce any of the pooled substances from any pooled part of such lands, whereupon all such lands formerly included in such unit and as to which the Lease covering the same shall have been terminated, shall be excluded in determining the production to be allocated to the respective lands in such units and in prorating taxes; and in the event of the failure of Lessor's or any other owner's title as to any portion of the land included in any such operating unit; such portion of such land shall likewise be excluded from such unit; provided that Lessee shall not be held to account for any production allocated to any lands excluded from any such operating unit unless and until Lessee has actual knowledge of the aforesaid circumstances requiring such exclusion. Lessee may, at any time either before or after the commencement of the drilling of a well on lands included in any such operating unit but prior to the discovery thereon of the substance for which the unit was formed, or at any time after the abandonment of all wells drilled on such unit, wholly dissolve such unit by executing and recording in the office of the appropriate County Recorder a Declaration of Dissolution.

Promptly after execution of such Declaration of Dissolution Lessee shall give written notice thereof to Lessor. Upon the dissolution of any such operating unit, whether or not this Lease or any other Lease involved therein remains in

effect, all rights of Lessor hereunder to royalty on pooled substances produced from the lands which were so pooled (other than the Leased Land) shall cease and terminate; but such dissolution shall not otherwise affect or impair any of Lessee's rights or obligations under this Lease, including its right upon obtaining the prior written consent of Lessor to create a new operating unit or units out of the lands previously pooled pursuant to this Paragraph, or constitute a surrender of any part of or any interest in the leasehold estate created hereby. The sale, conveyance or other transfer of, or of any interest in, any portion or portions of the Leased Land which are at the time of such transfer subject to an operating unit shall (unless the instrument effecting such transfer expressly provides otherwise) be deemed to include and shall operate as a transfer and assignment of all of the transferor's interest, rights and benefits under this Lease (including the right to royalty on allocated production from the lands subject to any such unit) insofar as such interest, rights and benefits pertain to or are allocated hereunder to the portion or portions of the Leased Land or interest therein so transferred. For the purpose of determining drilling obligations in such unit, which shall be equal to the drilling obligations set forth hereinabove in this Lease, the entire acreage so pooled shall be treated as if it were covered by one Lease and the drilling of a well in any part of such unit, whether or not on land covered by this Lease, shall fulfill Lessee's drilling obligations under the Lease to the same extent as if such well were drilled on land covered by this Lease and no offset obligations shall accrue with respect to the tracts of and included within any pooled unit as a result of wells drilled therein.

16. Seismic Activities. Lessor hereby grants to Lessee or to Lessee's nominee, for Lessee's benefit, subject to Lessee obtaining a Conditional Use Permit therefore as provided in Paragraph 6.1, above, permission to conduct seismic or geophysical surveys on said land by any method, whether now known or not, provided that Lessee, or Lessee's nominee shall pay the party or parties entitled thereto for any and all damages to person or property, including damage to water wells located on said land, resulting from the making of such surveys. Notwithstanding anything herein to the contrary, nothing contained in this Lease is intended to grant to Lessee the exclusive right to conduct seismic and other geophysical operations across the Leased Land from and after the point in time at which portions (by depth or otherwise) of the Leased Land are released or surrendered to Lessor, such that such operations may be conducted by others to evaluate the released or surrendered portions of the Leased Land. In the event Lessee shall conduct seismic or other geophysical surveys over the Leased Land, Lessor shall be entitled to receive a copy thereof including any such data in digital form at such time as such data is available to Lessee.

Lessor expressly reserves the right to conduct seismic and other geophysical operations across the Leased Land on its own behalf and to grant such right to third parties from time to time and at any time. Any rights, data, fees and revenues attributable to the exercise by Lessor of such rights shall be the sole property of Lessor or its licensee, and Lessee shall not be entitled to see such data or share in such revenues or fees.

Additionally, Lessor, its affiliates, successors, assigns or agents, shall have the right to review and inspect during normal business hours upon ten (10) days written notice, all geophysical and seismic data obtained by Lessee under this Paragraph.

17. Definitions. The following terms or phrases, and variations thereof, except where the context requires a different meaning, shall have the following meanings in this Lease:

(a) The words "drilling operations" as used herein shall mean the location of a drilling rig on the Leased Land or lands pooled therewith and the spudding of a well both of which must have occurred before "drilling operations" will be deemed to have commenced.

(b) Lessee shall have met its minimum development program under Paragraph 4 and the Leased Land shall be deemed "fully drilled" when there has been drilled a sufficient number of oil and/or gas wells to earn Well Tracts, as hereinafter defined, to encompass all of the Leased Land.

(c) The term "suitable offset location" as used in Paragraph 5 of this Lease shall mean a location within a distance from the boundary line separating the properties equal to the distance from the well to be offset to said boundary line (though the offset well need not in any event be closer than 200 feet from said boundary line) and within one-half (1/2) of such distance from a line drawn at right angles to such boundary line from the well to be offset through such boundary line and extended through the Leased Land.

(d) A "Well Tract" as used herein shall mean the following:

i. In the case of an oil well producing from a depth of 4,000 feet or less - forty (40) acres;

- ii. In the case of an oil well producing from a depth of 4,001 feet to 8,000 feet - eighty (80) acres;
 - iii. In the case of an oil well producing from 8,001 feet or deeper – one hundred twenty (120) acres;
 - iv. In the case of a gas well producing from a depth of 8,000 feet or less - one hundred sixty (160) acres;
 - v. In the case of a gas well producing from 8,001 feet to 12,000 feet - three hundred twenty (320) acres;
 - vi. In the case of a gas well producing from below 12,000 feet - six hundred forty (640) acres;
 - vii. In the case of a horizontal well – 240 acres in compact shape evenly spaced on either side of the horizontal or near horizontal portion thereof open to production.
 - viii. In the case of substantially deviated well – the greater of eighty (80) acres, or the acreage earned by the depth of the producing interval thereof, or if such well is of the type described in subparagraph ix., below, the acreage therein provided for.
 - ix. In the case of a well drilled into multiple, separate, accumulations of oil or gas which are reasonably determined to be capable of production in paying quantities, 660' on either side and 330' on either end of that portion of the well bore from the first such accumulation encountered to the last such accumulation encountered and open to production.
 - x. In the case of a well which meets the criteria of subparagraph ix, above, and is also a horizontal well, the greater of the acreage provided under subparagraph vii or ix, above.
- (e) The term "oil well" is any well
- i. which produces crude petroleum oil not associated with gas at the time of production, or
 - ii. which produces one barrel or more of crude petroleum oil to each 2,000 cubic feet of natural gas, or
 - iii. which produces crude petroleum oil from a formation or producing horizon productive of oil only, encountered in a well bore through which gas also is produced through the inside of another string of casing.
- (f) The term "gas well" is any well
- i. which produces natural gas not associated with or blended with crude petroleum oil at the time of production, or
 - ii. which produces more than 2,000 cubic feet of natural gas to each barrel of crude petroleum oil from the same producing horizon, or
 - iii. which produces natural gas only encountered in well bore through which crude petroleum oil also is produced through the inside of another string of casing.
- (g) For purposes hereof, a horizontal well shall mean a well drilled, completed or recompleted in a manner in which the horizontal or near horizontal component of the completion interval in the geological formation exceeds the vertical or near vertical component thereof and exceeds 300 feet in such formation.
- (h) For purposes hereof a substantially deviated well shall mean a well for which the producing interval is located at least One Thousand Three Hundred Twenty (1,320) feet distant, horizontally, from the surface drillsite thereof.
- (i) The term "paying quantities" as used herein, shall mean production in quantities sufficient to yield a return in excess of operating costs.

(j) The term "Injection Well" as used herein shall mean a well used to inject water or gas for the purposes of maintaining reservoir pressure or waterflooding a formation in connection with secondary recovery operations.

(k) The term "Disposal Well" as used herein shall mean a well used to inject produced water from the Leased Lands for purposes of disposing of such water.

(l) The term "market price" as used herein if oil is not sold or is sold to an affiliate of Lessor, shall mean the highest posted price available in the vicinity of the Leased Land for oil of like quality as that produced hereunder.

18. **Waiver.** The waiver by Lessor of any breach of any term, covenant or condition herein contained shall not be deemed to be a waiver of such term, covenant or condition for any subsequent breach of the same or any other term, covenant or condition herein contained. The subsequent acceptance by Lessor of any sum due under this Lease shall not be deemed to be a waiver of any preceding breach by Lessee of any term, covenant or condition of this Lease, other than the failure of Lessee to pay the particular sum accepted.

19. **Authority to Execute.** If Lessee is a corporation, each individual executing this Lease on behalf of said corporation represents and warrants that he is duly authorized to execute and deliver this Lease on behalf of said corporation in accordance with a duly adopted resolution of the Board of Directors of said corporation or in accordance with the bylaws of said corporation, and that this Lease is binding upon said corporation in accordance with its terms.

Upon request, Lessee shall supply a copy of an adopted resolution or the bylaws which empower the party executing this to act on behalf of the corporation.

20. **Notice Periods.** In addition to the notice requirements set forth elsewhere in this Lease, Lessee shall give Lessor oral notice by telephone or in person, followed by prompt written confirmation, at the telephone number and address set forth in Paragraph 4 above, as follows:

(a) Notice at least seventy-two (72) hours prior to entry on the Leased Land with a drilling rig;

(b) Notice at least seventy-two (72) hours prior to spudding any well drilled on the Leased Land or on land pooled therewith;

(c) Notice within seventy-two (72) hours of the release of a drilling rig from any well on the Leased Land or any land pooled therewith;

(d) Notice within seventy-two (72) hours of completion of any well drilled on the Leased Land or on land pooled therewith;

(e) Notice at least seventy-two (72) hours prior to abandonment of any well drilled on the Leased Land or on land pooled therewith;

(f) Notice at least seventy-two (72) hours prior to conducting any geological, geophysical or seismic activities on the Leased Land or pursuant to this Lease;

(g) Notice within seventy-two (72) hours of the first sale of any substance from a well drilled on the Leased Land or on land pooled therewith;

(h) Notice of cessation of production accompanied by a description of the reasons therefor, within fifteen (15) consecutive days following any such cessation;

(i) Notice within ten (10) days of the completion of any well with a producing interval within 1320 feet of an exterior boundary of the Leased Land in which Lessee has any economic interest upon adjacent lands that are not pooled with the Leased Land and in which Lessor is not a mineral Owner, which notice shall include a description of such well, its producing zone(s) and surface drill site and bottom hole location.

21. **Attorneys' Fees and Court Costs.** The substantially prevailing party in any action regarding this Lease shall be entitled to its reasonable attorneys' fees and court costs (which shall include the cost of staff time or expert witnesses) including, but not limited to, appeals, if any.

22. **Hazardous Waste.** (a) Lessee acknowledges that Lessor shall not be deemed to have made (and Lessor hereby disclaims) any representation or warranty, express or implied, as to the condition of the Leased Land or any improvements located thereon.

(b) If Lessee uses, generates, manufactures, produces, stores, releases, discharges, or disposes of on, under or about the Leased Land or transports to or from the Leased Land any hazardous substance or allows any other person or entity to do so, it will do so in strict accordance with applicable requirements of state, federal, or local laws, regulations, ordinances, rules or guidelines. Such requirements include, but are not limited to, containment systems and administrative controls.

(c) Lessee shall give written notice to Lessor within twenty-four (24) hours of:

i. any spill or release that is required to be reported to the California Governor's Office of Emergency Services ("OES") and/or the Environmental Protection Agency ("EPA");

ii. any proceeding or inquiry by any governmental or regulatory authority with respect to the presence of any hazardous substance on the Leased Land or the migration thereof from or to other property;

iii. all claims made or threatened by any third-party against the Leased Land relating to any loss or injury resulting from any hazardous substance; and

iv. Lessee's discovery of any occurrence or condition on any real property adjoining or in the vicinity of the Leased Land that could cause the Leased Land or any part thereof to be subject to any restrictions on ownership, occupancy, transferability or use under any environmental law.

(d) Lessor shall have the right to join and participate in, as a party if it so elects, any legal proceedings or actions initiated in connection with any environmental law or regulations.

(e) Lessee hereby agrees to protect, defend, indemnify and hold harmless Lessor, its directors, officers, employees, agents, successors and assigns, against and from any and all costs, claims, loss or liability, including third-party claims and, regardless of legal theory, arising directly or indirectly out of or attributable to any soil or ground water contamination on, under or adjacent to the Leased Land or the storage, release, threatened release or disposal of wastes of any kind on the Leased Land (the "Contamination"), including without limitation costs of clean-up, civil penalties assessed for any such contamination, disposal or other remedial or preventative action. This indemnity and hold harmless agreement shall apply to any contamination caused by Lessee, its affiliates, successors, assigns, employees, agents, consultants, contractors or subcontractors and shall survive the termination or expiration of this lease; provided, however, this indemnity shall not pertain to any such Contamination in any way associated with the activities of Lessor, its agents or contractors related in any way to the landfill operated on the Leased Lands.

(f) In the event that any investigation, site monitoring, containment, cleanup, removal, restoration or other remedial work of any kind or nature (the "Remedial Work") is reasonably necessary under any applicable local, state or federal law or regulation, any judicial order, or by any governmental or non-governmental entity or person because of Lessee's operations, or in connection with Lessee's operations, the current or future presence, suspected presence, release or suspected release of a hazardous substance into the air, soil, groundwater, surface water or soil vapor at, on, about, under or within the Leased Land (or any portion thereof), Lessee shall within the time provided by applicable law, regulation, order or agreement and if none then within thirty (30) days after written demand for performance thereof by Lessor, commence to perform, or cause to be commenced, and thereafter diligently prosecuted to completion, all such Remedial Work. All Remedial Work shall be performed by one or more contractors, approved in advance in writing by Lessor and under the supervision of a qualified consultant approved in advance in writing by Lessor. All costs and expenses of such Remedial Work shall be paid by Lessee including, without limitation, the charges of such contractor(s) and/or the qualified consultant, and Lessor's reasonable attorney's fees and costs incurred in connection with monitoring or review of such Remedial Work. In the event Lessee shall fail to timely commence, or cause to be commenced, or fail to diligently prosecute to completion, such Remedial Work, Lessor may, but shall not be required to, cause such Remedial Work to be performed and all costs and expenses thereof, or incurred in connection therewith, shall become part of Lessee's obligations under this

Lease. Nothing herein contained shall be construed to impose obligation upon Lessee pertaining to the operation of the landfill located on the Leased Premises by or on behalf of Lessor.

(g) Lessor is authorized by itself, its agents, employees or workmen to enter at any reasonable time with at least 24 hour notice to Lessee upon any part of the Leased Land for the purposes of inspecting the same for hazardous substances and Lessee's compliance with this Paragraph and such inspections may include, without limitation, subsurface soil or water sampling and/or analysis. Any such testing shall be conducted at Lessor's sole risks and expense and Lessee shall not be responsible for any costs in connection with the foregoing. Any such testing shall not occur more frequently than once every five years.

(h) Nothing in this Paragraph 22 shall limit any rights of Lessor or obligations of Lessee under this Lease, but shall be in addition to all such rights and obligations.

23. Keeping and Inspection of Records.

23.1. **Well Data.** Lessee shall provide Lessor's attorney, without charge, all geologic and well information set forth in Exhibit "B" attached hereto and made a part hereof for any wells drilled upon the Leased Land or lands pooled therewith and all data and information (geological and otherwise) obtained by Lessee in the course of its drilling, development and producing operations on the Leased Land or lands pooled therewith having to do with the mechanical histories of wells, the thickness, character and content of the formations penetrated and the amount and kind of production obtained, including but not limited to, the following: all logs, electric logs, electric surveys, directional surveys, well histories, core records, daily or weekly drilling reports, well completion reports, notices and reports to the Division of Oil, Gas and Geothermal Resources or other public authority and all replies, responses or comments thereon by said Division or authority, detailed fossil assemblage in each well bore, oriented cores, dipmeter and directional survey data, records of core analyses and of results obtained in all formation tests, potential tests, water witch runs and pressure determinations, and all other factual data or information in any way relating to subsurface conditions, and also all production records relating to the quantity or nature of the production obtained from wells on the demised premises or lands pooled therewith and, upon request, analyses in the possession of Lessee of the hydrocarbons produced. Such production records shall be furnished to Lessor at least as often as once each month. Lessee shall keep Lessor promptly and fully advised in writing as to the extent, nature and progress of all work on the demised premises or lands pooled therewith. The foregoing requirements of this section shall not be construed to require Lessee to develop any data or information but only to require Lessee to make available whatever data or information may come into its possession, except that Lessee shall run at least one (1) electric log to as near total depth as is practicable in each well drilled by Lessee on the Leased Land or lands pooled therewith.

Lessor agrees to assert confidential status for all such information not otherwise in the public domain under the California Public Records Act and as attorney-client privileged information for a period of three (3) years from the date of receipt thereof. Upon request, Lessee shall advise Lessor fully as to the progress of all work upon the Leased Land. Nothing in this provision shall be construed as authorization to receive interpretative data.

23.2. **Copies of Lessee's Contracts.** Within thirty (30) days after entering into any contract or agreement for the treatment, processing, extraction, transportation, sale or delivery of any hydrocarbons produced from the Leased Land or lands pooled therewith (excepting contracts for the refining of oil), or any amendment, modification, extension or renewal of any such contract or agreement, Lessee shall deliver a copy of it to Lessor. Notwithstanding the foregoing, sales of production for periods not exceeding one (1) year shall be provided only upon written request of Lessor.

23.3. **Records and Accounts.** Lessee shall keep true, full and correct books of account, showing its account of the production of oil, gas and other hydrocarbon substances from the Leased Land or lands pooled or unitized therewith, and shall maintain such records for the term of this Lease and for three years thereafter. Such books, together with all other records of Lessee relating to the performance by Lessee of the covenants hereof, shall be open for audit, copying and inspection by Lessor or its agent at all reasonable times throughout such period. Lessee shall furnish Lessor monthly written statements of the total production from the Leased Land or lands pooled or unitized therewith and the deliveries of oil, gas or other hydrocarbons therefrom during the preceding calendar month and the royalties payable in respect thereto and the data upon which the amount of such royalties is computed, and also copies of the run tickets covering such deliveries.

23.4. **Records of Division of Oil, Gas and Geothermal Resources.** Lessee hereby authorizes Lessor its representatives or agents, to examine and take copies of all records of the Division of Oil, Gas and Geothermal Resources of the State of California (including all officers, deputies and agents thereof) and all records of any other public authorities relating to any wells drilled upon the Leased Land or lands pooled therewith, including, but not limited to, all reports, records, notices and statements filed by Lessee. Lessor agrees to keep all such records, contracts and logs confidential if, to the extent, and during the period that they are on confidential status with the Division of Oil, Gas and Geothermal Resources. Except as to the foregoing confidentiality, Lessee hereby waives all restrictions now or hereafter imposed by statute or otherwise upon the use of such records by the Lessor as evidence in any litigation by or against Lessee.

23.5. **Statement to Lessor.** The receipt by Lessor of any statement, or any payment of royalty for any period, shall not bind Lessor or Lessee as to the correctness of the statement or payment. Lessor shall also be entitled, from time to time, to one or more independent audits of the records by a certified public accountant designated by Lessor for the purpose of determining compliance with this Lease. Such audit shall be conducted during usual business hours at Lessee's place of business within the State of California. If the audit shows that there is a deficiency in the payment of royalty, the deficient shall be immediately due and payable. The costs of the audit shall be paid by Lessor unless the final adjudicated or agreed audit shows that Lessee understated proper royalty payments to Lessor by more than ten percent (10%), in which event Lessee shall pay all costs of the audit.

23.6. **Inspection by Lessor.** Lessor, at its sole cost, risk and expense, shall have the right, without hindrance, (a) to enter upon the Leased Land and to examine the work done and in progress thereon and to take samples of production, (b) to inspect Lessee's works, tanks and appliances, and (c) to examine, gauge and meter any or all of the hydrocarbons produced from the Leased Land or lands pooled therewith. Lessor agrees to make a reasonable attempt to contact Lessee prior to entry onto Leased Land or lands pooled therewith for the purposes set forth above. Lessor shall indemnify Lessee from and against any claims, damages, awards arising by virtue of its exercise of the rights granted in this paragraph or paragraph 22 (g).

24. **Lessor Option to Take Produced Water.** Lessor shall have the option at any time and from time to time to elect by written notice to Lessee to take any quantity of produced water from wells operated by Lessee on the Leased Land at no charge to Lessor, but into storage facilities and/or pipeline to be provided by Lessor and not required or useful by Lessee for its operations on the Leased Land or lands pooled therewith for Lessor's use or treatment and use.

25. **Lessor's Option to Purchase.** Lessor shall have the option, exercisable within the first one hundred eighty days of the twenty-fourth (24th) year of this Lease if it is then still in effect, exercisable by written notice from Lessor to Lessee, to purchase all of Lessee's right, title and interest in this Lease and in all wells thereon and operating equipment and pipelines associated therewith at the fair market value thereof.

26. **Savings Provision.** It is the intent of the Lessor that this lease is executed in accordance with its authority as a Charter Rule City and that the secondary term as stated herein is in the best interest of the City, provided, however, in the event that the term of this lease, if any beyond the Primary Term, violates any law existing on the date of this lease or the City's Charter as it exists on the date of this lease with respect to the term of the lease, then this lease shall be automatically amended to provide that the secondary term shall in no event extend beyond the maximum term allowed by law.

27. **Amendment.** This Lease may be amended without further bidding; but only by mutual written agreement of the parties hereto.

28. **Counterpart Execution.** This Lease may be executed in multiple counterparts, all of which, taken together, shall constitute one single Lease.

LESSEE:
MATRIX OIL CORPORATION

LESSOR:
CITY OF WHITTIER

By: _____
Signature (title)

By: _____
Stephen W. Helvey, City Manager

Printed Name

CLAYTON WILLIAMS ENERGY, INC.

By: _____
Signature (title)

Printed Name

APPROVED AS TO FORM:

By: _____
City Attorney

Date: _____

EXHIBIT "A"

All of those lands located in the incorporated area of the City of Whittier acquired by the City of Whittier under the following Deeds:

1. Grant Deed from Mountains Recreation and Conservation Authority to the City of Whittier dated December 20, 1995, and recorded on December 26, 1995, as Instrument Number 95-2043171, Los Angeles County Official Records; and
2. Grant Deed from The Trust for Public Land to the City of Whittier dated September 20, 1995, and recorded on October 16, 1995, as Instrument Number 95-1666829, Los Angeles County Official Records.



APN's:

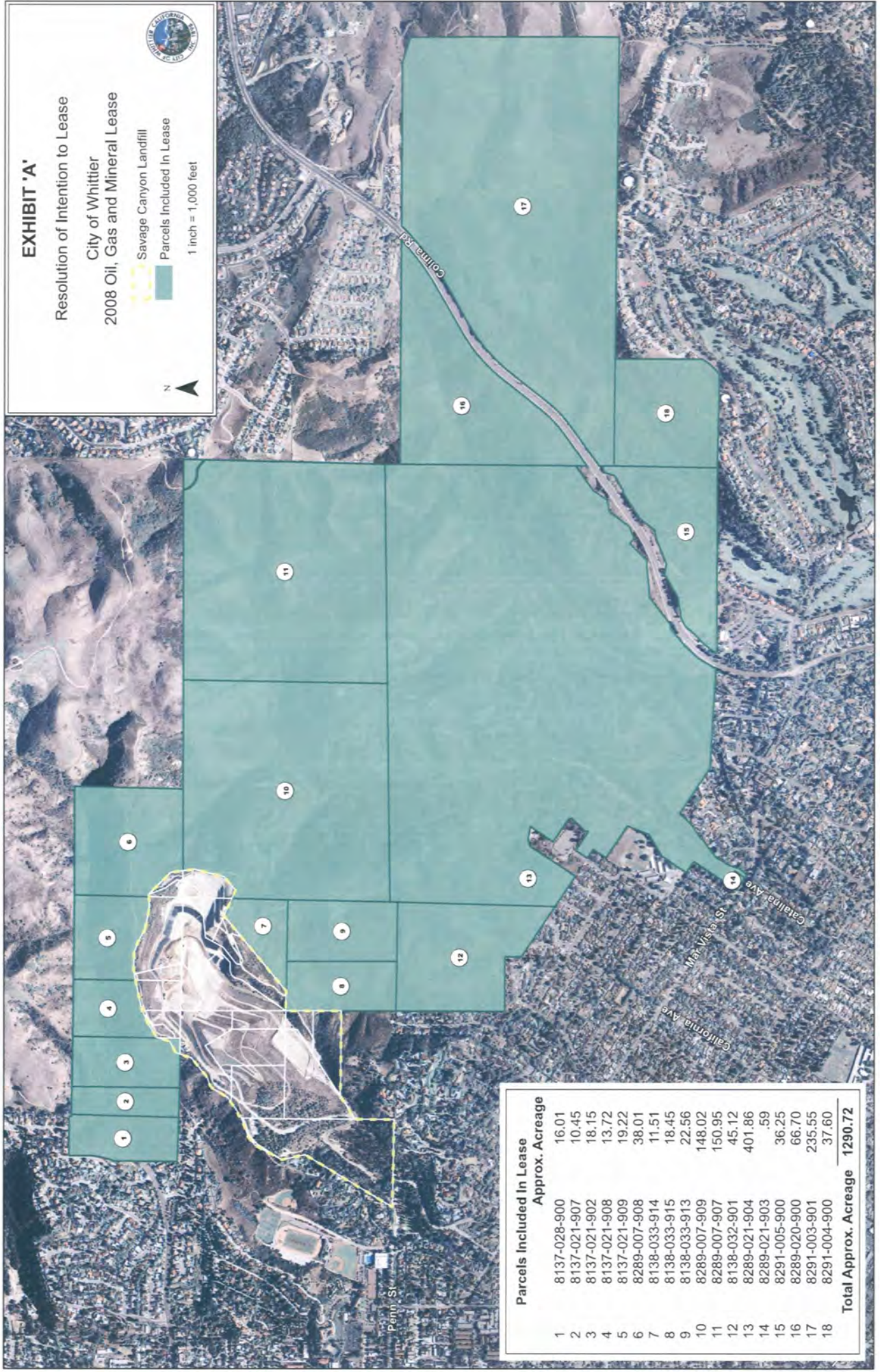
1. 8137-028-900, Approximately 16.01 acres
8137-021-907, Approximately 10.45 acres
8137-021-902, Approximately 18.15 acres
8137-021-908, Approximately 13.72 acres
8139-021-909, Approximately 19.22 acres
8289-007-908, Approximately 38.01 acres
8138-033-914, Approximately 11.51 acres
8138-033-915, Approximately 18.45 acres
8138-033-913, Approximately 22.56 acres
8289-007-909, Approximately 148.02 acres
8289-007-907, Approximately 150.95 acres
8138-032-901, Approximately 45.12 acres
8289-021-904, Approximately 401.86 acres
8289-021-903, Approximately 0.59 acres
8291-005-900, Approximately 36.25 acres
8291-004-900, Approximately 37.60 acres
2. 8289-020-900, Approximately 66.70 acres
8291-003-901, Approximately 235.55 acres

Total Approximate Area 1290.72 acres

EXHIBIT 'A'

Resolution of Intention to Lease
 City of Whittier
 2008 Oil, Gas and Mineral Lease

 Savage Canyon Landfill
 Parcels Included In Lease
 1 inch = 1,000 feet



Parcels Included In Lease	Approx. Acreage	
1	8137-028-900	16.01
2	8137-021-907	10.45
3	8137-021-902	18.15
4	8137-021-908	13.72
5	8137-021-909	19.22
6	8289-007-908	38.01
7	8138-033-914	11.51
8	8138-033-915	18.45
9	8138-033-913	22.56
10	8289-007-909	148.02
11	8289-007-907	150.95
12	8138-032-901	45.12
13	8289-021-904	401.86
14	8289-021-903	.59
15	8291-005-900	36.25
16	8289-020-900	66.70
17	8291-003-901	235.55
18	8291-004-900	37.60
Total Approx. Acreage	1290.72	

RECORDING REQUESTED BY AND
WHEN RECORDED MAIL TO:

NAME

MAILING
ADDRESS

CITY,
STATE
ZIP CODE

(SPACE ABOVE THIS LINE RESERVED FOR RECORDER'S USE)

Documentary Transfer Tax \$ _____
___ Computed on value of interest conveyed.
___ Computed on value of interest conveyed less liens
and encumbrances remaining thereon at time of sale.
___ No property transfer tax due.

By: _____

**OIL, GAS AND MINERAL LEASE
(SHORT FORM)**

THIS LEASE AND AGREEMENT, made and entered into this 28th day of October, 2008, by and between the **CITY OF WHITTIER**, a charter municipality of the State of California, hereinafter called "Lessor", and Matrix Oil Corporation, a California corporation (as to an undivided 25%), and Clayton Williams Energy, Inc., a Delaware corporation (as to an undivided 75%), hereinafter called "Lessee".

WITNESSETH:

Lessor hereby leases to Lessee and Lessee hereby leases from Lessor the land hereinafter described, for the purposes and with the exclusive right of prospecting, exploring by geological, geophysical, and all other methods, mining, drilling and operating said land for oil, gas, other hydrocarbons, associated substances, sulphur, nitrogen, carbon dioxide, helium, and other commercially valuable substances* which may be produced through wells on said land, similar to the above mentioned substances. The land hereby leased is situated in Los Angeles County, California, and is described as follows:

SEE EXHIBIT "A" ATTACHED HERETO AND MADE A PART HEREOF

and containing 1280.00 acres, more or less, hereinafter referred to as "said land."

*except for water and geothermal resources

This lease is made for the term and upon and subject to each and all terms, provisions, covenants and conditions set forth in the certain Oil, Gas and Mineral Lease of even date herewith between the parties hereto covering the land hereinabove described, and said Oil, Gas and Mineral Lease is hereby incorporated herein with the same force and effect as though herein set forth at length.

IN WITNESS WHEREOF, said parties have caused this lease to be duly executed at the date first hereinabove written.

LESSOR:

LESSEE:

CITY OF WHITTIER

MATRIX OIL CORPORATION

By: _____
Stephen W. Helvey, City Manager

By: _____
Its: _____

APPROVED AS TO FORM:

CLAYTON WILLIAMS ENERGY, INC.

By: _____
City Attorney

By: _____

Date: _____

Its: _____

ALL-PURPOSE ACKNOWLEDGMENT FOR CALIFORNIA

STATE OF CALIFORNIA)
) ss.
 COUNTY OF _____)

On _____, 2008, before me, _____
 Date Name And Title Of Officer (e.g. "Jane Doe, Notary Public")

personally appeared _____
 Name(s) of Signer(s)

who proved to me on the basis of satisfactory evidence to be the person(s) whose name(s) is/are subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their authorized capacity(ies), and that by his/her/their signature(s) on the instrument the person(s), or the entity upon behalf of which the person(s) acted, executed the instrument.

I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing paragraph is true and correct.

WITNESS my hand and official seal.

Place Notary Seal Above

 Signature of Notary Public

OPTIONAL

Though the information below is not required by law, it may prove valuable to persons relying on the document and could prevent fraudulent removal and reattachment of this form to another document.

CAPACITY CLAIMED BY SIGNER

- Individual
- Corporate Officer

 Title(s)
 Partner(s) Limited
 Attorney-In-Fact General
 Trustee(s)
 Guardian/Conservator
 Other: _____

Signer is representing:
 Name Of Person(s) Or Entity(ies)

DESCRIPTION OF ATTACHED DOCUMENT

 Title or Type of Document

 Number Of Pages

 Date Of Document

 Signer(s) Other Than Named Above

EXHIBIT "A"

All of those lands located in the incorporated area of the City of Whittier acquired by the City of Whittier under the following Deeds:

1. Grant Deed from Mountains Recreation and Conservation Authority to the City of Whittier dated December 20, 1995, and recorded on December 26, 1995, as Instrument Number 95-2043171, Los Angeles County Official Records; and
2. Grant Deed from The Trust for Public Land to the City of Whittier dated September 20, 1995, and recorded on October 16, 1995, as Instrument Number 95-1666829, Los Angeles County Official Records.

APN's:

1. 8137-028-900, Approximately 16.01 acres
8137-021-907, Approximately 10.45 acres
8137-021-902, Approximately 18.15 acres
8137-021-908, Approximately 13.72 acres
8139-021-909, Approximately 19.22 acres
8289-007-908, Approximately 38.01 acres
8138-033-914, Approximately 11.51 acres
8138-033-915, Approximately 18.45 acres
8138-033-913, Approximately 22.56 acres
8289-007-909, Approximately 148.02 acres
8289-007-907, Approximately 150.95 acres
8138-032-901, Approximately 45.12 acres
8289-021-904, Approximately 401.86 acres
8289-021-903, Approximately 0.59 acres
8291-005-900, Approximately 36.25 acres
8291-004-900, Approximately 37.60 acres
2. 8289-020-900, Approximately 66.70 acres
8291-003-901, Approximately 235.55 acres

Total Approximate Area 1290.72 acres

EXHIBIT 'A'

Resolution of Intention to Lease

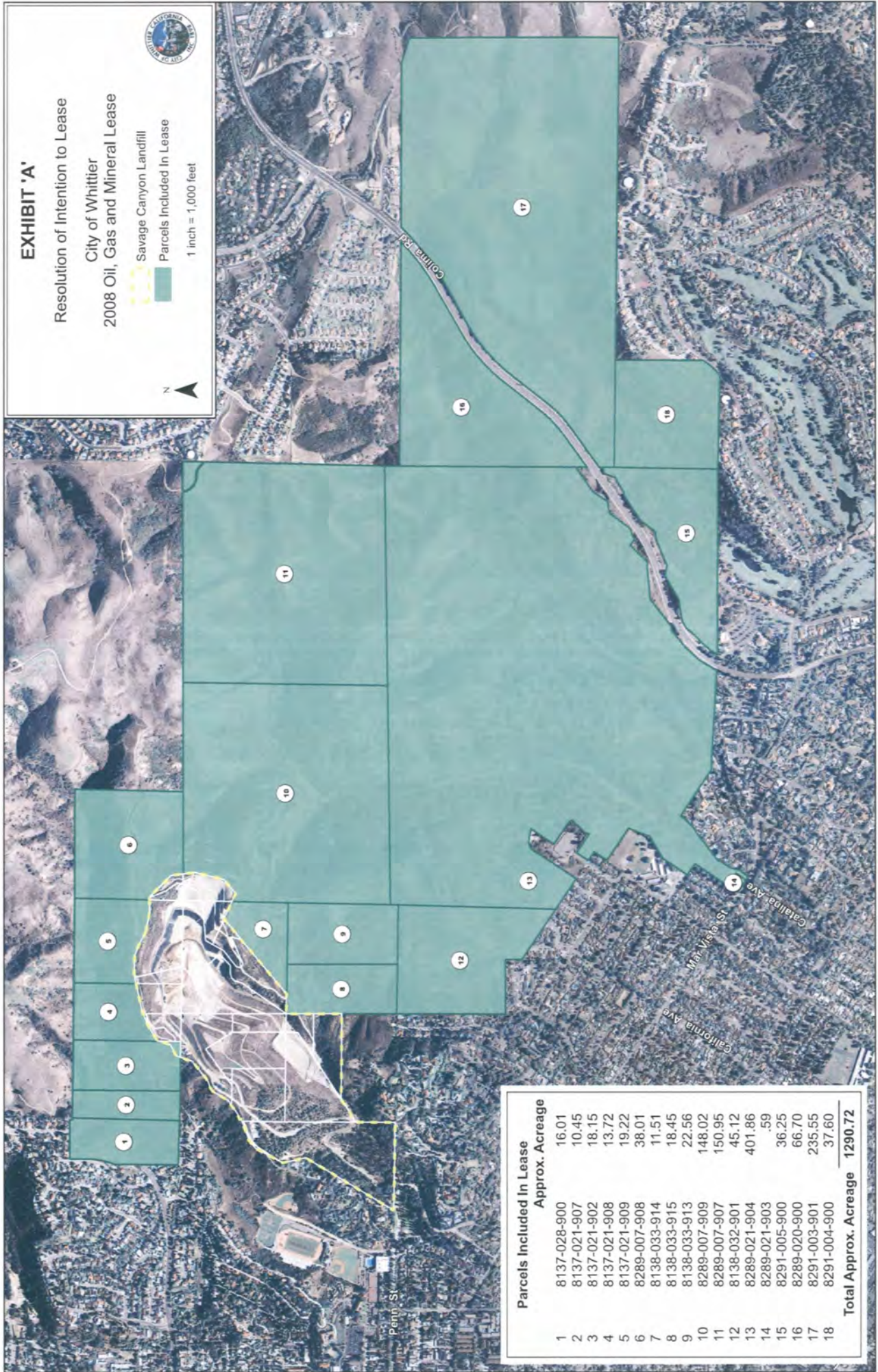
City of Whittier

2008 Oil, Gas and Mineral Lease

Savage Canyon Landfill

Parcels Included In Lease

1 inch = 1,000 feet



Parcels Included In Lease	Approx. Acreage	
1	8137-028-900	16.01
2	8137-021-907	10.45
3	8137-021-902	18.15
4	8137-021-908	13.72
5	8137-021-909	19.22
6	8289-007-908	38.01
7	8138-033-914	11.51
8	8138-033-915	18.45
9	8138-033-913	22.56
10	8289-007-909	148.02
11	8289-007-907	150.95
12	8138-032-901	45.12
13	8289-021-904	401.86
14	8289-021-903	59
15	8291-005-900	36.25
16	8289-020-900	66.70
17	8291-003-901	235.55
18	8291-004-900	37.60
Total Approx. Acreage	1290.72	