

Executive Summary of the Proposed Development Agreement between E&B Natural Resources Management Corporation and City of Hermosa Beach to be Considered by the Voters at the March 3, 2015 Special Election as Part of Measure O

Consideration by the voters of the proposed E&B Oil Drilling & Production Project implements a 2012 Settlement Agreement between the City of Hermosa Beach, E&B Resources Management Corporation (“E&B”) and Macpherson Oil Company (for itself and Windward Associates) to resolve a lawsuit brought by Macpherson Oil Company against the City for breach of contract regarding oil drilling at the site of the existing City Maintenance Yard at 555 Sixth Street. The Settlement Agreement obligates the City, at E&B’s request, to ask the voters whether to (1) amend the Hermosa Beach Municipal Code to allow E&B’s oil drilling and production project to proceed at the City maintenance yard, and (2) approve a development agreement that would afford E&B a vested right to proceed with the Project notwithstanding any future inconsistent change in the City’s Municipal Code.

A development agreement is an agreement authorized under state law that allows the parties to agree to freeze applicable zoning rules, regulations and policies that are in place at the time of the execution of the agreement in order to protect the project developer from future changes in the law that would adversely affect the project. This is what is meant by affording the developer a “vested right.”

The proposed development agreement between the City and E&B that will appear on the ballot is 48 pages long and includes four exhibits consisting of an additional 250 pages. This document prepared by the City summarizes the major provisions of the development agreement. The development agreement is hereinafter referred to as “the agreement.”

The main body of the agreement contains the following major provisions:

- **Preliminary recitals of the events that led to the E&B project ballot measure.**
- **Definitions of the defined terms used in the Agreement.**
- **A grant of vested rights to the project (Section 3.1)**
 - *If approved by the voters, the agreement provides assurances to E&B that it can proceed with this project (including the pipeline and subject to all of the conditions and mitigation measures) for the term of the agreement pursuant to the laws in effect when the ballot measure is approved. This means future attempts to change the law and prohibit oil drilling at the City Yard site will not apply to this project, which can proceed under this agreement. These assurances are granted in exchange for the public benefits listed in Exhibit C to the agreement.*
 - *This right to proceed applies only to this project on the City Yard. This agreement does not apply to any other site or any other project proposed in the City now or in the future.*
- **A provision governing how the project may be transferred by E&B to a third party (Section 4.1)**
 - *E&B may sell or transfer its rights and obligations under the agreement to a third party with the City’s approval.*
 - *City may withhold or delay approval if the new party lacks the financial ability or capability to implement the project with the equivalent capabilities of E&B. Nationally and regionally recognized oil and gas companies are deemed to meet this requirement.*

- *City may also withhold or delay approval if the new party has a record of dangerous or unhealthy performance failures at other oil drilling and production facilities or if E&B is in default of the agreement.*
 - *E&B may not transfer this project to Macpherson or any of its related companies.*

- **Rules governing how changes, both major and minor may be made to the project (Section 4.2)**
 - *Some refinements or modifications of the project may be required during the life of the project. The City Manager will determine whether a change is major or minor, subject to City Council approval. Given the complexity of the project, the City Manager may consult with technical experts in determining whether a change is major or minor.*
 - *Major changes require, among any other required approvals, an amendment to the agreement, which must be approved by the voters.*
 - *Minor changes are approved by a letter from the City Manager, subject to City Council approval at a public Council meeting. Minor changes do not require an amendment to the agreement or a public hearing.*
 - *The following are examples of major project changes:*
 - *Changes to the permitted use of the property;*
 - *Changes requiring a legislative act (such as a change to the Zoning Code or General Plan);*
 - *Increases the intensity of the project;*
 - *Changes that will have adverse environmental impacts requiring a subsequent or supplemental EIR under the California Environmental Quality Act; or*
 - *Changes that create a situation adverse to public health or safety.*

- **A requirement that the Agreement be reviewed annually by the City Council (Section 4.3)**
 - *Every twelve months, the City will review the extent of E&B's good faith, substantial compliance with the terms of the agreement.*
 - *The City Council may order special review of compliance with the Agreement at any time.*
 - *E&B may request a hearing to discuss its performance under the Agreement.*

- **Available remedies in the event of a default by either party, including the City's right to suspend the project under certain circumstances and exact penalties from E&B for violations (Section 5.1)**
 - *The remedies for failure to comply with the terms of the Agreement are as follows:*
 - *Following a notice of default and opportunity for that party to cure the default, either party may sue the other party to cure, correct or remedy any default, to enforce any agreements provisions, to enjoin any threatened or attempted violation hereof, or to obtain any other remedies.*
 - *If the City brings a lawsuit against E&B for violation of the Agreement or conditions of approval (following notice of violation and E&B's failure to cure) or violation of a stop order issued under the Oil Code, a court may impose civil penalties against E&B up to \$10,000/day for each day E&B is determined to be noncompliant.*
 - *City may sue E&B for monetary damages if E&B fails to pay any amounts owing under the agreement.*
 - *If E&B's failure or refusal to perform any provision of the Agreement causes an immediate and serious threat to life, health, property or natural resources, the City may pursue all legal remedies including immediate project suspension*

available under the Hermosa Beach Oil Code Chapter 21-A and Section 21 of the Lease.

- *E&B may not seek monetary damages for City's default under the Agreement. This means that E&B's only recourse is to sue the City for specific performance, under which the Court could order the City to comply with the terms of the agreement.*
- **The term of the Agreement and how and under what circumstances the Agreement may be terminated prior to expiration (Section 5.2 and 6.1)**
 - *The agreement becomes effective on the date that the California Coastal Commission approves the Agreement; however, in the event of litigation challenging the Agreement or the Project Approvals, the Agreement will not become effective until the date the litigation is concluded in a manner that upholds the E&B's right to proceed.*
 - *Once effective, the term of the Agreement is commensurate with the remaining term of the Lease that the City entered into with Macpherson Oil Company in 1992, which was assigned to E&B. The Lease period has been tolled during the litigation mentioned above and thirty-four years remain on the Lease. This means that the term of the agreement will run for thirty-four years from the date the California Coastal Commission approves the Agreement.*
 - *Both parties have the right to terminate the agreement early if the other party defaults and fails to cure the default within the cure period.*
 - *E&B is not obligated to proceed with the project, if approved, and could terminate the agreement in the event it chooses not to proceed.*
- **An indemnification by E&B protecting the City from its activities and requirements for insurance coverage for the project (Section 6.5)**
 - *E&B must defend, protect, indemnify and hold harmless the City from and against any claims by a third party for damages, costs, expenses, liabilities, and losses of any kind claimed to arise in any way from the project. This is very broad and also includes E&B paying the reasonable fees for accountants, attorneys, engineers, and other professional consultants needed to defend against the claim. The only limit on this indemnification is that E&B is not required to pay for actions resulting from the City's own gross negligence or intentional acts.*
 - *The City may allow E&B to defend against the claims, or the City may elect to participate directly in the litigation, in which case City may select its own lawyers and E&B will pay for the legal costs.*
- **An enforced delay provision that suspends the parties' performance in the event of occurrences outside the parties' control (Section 6.24)**
 - *This is a standard term in many contracts, also referred to as Force Majeure Delay.*
 - *Performance delays will not be considered a default where the performance delay are due to occurrences outside the parties' control, such as war, riots, floods, earthquakes, strikes, fires, third party challenges to the Project, and delays due to the enforcement of environmental regulations.*
 - *If one of these situations takes place and prevents the party from performing, the agreement shall be extended for the period of time that the cause of the enforced delay exists.*

- *The extension is not granted automatically. The party claiming enforced delay must provide timely notice to the other party. The City Council may grant a longer extension or waive the timely notice requirement by finding that the enforced delay is reasonably required.*
- **A requirement that E&B reports to the City any lawsuits, notices of violation or investigations concerning alleged violations of law or permits arising from or related to E&B's other oil and gas drilling and production operations. (Section 6.26)**
 - *E&B is required to notify the City within 15 days of receipt notice of any lawsuits, notices of violation, or notices of administrative or governmental agency investigations concerning alleged violations of any law or permit condition raising material issues at E&B's oil and gas drilling and production operations.*
 - *In addition to notifying the City, E&B must provide the City with the documents initiating the proceeding against E&B. The City may request any documents E&B files in response or the final decision in the matter. E&B is not obligated to send the City routine correspondence in the matter.*

The four Exhibits (A-D) to the Agreement are as follows:

Exhibit A, comprised of A-1, A-2 and A-3, set forth the legal property descriptions for the City Yard site, the supply and staging site at 602 Cypress Avenue, and parking lot that will be utilized at 636 Cypress Avenue.

Exhibit B is a lengthy project description, derived from the EIR.

Exhibit C summarizes the financial benefits that the City will receive in exchange for granting the vested rights to proceed with the project for the term. If the voters approve the project, E&B will provide the following benefits in addition to the royalties set out in the Lease:

- 1. Five, annual accelerated uplands royalty payments of up to \$1,000,000 commencing with issuance of the City drilling permit for first well to be counted towards the City's future, unrestricted royalties.**

The 1992 Lease discussed above sets out the schedule for royalty payments for oil derived from the uplands and the tidelands. Royalties derived from oil taken from the tidelands is restricted for tidelands uses. Royalties derived from oil taken from the uplands is unrestricted. So this benefit means that E&B will accelerate uplands (unrestricted) royalty payments to the City at the issuance of the first drilling permit. Without having to pay interest or taking into account the time value of money, the accelerated payments will be counted toward and offset against future, unrestricted royalties. These payments are estimated to continue for five years for a total of \$5,000,000, until actual royalties start coming in. If these accelerated payments are more than the actual uplands royalties, City does not have to repay the overpayment.

- 2. Bonus payments during years 4-13 of the Lease to ensure \$1 Million royalty amount.**

The Lease provides for a \$500,000 Minimum Royalty starting on the fourth anniversary of the completion of the first well drilled and continuing to the thirteenth anniversary. When

actual royalties are received during years 4-13 under the Lease, the City is supposed to receive a minimum royalty payment of \$500,000. E&B has agreed in the Development Agreement to ensure that the City receives a minimum of \$1,000,000 per year during those years. These bonus payments are not royalties; but rather bonus payments to the City as lessor of the property. Thus, these payments are also unrestricted funds.

- 3. E & B will pay for and implement the Remedial Action Plan for the Project to remediate soil contamination at the existing City Maintenance Yard if the Project proceeds to Phase 3, full production. If the Project does not proceed to Phase 3, E & B will conduct remediation activities at the City Maintenance Yard to allow the site to be used for industrial and commercial purposes.**

There is documented soil contamination at the City Yard site (and analyzed in the EIR) which must be assessed and remediated. In lieu of the City paying for the remediation, E&B will implement and pay for the remediation activities onsite.

- 4. E&B will forgive the City's obligation (set forth in the Settlement Agreement) to pay E&B \$ 3.5 Million upon issuance of the drilling permit for the first well and if E&B proceeds with Phase 3 of the Project, E&B will advance \$6.5 Million to the City for permanent relocation of the City Maintenance Yard.**

If the voters approve the project, the City has the option of moving the City Yard directly to a permanent location, or to a temporary facility and then to a permanent facility. If the project proceeds to Phase 3, the City can use the \$6.5 Million advance to pay for the permanent City Yard relocation.

- 5. Payment of 1% of gross revenues to City to fund community improvements.**

In addition to the royalty payments already required under the Lease and set forth above, E&B will pay the City an additional 1% of all of the project gross revenues. The money may be used in the City's sole discretion to pay for community improvements.

- 6. Creation of a Hermosa Beach Residential Property Fund to provide owners of residential properties within 600 feet of the Project with assurance that they will incur no loss as a result of the Project to their property's fair market value.**

- a. Residents who own residential properties within 600 feet of the Project can voluntarily participate in a Hermosa Beach Residential Property fund. The Fund will pay the difference between an eligible property's actual negotiated sale price and the appraised Market Value of the property, which will be determined as if the Project had not been built. A predetermined independent appraisal process will demonstrate if there is a loss in the market value of an owner's residential property. There will be a \$25 Million cap on the total amount of the benefits that the fund can pay out. The fund will commence upon City's issuance of the drilling permit for the first well and will continue until either six years have passed or one year after completion of the final well, whichever is later, or the entire funding cap has been dispersed to eligible property owners. The Fund will be administered by a qualified, independent fund administrator.*

In addition to the above, Recital J of the agreement acknowledges that E&B has assigned to the Hermosa Beach Education Foundation a 1% overriding royalty interest in oil and gas produced from the

project site, with a \$1,000,000 advance payment of royalty to the Foundation upon issuance by the City of the drilling permit for the first well.

Exhibit D contains all of the conditions of approval and environmental mitigation measures identified in the Environmental Impact Report governing the project, including provisions that E&B pay for all of the City's costs in administering and enforcing the project conditions and hiring of an environmental monitor to ensure compliance with all project conditions over the life of the project.

Exhibit D-1 includes the restatement of the 1993 Conditional Use Permit conditions (replacing some conditions with stricter mitigation measures and modifying the conditions to reflect the existence of a development agreement). The 1993 Conditional Use Permit was granted by the City for a proposed oil and gas drilling and production at the City Maintenance Yard site and that Conditional Use Permit is abandoned and superseded by the development agreement, which contains the same or stricter conditions and mitigation measures.

Exhibit D-2 contains approximately 20 pages of the City's project conditions drafted specifically for this project, and Exhibit D-3 reflects the Mitigation Monitoring Plan derived from the Environmental Impact Report, incorporating all of the environmental mitigation measures required in the Environmental Impact Report and identifying the responsible party and timing for their implementation.