IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re	:	Chapter 11
CALIFORNIA RESOURCES CORPORATION, *et al.*,[1]	:	Case No. 20-33568 (DRJ)
	:	Jointly Administered
Debtors.	:	

A HEARING WILL BE CONDUCTED ON THIS MATTER ON AUGUST 14, 2020 AT 9:00 AM (PREVAILING CENTRAL TIME). IF YOU OBJECT TO THE RELIEF REQUESTED, YOU MUST RESPOND IN WRITING, SPECIFICALLY ANSWERING EACH PARAGRAPH OF THIS PLEADING. UNLESS OTHERWISE DIRECTED BY THE COURT, YOU MUST FILE YOUR RESPONSE WITH THE CLERK OF THE BANKRUPTCY COURT WITHIN TWENTY-ONE DAYS FROM THE DATE YOU WERE SERVED WITH THIS PLEADING. YOU MUST SERVE A COPY OF YOUR RESPONSE ON THE PERSON WHO SENT YOU THE NOTICE; OTHERWISE, THE COURT MAY TREAT THE PLEADING AS UNOPPOSED AND GRANT THE RELIEF REQUESTED.

PLEASE NOTE THAT ON MARCH 24, 2020, THROUGH ENTRY OF GENERAL ORDER 2020-10, THE COURT INVOKED THE PROTOCOL FOR EMERGENCY PUBLIC HEALTH OR SAFETY CONDITIONS (GENERAL ORDER 2020-4).

IT IS ANTICIPATED THAT ALL PERSONS WILL APPEAR TELEPHONICALLY AND ALSO MAY APPEAR VIA VIDEO AT THIS HEARING. AUDIO COMMUNICATION WILL BE BY USE OF THE COURT'S REGULAR DIAL-IN NUMBER. THE DIAL-IN NUMBER IS +1 (832) 917-1510. YOU WILL BE ASKED TO KEY IN THE CONFERENCE

[1] The Debtors in these chapter 11 cases and the last four digits of their U.S. taxpayer identification numbers are: California Resources Corporation (0947); California Heavy Oil, Inc. (4630); California Resources Coles Levee, L.P. (2995); California Resources Coles Levee, LLC (2087); California Resources Elk Hills, LLC (7310); California Resources Long Beach, Inc. (6046); California Resources Mineral Holdings LLC (4443); California Resources Petroleum Corporation (9218); California Resources Production Corporation (5342); California Resources Production Mineral Holdings, LLC (9071); California Resources Real Estate Ventures, LLC (6931); California Resources Royalty Holdings, LLC (6393); California Resources Tidelands, Inc. (0192); California Resources Wilmington, LLC (0263); CRC Construction Services, LLC (7030); CRC Marketing, Inc. (0941); CRC Services, LLC (6989); Monument Production, Inc. (0782); Oso Verde Farms, LLC (7436); Socal Holding, LLC (3524); Southern San Joaquin Production, Inc. (4423); Thums Long Beach Company (1774); Tidelands Oil Production Company LLC (5764). The Debtors' corporate headquarters is located at 27200 Tourney Road, Suite 200, Santa Clarita, CA 91355.

ROOM NUMBER. JUDGE JONES' CONFERENCE ROOM NUMBER IS 205691.

FURTHER INFORMATION REGARDING TELEPHONE AND VIDEO APPEARANCES AT THIS HEARING IS AVAILABLE IN GENERAL ORDER 2020-4, WHICH CAN BE FOUND ON THE COURT'S WEBSITE AT: HTTP://WWW.TXS.USCOURTS.GOV/BANKRUPTCY/GENORD.

HEARING APPEARANCES SHOULD BE MADE ELECTRONICALLY AND IN ADVANCE OF THE HEARING. YOU MAY MAKE YOUR ELECTRONIC APPEARANCE BY DOWNLOADING THE FREE GOTOMEETING APPLICATION AND ENTERING THE MEETING CODE "JudgeJones". ONCE CONNECTED TO GOTOMEETING, CLICK THE SETTINGS ICON IN THE UPPER RIGHT CORNER AND ENTER YOUR NAME UNDER THE PERSONAL INFORMATION SETTING. SUBMITTING YOUR APPEARANCE ELECTRONICALLY IN ADVANCE OF THE HEARING WILL NEGATE THE NEED TO MAKE AN APPEARANCE ON THE RECORD AT THE HEARING.

DEBTORS' MOTION FOR AN ORDER AUTHORIZING, BUT NOT DIRECTING, THE DEBTORS TO IMPLEMENT (I) THE QUARTERLY INCENTIVE PLAN, (II) THE INCENTIVE AND RETENTION PLAN AND (III) THE SUPPLEMENTAL RETENTION

California Resources Corporation ("CRC") and certain of its affiliated debtors and debtors-in-possession (collectively, the "Debtors") hereby submit this motion (the "Motion") for entry of an order, substantially in the form attached hereto as Exhibit A (the "Order"), pursuant to sections 105, 363, 503, 1107 and 1108 of title 11 of the United States Code, 11 U.S.C. §§ 101 *et seq*. (the "Bankruptcy Code"), authorizing, but not directing, the Debtors to implement (a) the proposed Quarterly Incentive Plan (the "QIP"), (b) the proposed Incentive and Retention Plan (the "Employee Compensation Program") and (c) the Supplemental Retention (as defined below, and together with the QIP and the Employee Compensation Program, the "Compensation Programs"). In support of the Motion, the Debtors rely upon the *Declaration of Todd A. Stevens in Support of the Debtors' Chapter 11 Petitions and First Day Pleadings*, filed on July 15, 2020 [Docket No. 20] (the "Stevens First Day Declaration"), the *Declaration of Brian Cumberland in Support of the Debtors' Motion for an Order Authorizing, but not Directing, the Debtors to*

Implement (I) the Quarterly Incentive Plan, (II) the Incentive and Retention Plan and (III) the Supplemental Retention, attached hereto as Exhibit B (the "Cumberland Declaration"), the *Declaration of Mark Rajcevich in Support of the Debtors' Motion for an Order Authorizing, but not Directing, the Debtors to Implement (I) the Quarterly Incentive Plan, (II) the Incentive and Retention Plan and (III) the Supplemental Retention*, attached hereto as Exhibit C (the "Rajcevich Declaration") and the *Declaration of Daniel S. Watts in Support of the Debtors' Motion for an Order Authorizing, but not Directing, the Debtors to Implement (I) the Quarterly Incentive Plan, (II) the Incentive and Retention Plan and (III) the Supplemental Retention*, attached hereto as Exhibit D (the "Watts Declaration", and together with the Stevens First Day Declaration, the Cumberland Declaration and the Rajcevich Declaration, the "Declarations"). In further support of the Motion, the Debtors respectfully state as follows:

Background

1. On July 15, 2020 (the "Petition Date"), each Debtor filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code. The Debtors are an independent oil and natural gas exploration and production company operating properties exclusively within the state of California. The Debtors also own or control a network of natural gas processing plants, power plants, oil and natural gas gathering systems and other related assets.

2. The Debtors, as with others in their industry, faced financial and operational challenges as a result of commodity price declines beginning in 2018, disruptions in the commodity markets during the first few months of 2020 and the exacerbation thereof by the COVID-19 global pandemic. As a result, the Debtors announced in March 2020 that they were reducing their capital investment to a level that maintains the mechanical integrity of their facilities to operate them in a safe and environmentally responsible manner. These challenges were discussed in more detail in the Stevens First Day Declaration.

3. As a result of this volatile operating and financial environment, the Debtors determined that the incentive programs that the Debtors established in February 2020 for all bonus-eligible employees of the Debtors (the "Employees") no longer appropriately aligned Employees' compensation opportunities with the Debtors' objectives for 2020. Additionally, the Debtors determined that maintaining the continuity and focus of the Debtors' workforce during this period of uncertainty was critical to the Debtors' operations and restructuring success.

4. The Compensation Committee (the "Compensation Committee") of the Board of Directors of California Resources Corporation (the "Board"), working with Alvarez & Marsal ("A&M"), developed (a) the QIP for the Debtors' senior management, which replaced the 2020 long-term incentive awards for those Employees, and (b) the Employee Compensation Program, which replaced the 2020 annual and long-term incentive awards for the other Employees. The Compensation Programs do not increase the target compensation opportunities payable under the annual or long-term incentives adopted by the Debtors in the first quarter of 2020, with the exception of a select group of non-insider Employees that were granted supplemental retention awards because the Debtors identified such Employees as raising particular retention concerns. The Compensation Programs are not focused solely on management; instead, the programs recognize the importance of incentivizing the broader population to stay focused and work collectively to achieve common goals.

5. The Compensation Programs represent the only direct compensation opportunities for 2020 (other than base salary). The Employee Compensation Program also provides the primary go-forward vehicle for retention-based compensation for non-insider participants in that program, as few legacy retention awards remain outstanding. Accordingly, the Compensation Programs are a critical tool in incentivizing the Employees to enhance the

Debtors' operational performance in this challenging environment and to execute a successful reorganization for the Debtors and their stakeholders.

Jurisdiction and Venue

6. The Court has jurisdiction to consider this matter pursuant to 28 U.S.C. § 1334. Venue is proper pursuant to 28 U.S.C. §§ 1408 and 1409. This matter is a core proceeding pursuant to 28 U.S.C. § 157(b). The Debtors consent, pursuant to Bankruptcy Rule 7008, to the entry of a final order by the Court in connection with this Motion to the extent that it is later determined that the Court, absent consent of the parties, cannot enter final orders or judgments in connection herewith consistent with Article III of the United States Constitution. The statutory predicates for the relief requested herein are sections 105, 363, 503, 1107 and 1108 of the Bankruptcy Code, Bankruptcy Rules 6003 and 6004 and the Procedures for Complex Chapter 11 Cases in the Southern District of Texas (the "Complex Case Procedures").

Relief Requested

7. By this Motion, the Debtors seek entry of an order, substantially in the form attached hereto as Exhibit A (the "Proposed Order"), (a) authorizing and approving (i) the Quarterly Incentive Plan, (ii) the Incentive and Retention Plan and (iii) the Supplemental Retention, and (b) granting related relief.

8. In support of this Motion, the Debtors submit the Stevens First Day Declaration, the Cumberland Declaration, the Rajcevich Declaration and the Watts Declaration.

The Compensation Programs

I. The Debtors' 2020 Incentive Compensation Opportunities

9. In the ordinary course, the Debtors maintained two primary employee incentive compensation programs consisting of (1) annual cash incentives and (2) long-term cash- or equity-settled incentives that generally have a value tied to the Debtors' stock price. *See*

Watts Decl. ¶¶ 6-8. These programs were key elements in the Debtors' compensation programs that were designed to attract, retain and incentivize talented employees to achieve certain financial and operational results and to align compensation with shareholders. *See* Watts Decl. ¶ 6.

10. The annual cash incentives for 2020 were designed to promote the achievement of financial, operating and strategic results aligned to stockholder value. Incentives would be earned to the extent that CRC and its subsidiaries achieved predetermined goals tied to the "value creation index"[2] of CRC and its subsidiaries (designed to measure CRC's disciplined, consistent and effective capital allocation), EBITDAX,[3] net debt[4] and sustainability,[5] as well as the Employee's achievement of individual goals. The performance criteria were set at levels determined based on expected results under CRC's business plan at the time the criteria were established in February 2020, with target performance criteria set at levels that would represent a successful execution of the 2020 business plan. *See* Watts Decl. ¶ 7.

11. To promote retention and pay-for-performance, the long-term incentives for 2020 for the Debtors' executives consisted of a mix of time-vested restricted stock unit

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2 "Value creation index" or "VCI" is used for project selection and capital allocation across CRC's portfolio of opportunities. VCI is a ratio that measures the present value of the future cash flows from all development (new drills and capital workovers) in each plan year per discounted dollar of investment, calculated as A divided by B where "A" is the discounted expected future cash flows and "B" is the discounted capital invested for the plan year, excluding JV partner funding. The discounted expected future cash flows of the 2020 investments would be calculated by taking CRC's share of future revenues minus production costs and production taxes but before any general and administrative charges, interest expense, income taxes and other corporate payments. The future cash flow calculations would be based on the price for each respective year and would include impacts of hedges placed within the calendar year.

3 "EBITDAX" is defined as earnings before interest expense; income taxes; depreciation, depletion and amortization; exploration expense; other unusual, out-of-period and infrequent items; and other non-cash items.

4 "Net debt" is measured as the face value of outstanding debt *less* unrestricted cash.

5 The sustainability goals measured safety, spill prevention, net water supplied to agriculture and project milestones relating to water recycling, renewable energy, methane capture, carbon capture, workforce diversity and community partnerships. Several of the sustainability goals were designed to drive progress towards CRC's "2030 Sustainability Goals".

awards and performance-based awards. Performance-based awards were granted in the form of stock options with an exercise price equal to 110% of the stock price on the grant date and performance stock units. The number of performance stock units that were ultimately earned would be determined based on CRC's relative total shareholder return and VCI over a three-year performance period ending in 2022. In recent years, long-term incentives for non-executive employees have been granted in cash-settled phantom shares. *See* Watts Decl. ¶ 8.

12. The annual and long-term incentives adopted in February 2020 were consistent with the Debtors' ordinary course practices. *See* Watts Decl. ¶¶ 7-8, 10.

II. The Development of the Compensation Programs

13. Following the market downturn in the industry and the global economic downturn caused by the COVID-19 pandemic, it became apparent as early as March 2020 that the Debtors' existing incentive compensation programs needed to be modified. The unprecedented economic environment meant that traditional financial and operational metrics were ineffective in the short term, and several of the metrics underpinning the incentives no longer aligned with the Debtors' adjusted priorities following the Debtors' decision to reduce their capital investment. For example, cuts to the Debtors' capital spending budget to a level that maintains the mechanical integrity of their facilities to operate them in a safe and environmentally responsible manner meant that the VCI performance metric no longer adequately represented the Debtors' capital allocation, and the dramatic drop in oil prices made the previously-set EBITDAX goals unlikely to be reached. Additionally, as a result of stay-at-home restrictions implemented in connection with the COVID-19 pandemic, certain of the metrics would have required activities by Employees that were no longer appropriate or safe. The long-term incentives adopted by the Debtors in February were tied, in part, to capital allocation metrics that no longer reflected the Debtors' operating environment and, at current

share prices, provide minimal value to employees. As a result, the Debtors' incentive programs no longer effectively incentivized Employees at a time when a significant portion of the intended performance period remained. *See* Watts Decl. ¶ 11.

14. During the uncertainty arising in the first quarter of 2020, the Debtors also experienced attrition in several key positions within the organization, including senior reservoir, process, data and electrical engineers, area operational managers, commercial and marketing professionals, and a senior member of the accounting team. *See* Watts Decl. ¶ 12. Although the job market in the United States is experiencing unprecedented contraction, individuals within the Debtors' workforce have skills and knowledge that continue to be in demand within the Debtors' industry, particularly within California, which is far from the center of the nation's oil and gas industry. The retention of the Debtors' workforce is critical, particularly following the reduction in force conducted in October and November 2019, pursuant to which the employment of approximately 220 of the Debtors' employees terminated. *See* Watts Decl. ¶ 12. The lack of meaningful and effective incentive opportunities, which in many cases represented a significant portion of an Employee's 2020 compensation opportunities, amplified the retention risk that the Debtors already faced due to decreasing stock prices, a volatile oil industry and the widespread effects of the COVID-19 pandemic. *See* Watts Decl. ¶¶ 10, 12.

15. In March 2020, the Compensation Committee engaged A&M to provide compensation advice with respect to the Debtors' compensation programs. A&M conducted analyses to consider the cost and structure of the Debtors' programs and met with the Debtors' management, the Board, the Compensation Committee and the Special Committee of the Board over the course of approximately two months to discuss approaches to structuring compensation programs that would meet the Debtors' compensation objectives in the current environment and that reflect current market practices by distressed companies. *See* Watts Decl. ¶¶ 12-13.

16. After concluding that the annual and long-term incentives granted in February 2020 were ineffective and with A&M's review and advice, the Compensation Committee, in its business judgment, determined that it was appropriate to replace those programs. Because the Compensation Programs are designed to replace, rather than supplement, the incentives originally implemented in 2020, the Compensation Committee determined that the compensation opportunities under the replacement programs should continue the target compensation levels previously approved in the ordinary course for 2020, subject to additional supplemental retention awards to select non-insider employees that the Debtors determine present a significant retention risk. *See* Watts Decl. ¶ 14. On May 19, 2020, the Compensation Committee approved the Compensation Programs to collectively replace the annual and long-term incentives for 2020. *See* Watts Decl. ¶ 14.

17. In light of the evolving market conditions, which add uncertainty to the effectiveness of any performance-based compensation program, and the identified retention concerns, the Compensation Committee determined that a portion of the opportunities under the new programs should include a direct retentive component. Accordingly, the annual incentive portion of target total incentive opportunity for participants in the Quarterly Incentive Plan (representing, on average, 24% of the QIP Participants' target total incentive opportunity, *i.e*. the total annual and long-term incentives), and 50% of the target total incentive opportunity for participants in the Employee Compensation Program, was delivered in the form of retention awards.[6] The retention awards granted to participants in the Quarterly Incentive Plan were prepaid, with a requirement that the awards be repaid by the participant in the event of a termination for "cause" or voluntary resignation before the earliest of (x) one year following the

[6] The remainder of the QIP Participants' target total incentive opportunity, *i.e.*, the long-term incentive portion, and the ECP Participants' target total incentive opportunity, *i.e.*, 50% of the total, was granted in the form of incentive payments under the QIP.

payment date, (y) the completion of a restructuring and (z) the effective date of a sale of the Debtors. As described in more detail below, the retention awards granted to participants in the Employee Compensation Program will be payable in quarterly installments. The remaining incentive opportunity for each Employee may be earned under the QIP and the Employee Compensation Program only to the extent that predetermined performance metrics are achieved. *See* Cumberland Decl. ¶¶ 12, 13, 27-28.

18. Following considerable discussion and consideration among the Compensation Committee, the Debtors' management and A&M, the Compensation Committee approved the metrics that apply to the incentive component of the Compensation Programs on May 26, 2020. *See* Watts Decl. ¶ 14. Those metrics resulted from careful review and reflect input from A&M and changes determined by the Compensation Committee that make the metrics more difficult to achieve, to ensure that they truly incentivize meaningful performance. *See* Rajcevich Decl. ¶¶ 12,14. The total quarterly incentive and retention awards that may be earned during 2020 by the approximately 1,132 Employees under the QIP, Employee Compensation Program and Supplemental Retention as of May 2020, at the target level of performance as applicable, equals approximately $35.6 million, $28.4 million of which is payable to the 1,123 Employees eligible for payments under the Employee Compensation Program and Supplemental Retention as of May 2020. *See* Cumberland Decl. ¶¶ 16-17, 29.

III. The QIP

A. QIP Participants

19. The QIP participants are the nine members of the Debtors' senior leadership team (the "QIP Participants"). The QIP Participants are critical to the Debtors' restructuring efforts and comprise the Debtors' President and Chief Executive Officer; Executive Vice President Public Affairs; Executive Vice President Operations and Geoscience; Senior

Executive Vice President, Chief Administrative Officer and General Counsel; Senior Executive Vice President and Chief Financial Officer; Executive Vice President Operations and Engineering; Executive Vice President Corporate Development and Strategic Planning; Executive Vice President Finance; and Vice President and Controller.[7] *See* Watts Decl. ¶ 14. The QIP Participants' role in driving the Debtors' business and strategic decisions and familiarity with, and understanding of, the Debtors' operations, customers, suppliers and assets that are already crucial to the day-to-day operation of the Debtors' businesses will also be vital to the Debtors' ability to execute a value-maximizing restructuring for the benefit of all stakeholders.

B. QIP Metrics

20. The QIP provides for the quarterly payment of incentive-based cash awards (the "QIP Payments") during the following remaining performance periods: July 1, 2020 – September 30, 2020; October 1, 2020 – December 31, 2020; January 1, 2021 – March 31, 2021; and April 1, 2021 – June 30, 2021 (each, a "Performance Period"); *provided* that the board of directors of CRC following emergence from these chapter 11 cases may terminate the QIP earlier than June 30, 2021. Cumberland Decl. ¶ 13. Payments are earned based upon achievement of the following operational and financial performance targets (the "Performance Metrics"):

[7] The QIP Participants are the Debtors' "insiders" as defined in section 101(31) of the Bankruptcy Code ("Insiders"), and represent all employees designated as "executive officers" (as defined in the Securities Exchange Act of 1934, as amended (the "Exchange Act")) or as "officers" for purposes of section 16 of the Exchange Act (which reflects all individuals in charge of a principal business unit, division or function, or who perform a policy-making function) for 2020 and during these chapter 11 cases, all directors, all individuals appointed to their positions by the Board, managerial employees who directly report to the Board or Chief Executive Officer and all Executive Vice Presidents.

		Payout Earned		
Performance Metric	**Weight**	**Threshold (50% Payout)**	**Target (100% Payout)**	**Maximum (200% Payout)**
Expense Reduction / Control				
Cumulative Operating Margin*	35%	*See table below*	*See table below*	*See table below*
G&A Reduction*	30%	*See table below*	*See table below*	*See table below*
Liquidity / Facility Utilization*	25%	*See table below*	*See table below*	*See table below*
Sustainability				
Safety (Workforce IIR)*	2.5%	0.60	0.50	0.40
Spill Prevention Rate*	2.5%	99.9996%	99.9997%	99.9998%
Net Water Supplied to Ag*	2.5%	240%	270%	290%
Sustainability Progress Milestones:*	2.5%	Complete 1/3	Complete 2/3	Complete 3/3
Water Recycling				
Carbon Capture				
Methane				

* Goals for final Performance Period are the Cumulative Performance Goals.

See Rajcevich Decl. ¶ 10.

21. The Performance Metrics were designed to incentivize Employees to focus their efforts primarily on what the Debtors believe will be the key drivers of their operating and restructuring efforts. Specifically, cumulative operating margin was selected to incentivize Employees to maximize value for the Debtors' stakeholders by operating effectively within a volatile and uncertain environment. As shown in the table below, this metric is measured on an accrual basis beginning April 1, 2020 in order to reflect the post-COVID-19 environment impact on commodity pricing and to lessen volatility due to current quarter pricing. *See* Rajcevich Decl. ¶ 9-10.

Cumulative Operating Margin*
(Measured April 1, 2020 through end of applicable Performance Period)

Performance Period	Threshold (50% Payout)	Target (100% Payout)	Maximum (200% Payout)
Q3 2020	25.1%	35.3%	43.0%
Q4 2020	27.7%	40.3%	49.0%
Q1 2021	29.0%	42.4%	51.5%
Q2 2021	29.8%	43.6%	52.8%

* Goals for final Performance Period are the Cumulative Performance Goals.

22. In recognition of the benefits that all stakeholders would receive as the Debtors reduce their overhead, the second metric in the program is tied to the Debtors' reduction in general and administrative expenses, as measured on an accrual basis excluding restructuring expenses, incentive/retention compensation and severance costs. Due to the volatility in oil prices, the targets applicable to this Performance Metric are tied to different levels of oil prices and require increasing reductions in consistently lower pricing environments as shown in the table below. *See* Rajcevich Decl. ¶ 9-10.

G&A Reduction*
(Measured July 1, 2020 through end of applicable Performance Period)

Quarter / Baseline Cumulative G&A Expenses ($ in 000s)	Average price / Bbl for Performance Period	Threshold (50% Payout)	Target (100% Payout)	Maximum (200% Payout)
Q3 2020 $55,153	$35 or higher	(0.7%)	(1.4%)	(2.2%)
	$25-$35	(1.4%)	(2.9%)	(4.3%)
	Less than $25	(2.2%)	(4.3%)	(6.5%)
Q4 2020 $112,627	$35 or higher	(2.0%)	(3.9%)	(5.9%)
	$25-$35	(3.9%)	(7.9%)	(11.8%)
	Less than $25	(5.9%)	(11.8%)	(17.7%)
Q1 2021 $168,940	$35 or higher	(2.4%)	(4.9%)	(7.3%)
	$25-$35	(4.9%)	(9.7%)	(14.6%)
	Less than $25	(7.3%)	(14.6%)	(21.9%)
Q2 2021 $225,254	$35 or higher	(2.7%)	(5.3%)	(8.0%)
	$25-$35	(5.3%)	(10.7%)	(16.0%)
	Less than $25	(8.0%)	(16.0%)	(24.0%)

* Goals for final Performance Period are the Cumulative Performance Goals.

23. The liquidity/facility utilization Performance Metric is designed to measure the capacity utilization of the "funded" portion of the Debtors' credit facility during the restructuring on a cash basis, excluding (1) any incremental new letters of credit issued under the credit sub-facility, (2) restructuring professional fees, and (3) incentive payments made under the QIP and the ECP Incentive Payments; *provided* that if the metric is measured in connection with a restructuring that is consummated prior to the 20th of the month, then the Intra-Month Measurement Goals (as set forth below) will be utilized to determine achievement. The goals applicable to the liquidity/facility utilization Performance Metric are shown in the table below, to be measured at the end of the applicable Performance Period or, if earlier, upon emergence from chapter 11 as determined by the Committee. *See* Rajcevich Decl. ¶ 9-10.

Liquidity / Facility Utilization* **
(Measured during restructuring)

Month-End Measurement

Performance Period	Threshold (50% Payout)	Target (100% Payout)	Maximum (200% Payout)
Q3 2020	15.0%	5.0%	0.0%
Q4 2020	17.5%	7.5%	0.0%

Intra-Month Measurement

Performance Period	Threshold (50% Payout)	Target (100% Payout)	Maximum (200% Payout)
Q3 2020	45.0%	35.0%	<=25%
Q4 2020	45.0%	35.0%	<=25%

* Goals for final Performance Period are the Cumulative Performance Goals.

** Liquidity/facility utilization goals are subject to adjustment by the Compensation Committee in its sole discretion in connection with future credit facilities.

24. Finally, the safety and sustainability goals were designed to continue to incentivize Employees to operate the business in a responsible manner and, in some cases, represent metrics included in the Debtors' original 2020 incentives. The safety goal measures the number of recordable injuries and illnesses per 100 workers, based on the total work hours of employees and contractors. The spill prevention rate measures the difference between barrels of oil equivalent (BOE) produced and the net volume of reportable spills of crude oil or condensate not recovered in liquid form, as a percentage of BOE produced. The net water supply to agriculture measures the ratio of the volume of reclaimed water supplied to agriculture or recharge to the volume of fresh water purchased for the Debtors' statewide operations. As a continuation of existing 2020 metrics, the safety and sustainability goals also require the Debtors to (1) design and permit the Elk Hills water recycling pipeline expansion, (2) complete the Elk Hills front-end engineering and design study for carbon capture technologies and (3) design a statewide methane capture strategy for gas-operated pneumatic valves. *See* Rajcevich Decl. ¶ 9.

C. QIP Payments

25. The level at which each Performance Metric is achieved is measured at the end of the Performance Period based on the threshold, target and maximum goals shown above. The range of payout opportunities, from 50% of target for threshold performance to 200% of target at or above maximum performance, is consistent with CRC's past practices as well as current market practices within the industry. *See* Cumberland Decl. ¶¶ 15-16, 19, 21. If the threshold performance level for any given metric is not achieved, no QIP Payment will be earned for that metric for that Performance Period. *See* Rajcevich Decl. ¶ 11.

26. After the final Performance Period, performance will also be assessed on a cumulative basis for the Performance Periods on a trailing basis against cumulative Performance Metrics. This "catch-up" provision will ensure alignment of aggregate pay and performance during the Performance Periods. As a result, QIP Participants are continuously incentivized to achieve maximum performance on a cumulative basis over the Performance Periods, because the "catch-up" provision allows the QIP Participants to earn any amounts that were "missed" from prior performance periods on a go-forward basis. *See* Cumberland Decl. ¶ 14.

27. Earned QIP Payments will be paid within 60 days after the applicable Performance Period subject to the QIP Participant's continued employment. Any unearned QIP Payments are forfeited upon a QIP Participant's termination of employment with the Debtors, except for a termination of employment by the Debtors without cause or by the QIP Participant due to a material change in position or responsibilities, annual base salary or a significant relocation of primary work location (greater than 150 miles), or due to death or disability, in which case, the next QIP Payment, to the extent earned based on actual performance, will be made on a pro rata basis based on the amount of time worked during the applicable period,

subject to the QIP Participant's execution and non-revocation of a release of claims within the 30 days following termination. *See* Cumberland Decl. ¶ 18.

28. The Debtors believe that the design of the QIP appropriately tailors the Employees' variable compensation opportunities to complement the Debtors' key goals and provides a dynamic approach to measuring performance during changing market conditions. The Debtors believe that this market-responsive approach to compensation will be critical in incentivizing Employees during the pendency of these chapter 11 cases and post-emergence.

D. QIP Compensation Opportunities and Diligence

29. The annual incentives established for QIP Participants in February 2020 provided a target opportunity that ranged from 50% to 110% of the QIP Participant's base salary, and the long-term incentives granted in the first quarter 2020 provided a target opportunity that ranged from approximately 100% to 600% of the QIP Participant's base salary. Accordingly, the aggregate incentive opportunities represented a significant portion of these Employees' target total direct compensation opportunities in the ordinary course. As a condition to participating in the QIP, each QIP Participant waived any rights under these programs. *See* Watts Decl. ¶ 14.

30. As discussed above, the QIP replaced the long-term incentives awarded to the QIP Participants in 2020. As part of the Debtors' diligence of the reasonableness of the QIP, A&M examined (a) the reasonableness of the QIP as compared to other executive-focused incentive plans focused on emergence (as opposed to a sale of the company) approved by bankruptcy courts in 2015 or later for companies within the energy, utilities or mining industries with greater than $1 billion in prepetition assets,[8] (b) the reasonableness of the target total direct

[8] The bankruptcy peer group used for this analysis comprised Alpha Natural Resources, Inc., Breitburn Energy Partners, LP, Bristow Group Inc., C&J Energy Services Ltd., Energy Future Holdings Corporation, FirstEnergy Solutions Corp., GenOn Energy, Inc., LINN Energy, LLC, McDermott International, Inc., Molycorp, Inc., Pacific Drilling S.A., Peabody Energy Corporation, Sabine Oil & Gas Corporation, Samson Resources Corporation and Ultra Petroleum Corporation. The Debtors were in approximately the 67th percentile of this peer group based on prepetition assets.

compensation (TDC) for QIP Participants relative to relevant talent market pay[9] and (c) the reasonableness of the target TDC for QIP Participants relative to the historical compensation established by the Debtors for that position. *See* Cumberland Decl. ¶ 19-25.

31. A&M concluded that the number of participants in the QIP is in the 57th percentile of the bankruptcy peer group. Additionally, the target total cost and average target cost of the unpaid portion of the QIP for 2020 is in the 70th percentile and 51st percentile, respectively, and the target total cost as a percentage of revenues is in the 26th percentile of the bankruptcy peer group. Each QIP Participant's target TDC represents between the 50th and 75th percentiles of the market except for one QIP Participant, whose target TDC is below the 25th percentile of the market. The Debtors believe that this target TDC range is appropriate, particularly in light of the higher cost of living applicable to the QIP Participants, who are based in California. Finally, A&M observed that the target TDC under the revised 2020 programs, comprised of base salary, the retention awards and the QIP opportunities, was equal to the target TDC established in February 2020 for each QIP Participant. *See* Cumberland Decl. ¶ 19-25.

IV. The Employee Compensation Program

A. Employee Compensation Program Participants

32. At the time of approval by the Board, the Employee Compensation Program included 1,123 non-insider employees as participants (the "ECP Participants"). *See* Cumberland

[9] The QIP participant's target TDC was reviewed against market data prepared by the Compensation Committee's compensation consultant, Meridian Compensation Partners, in October 2019, as well as survey data for executives not positioned in the Meridian report. Specifically, the comparator peer group utilized by Meridian comprised Cabot Oil & Gas Corporation, Callan Petroleum Corporation, Carrizo Oil & Gas, Inc., Cimarex Energy Co., Denbury Resources, Inc., Diamondback Energy, Inc., Gulfport Energy Corporation, Laredo Petroleum, Inc., Matador Resources Corporation, Murphy Oil Corporation, Oasis Petroleum Inc., Parsley Energy, Inc., PDC Energy, Inc., QEP Resources, Inc., Range Resources Corporation, SM Energy Company, Southwestern Energy Company, Whiting Petroleum Corporation and WPX Energy, Inc. Based on information provided by Meridian and publicly available in CRC's 2020 Proxy Statement, the Debtors were in approximately in the 58th percentile of this peer group based on asset value and the 74th percentile of this peer group based on enterprise value, in each case as of 2019. *See* Cumberland Decl. ¶ 30. Overall, the target TDC for the QIP Participants fell around the median of this peer group based on base salary, the target QIP Payments and prepaid retention payments discussed in Section III, ¶ 17 above.

Decl. ¶ 26. The ECP Participants perform a wide variety of functions critical to the Debtor's daily operations, which are key to the Debtors' ability to preserve and enhance the Debtors' ongoing operations and to carry out a successful reorganization. For example, ECP Participants include employees involved in engineering, marketing, supply chain, production operations, treasury, finance, accounting, legal, tax, corporate development, strategic planning, information technology, public relations, human resources and health, safety and environment (HSE) functions. All of the ECP Participants were participants in and waived any rights under the incentive compensation programs established by the Debtors in the first quarter of 2020. *See* Watts Decl. ¶ 14.

33. Many of the ECP Participants possess critical technical, industry and/or customer-specific expertise, including, among others, institutional knowledge regarding the Debtors' business operations, which would be difficult and costly for the Debtors to replace quickly. The loss of their services at this time could jeopardize the Debtors' operations and their ability to execute a value-maximizing restructuring and to emerge from chapter 11. As such, the Debtors believe that approval and implementation of the ECP is necessary to retain and incentivize the ECP Participants, which will in turn preserve and drive value throughout the pendency of these chapter 11 cases.

B. Employee Compensation Program Structure

34. The Employee Compensation Program provides for the payment of (a) incentive-based cash awards (the "ECP Incentive Payments") to the extent that the same Performance Metrics that apply to the QIP are achieved and (b) quarterly cash payments for the ECP Participants' continued employment with the Debtors (the "ECP Retention Payments"). *See* Cumberland Decl. ¶ 27.

35. The Debtors determined to base the ECP Incentive Payments on the same Performance Metrics that apply to the QIP in order to align and focus the broader workforce's efforts on the Debtors' key operational and strategic goals.

36. The ECP Retention Payments are payable in four installments on the last day of each of the following periods: May 19, 2020 – September 30, 2020; October 1, 2020 – December 31, 2020; January 1, 2021 – March 31, 2021 and April 1, 2021 – June 30, 2021 (each, a "Retention Period"). To be eligible to earn a ECP Retention Payment, a ECP Participant must be employed by the Debtors at the end of the applicable Retention Period. Any unearned ECP Retention Payments are forfeited upon a ECP Participant's termination of employment with the Debtors, except for a termination of employment by the Debtors without cause or due to death or disability, in which case, the next ECP Retention Payment will be made on a pro rata basis based on the amount of time worked during the applicable period, subject to the ECP Participant's execution and non-revocation of a release of claims within the 30 days following termination. Earned ECP Retention Payments will be paid within 30 days after the applicable Retention Period. *See* Cumberland Decl. ¶ 28.

C. Supplemental Retention Awards

37. In addition to the ECP Retention Payments, the Employee Compensation Program provides for the payment of additional quarterly cash retention payments for certain ECP Participants' continued employment with the Debtors (the "Supplemental Retention"). *See* Cumberland Decl. ¶ 29. Recipients of Supplemental Retention payments are limited to a select group of 60 non-insider employees that the Debtors determined presented a significant retention risk and whose departure would be particularly disruptive during the Debtors' restructuring, all of whom are ECP Participants. The total aggregate amount of Supplemental Retention payments payable during the third and fourth quarters of 2020 is approximately $1.4 million.

See Cumberland Decl. ¶ 29. The Supplemental Retention payments are payable in installments on the last day of each Retention Period and are subject to the same terms as the ECP Retention Payments, as described above in ¶ 36.

D. Employee Compensation Program and Supplemental Retention Opportunities and Diligence

38. Based on A&M's analysis, the annualized retention opportunities under the Employee Compensation Program represented approximately 16% of the ECP Participant's base salary, on average, and an average annualized cost per ECP Participant of approximately $24,000. If the Supplemental Retention is included, these retention opportunities comprised, on average, 17% of base salary and an average annualized cost per participant of approximately $26,000. *See* Cumberland Decl. ¶ 32. As discussed above, the Employee Compensation Program replaced the annual and long-term incentives awarded to the ECP Participants in 2020, and accordingly, award opportunities were designed to be commensurate with opportunities previously available to the same individuals under the Debtors' original 2020 programs. When the Supplemental Retention is considered, this aggregate payment opportunity for a given ECP Participant only represents a 1% increase to the aggregate compensation opportunities previously available to the ECP Participants under the Debtors' prior 2020 programs.

39. The Debtors considered the reasonableness of the structure of the incentive component of the Employee Compensation Program as discussed in Section III.D above. As part of the Debtors' diligence, A&M also examined the reasonableness of the ECP Retention Payments as compared to other retention programs approved by bankruptcy courts in

2015 or later for companies within the energy, utilities or mining industries with greater than $1 billion in prepetition assets.[10] *See* Cumberland Decl. ¶ 30.[11]

40. A majority of the peer key employee retention programs represented additional compensation to the participants—*i.e.*, the retention program was awarded *in addition* to existing incentive or other direct compensation opportunities, rather than replacing those programs as the Debtors have done. As a result, those programs were often scaled to a more specific group of participants rather than all bonus-eligible employees. For reference, the number of participants in the peer programs at the 50th percentile is 145, as compared to the 1,123 Employees eligible for the ECP Retention Payments as of the date the Board approved the program. In order to provide a more consistent measure of comparison, A&M determined to consider the ECP Retention Payments relative to peer programs on the basis of an annualized cost per participant. A&M concluded that, based on the average annualized participant cost as a percentage of the participant's salary, the ECP Retention Payments were in the 4th percentile and, based on the average annualized cost per participant, the ECP Retention Payments were in the 21st percentile of the bankruptcy peer group. Adding the proposed Supplemental Retention Payments, the retention opportunities were in the 5th percentile of the bankruptcy peer group based on the average annualized participant cost as a percentage of the participant's salary, and

[10] The bankruptcy peer group used for this analysis comprised Alpha Natural Resources, Inc., Basic Energy Services, Inc., Breitburn Energy Partners LP, Bristow Group Inc., C&J Energy Services Ltd., Energy Future Holdings Corp., Energy XXI, FirstEnergy Solutions Corp., Legacy Reserves Inc., LINN Energy, LLC, McDermott International, Inc., Pacific Drilling S.A., Patriot Coal Corporation (2015), Peabody Energy Corporation, Quicksilver Resources, Inc., Sabine Oil & Gas Corporation, Samson Resources Corporation and Ultra Petroleum Corp. The Debtors were in approximately the 73rd percentile of this peer group based on prepetition assets and the 43rd percentile based on number of employees. *See* Cumberland Decl. ¶ 31.

[11] Because available talent market compensation data are primarily depending on publicly disclosed compensation data, which are limited to named executive officers, a market review of each ECP Participant's target TDC was not possible. Additionally, given the number of ECP Participants, such review would not be feasible even if data were available.

the 23rd percentile of the bankruptcy peer group based on the average annualized cost per participant. *See* Cumberland Decl. ¶ 32.

Basis for Relief

V. The Compensation Programs are Ordinary Course Transactions under Section 363(c) of the Bankruptcy Code

41. Section 363(c)(1) of the Bankruptcy Code provides that a debtor in possession may "enter into transactions . . . in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing." 11 U.S.C. § 363(c)(1). Although the Bankruptcy Code does not define "ordinary course of business," courts in the Fifth Circuit apply a two-part test to determine whether a transaction is in the ordinary course of a debtor's business. *In re Cowin*, No. 13-30984, 2014 WL 1168714, at *40 (Bankr. S.D. Tex. Mar. 21, 2014). First, the court analyzes the transaction on a "horizontal" basis to determine whether the transaction commonly occurs in the debtor's industry; second, the court determines whether the proposed transaction is consistent with the debtor's prepetition practices, such that a hypothetical creditor would view the transaction as an ordinary or usual business practice, which is referred to as the "vertical" component of the test. *See, e.g., id.* at *40 n.55, *41 (noting that the "horizontal dimension test" is also known as the "comparable businesses" test and the "vertical dimension test" is also known as the "creditor expectations test"); *In re Patriot Place, Ltd.*, 486 B.R. 773, 793 (Bankr. W.D. Tex. 2013) (applying the "horizontal" and "vertical" tests). This two-part test for determining whether a transaction is in the ordinary course of a debtor's business is employed in other circuits, as well. *See, e.g., In re Dana Corp.*, 358 B.R. 567, 580-81 (Bankr. S.D.N.Y. 2006).

42. Although the Compensation Programs are not identical to the annual cash incentive and long-term incentive programs ordinarily offered by the Debtors, they are

continuations of the Debtors' historical practice to pay-for-performance and encourage retention. It is the Debtors' ordinary course practice to tailor the performance metrics to reflect current economic realities and operating conditions. For example, in 2018, the Debtors determined to reduce the portion of the annual incentive award determined based on individual performance from 40% to 20% for executives, and from 40% to 25% for non-executives. In 2019, the Debtors reduced the number of metrics under the annual incentive program to provide a greater focus on the Debtors' key objectives, as well as to set the VCI, EBITDAX and net debt performance targets at more rigorous levels than prior years to reflect the 2019 business plan. Also in 2019, the Debtors changed a performance metric applicable to the 2019 long-term performance awards from unit costs per BOE relative to industry peers to relative total shareholder return.[12] In addition, when establishing the previous 2020 compensation programs in February, the Debtors determined to reduce the weighting of the EBITDAX component from 25% to 20% and to add a sustainability project milestone component with a weighting of 5% as a performance metric for the 2020 annual incentive program, in order to drive progress on CRC's 2030 Sustainability Goals.[13] The Debtors recognized that the economy and market in which the Debtors operate have rapidly and significantly changed since February 2020 and, as discussed further in Section I.B above, determined that the Debtors' compensation programs should reflect this, spurring development of the QIP and Employee Compensation Program.

43. In addition, even though modified to include a retention-based component, the Compensation Programs do not increase the target compensation opportunities payable

[12] In 2018, the Debtors redesigned the performance-based long-term incentive awards, which had been settled in cash during the prior two years, to be entirely stock-based.

[13] *See* CRC's Proxy Statement for the fiscal year ended December 31, 2019, as filed with the Securities Exchange Commission (the "SEC") on Schedule 14A on March 24, 2020; CRC's Proxy Statement for the fiscal year ended December 31, 2018, as filed with the SEC on Schedule 14A on March 26, 2019; and CRC's Proxy Statement for the fiscal year ended December 31, 2017, as filed with the SEC on Schedule 14A on March 27, 2018.

under the annual and long-term incentive programs adopted by the Debtors during the first quarter of 2020 (with the exception of a select group of non-insider employees that the Debtors have determined present a significant retention risk, which only increases the ECP Participants' target compensation opportunities by 1%). Consequently, the Compensation Programs represent a continuation of the Debtors' past practice of offering incentive opportunities with market-responsive performance metrics and include individual target award opportunities that are commensurate with aggregate prepetition opportunity levels. For these reasons, the Compensation Programs are of the type that a hypothetical creditor would reasonably expect the Debtors to maintain in the ordinary course, satisfying the "vertical" component of the two-part test for ordinary course transactions within the Fifth Circuit. *See Cowin*, 2014 WL 1168714, at *40; *Patriot Place*, 486 B.R. at 792-94; *see also Dana Corp.*, 358 B.R. at 579 (finding that a debtor's postpetition incentive program was a "refinement" of historical practices and within the ordinary course of the debtor's business).

44. In addition, the Compensation Programs meet the horizontal dimension test because they are consistent within the Debtors' industry. *See Cowin*, 2014 WL 1168714, at *40. As discussed in Section III.D above, A&M examined the reasonableness of the QIP as compared to other incentive plans for companies within the energy, utilities or mining industries with greater than $1 billion in prepetition assets focused on emergence that were approved by bankruptcy courts in 2015 or later. From this analysis, A&M concluded that the QIP's number of participants, anticipated costs and the resulting TDC of the QIP participants were consistent with plans instituted by other companies in the Debtors' peer group. *See* Cumberland Decl. ¶¶ 19-25. As discussed in Section IV.D above, A&M also examined the reasonableness of the ECP Retention Payments as compared to other retention programs approved by bankruptcy courts in 2015 or later for companies within the energy, utilities or

mining industries with greater than $1 billion in prepetition assets, and determined such payments were consistent within the Debtors' peer group. *See* Cumberland Decl. ¶ 30.

45. Therefore, because the Compensation Programs are both "vertically" consistent with the Debtors' historical compensation practices and "horizontally" consistent with plans implemented by the Debtors' industry peers, the Debtors submit that the Compensation Programs constitute transactions in the ordinary course of the Debtors' businesses and request that the Court approve them as such pursuant to section 363(c) of the Bankruptcy Code.

VI. Implementing the Compensation Programs Is a Proper Exercise of the Debtors' Sound Business Judgment and Is Authorized Under Section 363(b) of the Bankruptcy Code

46. Even if the Compensation Programs are determined not to qualify as ordinary course transactions under the two-pronged test described above, section 363(b)(1) of the Bankruptcy Code provides that a debtor "after notice and a hearing, may use, sell or lease, other than in the ordinary course of business, property of the estate. . . ." 11 U.S.C. § 363(b)(1). However, "[f]or the debtor-in-possession . . . to satisfy its fiduciary duty to the debtor, creditors and equity holders, there must be some articulated business justification for using, selling, or leasing the property outside the ordinary course of business." *In re Cont'l Air Lines*, 780 F.2d 1223, 1226 (5th Cir. 1986) (citing *In re Lionel Corp.*, 722 F.2d 1063, 1071 (2d. Cir. 1983). Courts in this district require a debtor to show that the decision to use property of the estate outside of the ordinary course of business is a proper exercise of the debtor's sound business judgment. *See, e.g.*, *In re Viking Offshore (USA), Inc.*, No. 08-31219-H3-11, 2008 WL 1930056, at *2 (Bankr. S.D. Tex. Apr. 30, 2008) (applying the business judgment rule to determine whether the debtors' proposed bonuses were justified outside the ordinary course of business); *In re Mesa Air Grp., Inc.*, No. 10-10018 (MG), 2010 WL 3810899, at *3 (Bankr.

S.D.N.Y. Sept. 24, 2010) (approving employee incentive program as a "valid exercise of [the debtor's] business judgment" under both sections 363 and 503(c) of the Bankruptcy Code).

47. Upon the establishment of a proper business rationale, a "presumption of reasonableness attaches to a debtor's management decisions," and the Court should afford great deference to such decisions to avoid reevaluating with the benefit of hindsight. *In re Johns-Manville Corp.*, 60 B.R. 612, 616 (Bankr. S.D.N.Y. 1986); *see also Richmond Leasing Co.* v. *Capital Bank, N.A.*, 762 F.2d 1303, 1311 (5th Cir. 1985) ("More exacting scrutiny [than the business judgment standard] would slow the administration of the debtors' estate and increase its cost, interfere with the Bankruptcy Code's provision for private control of administration of the estate, and threaten the court's ability to control a case impartially."). This is because "[t]he § 363 mandate necessarily involves the concomitant discretion to exercise reasonable judgment in ordinary business matters", and, accordingly, "[w]here the debtor articulates a reasonable basis for its business decisions (as distinct from a decision made arbitrarily or capriciously), courts will generally not entertain objections to the debtor's conduct." *Johns-Manville Corp.*, 60 B.R. at 616; *In re Integrated Res., Inc.*, 147 B.R. 650, 656 (S.D.N.Y. 1992) ("Courts are loath to interfere with corporate decisions absent a showing of bad faith, self-interest or gross negligence.") (citing *Smith* v. *Van Gorkom*, 488 A.2d 858, 872-73 (Del. 1985)); *see also In re Gulf Coast Oil Corp.*, 404 B.R. 407, 415 (Bankr. S.D. Tex. 2009) (noting that section 363(b) dispositions of property by a debtor-in-possession are generally evaluated under the "business judgment test").

48. The Compensation Programs are the result of rigorous analysis and scrutiny undertaken by the Debtors with the assistance of independent compensation consultants and restructuring advisors. Moreover, the Compensation Committee of California Resources Corporation's board of directors, none of whose members are QIP Participants or ECP

Participants, reviewed and approved the Compensation Programs and determined that adopting such programs was in the best interest of the Debtors. In addition, because the Compensation Programs are designed to replace, rather than supplement, the incentives originally implemented in 2020, absent the adoption of the Compensation Programs participating employees would lose significant compensation opportunities and become retention risks at this critical stage of the chapter 11 cases. Consequently, the Compensation Programs are designed so that participants receive competitive pay and are properly incentivized to achieve financial and operational metrics that will maximize the value of the Debtors' estates and drive a successful reorganization.

49. Not only will approving the Compensation Programs encourage achievement of value-driving performance goals, but as discussed above, the anticipated costs of the Compensation Programs are fair and reasonable. *See* Cumberland Decl. ¶ 36. The Compensation Programs therefore align the interests of key employees with those of creditors by conditioning an increased opportunity for payment on the achievement of key value-driving indicators for the Debtors' business operations at an appropriate cost for the Debtors' financial position. For these reasons, the Compensation Programs are a proper exercise of the Debtors' business judgment in the best interests of the Debtors' estates and all stakeholders in these chapter 11 cases.

VII. Sections 503(c)(1) and 503(c)(2) Do Not Apply to the Compensation Programs

50. Sections 503(c)(1) and 503(c)(2) of the Bankruptcy Code limit the Debtors' ability to award retention and severance payments to "insiders." The Bankruptcy Code defines an insider to include, among other things, an "officer of the debtor" and a "person in control of the debtor." 11 U.S.C. § 101(31). Importantly, sections 503(c)(1) and 503(c)(2) are not applicable to the Employee Compensation Program. As discussed in ¶ 32, the ECP

Participants are all non-insider employees. Courts have concluded that an employee that has "at least a controlling interest in the debtor or . . . exercise[s] sufficient authority over the debtor so as to unqualifiably dictate corporate policy and the disposition of corporate assets" may be an insider. *In re Velo Holdings, Inc.*, 472 B.R. 201, 208 (Bankr. S.D.N.Y. 2012) (citations omitted). An employee's job title alone does not make such employee an "insider" under the Bankruptcy Code. *See In re Borders Grp. Inc.*, 453 B.R. 459, 469 (Bankr. S.D.N.Y. 2011) (stating that "[c]ompanies often give employees the title 'director' or 'director-level,' but do not give them decision-making authority akin to an executive," and that "none of them, including the Corporate Secretary, are insiders for purposes of section 101(31)"); *In re Glob. Aviation Holdings Inc.*, 478 B.R. 142, 150 (Bankr. E.D.N.Y. 2012) (finding that section 503(c)(1) is "inapplicable because [plan participants] are not insiders" including participants that held the title of "vice president" and "director"); *In re Pub. Access Technology.Com, Inc.*, 307 B.R. 500, 506 (E.D.Va. 2004) (stipulation only that an employee "held the title of Executive Vice President . . . . without more, is not sufficient to find that [he] was an 'officer' within the meaning of" section 101(31) of the Bankruptcy Code).

51. Further, although the QIP Participants are insiders, the Debtors submit that the QIP is not governed by section 503(c)(1) or 503(c)(2) of the Bankruptcy Code. "[S]ection 503(c) was not intended to foreclose a chapter 11 debtor from *reasonably* compensating employees, including 'insiders,' for their contribution to the debtors' reorganization." *Dana Corp.*, 358 B.R. at 575 (emphasis in original). Rather, section 503(c)(1) is specifically designed to restrict payments to insiders "for the purpose of inducing such person to remain with the debtor's business"—*i.e.*, those insider plans that are essentially "pay to stay" plans. *See, e.g.*, *Velo Holdings, Inc.*, 472 B.R. at 209 (finding that an incentive-based plan alleviated the need for a section 503(c)(1) analysis).

52. In determining whether a compensation plan is primarily incentivizing, courts consider whether the plan is "designed to motivate insiders to rise to a challenge or merely report to work." *In re Hawker Beechcraft, Inc.*, 479 B.R. 308, 313 (Bankr. S.D.N.Y. 2012) (plan where insiders could earn a bonus solely upon the consummation of either of two transactions, one of which was bound to occur, was not incentivizing). QIP Payments are based on actual achievement of the Performance Metrics, each of which is a key value-driving indicator for the Debtors' business operations. Rather than providing compensation for continued employment, which is the central feature of a retention payment, QIP Payments are earned only to the extent that achievement exceeds threshold, target or maximum performance evaluated independently for each Performance Metric. If the threshold performance level for any given metric is not achieved, no QIP Payment will be earned for that metric for that Performance Period.

53. The Performance Metrics were developed through substantial due diligence by the Debtors and their advisors and represent considerable challenges during these chapter 11 cases. For example, the targets applicable to the performance metric of reducing general and administrative expenses require increasing expense reductions in consistently lower pricing environments, as described in Section III.B. *See* Rajcevich Decl. ¶ 9. Moreover, the Compensation Programs as adopted include modifications implemented by the Compensation Committee that made the Performance Metrics more difficult to achieve. The Performance Metrics are not "lay ups" that will be easily achievable over the Performance Period, particularly given current market and operating conditions. *See* Rajcevich Decl. ¶ 14.

54. In addition, although the QIP was not crafted with the goal of retaining the QIP Participants, the fact that the QIP may encourage them to remain with the Debtors throughout these chapter 11 cases in order to receive their QIP Payments should not bar implementation of the QIP. *Dana Corp.*, 358 B.R. at 571 ("merely because a plan has some retentive effect does

not mean that the plan, overall, is retentive rather than incentivizing in nature"). Indeed, all successful incentive programs have the indirect benefit of incentivizing an employee to remain with the company. *See In re Global Home Prods. LLC*, 369 B.R. 778, 786 (Bankr. D. Del. 2007) (the analysis of a plan turns on whether the "plan is *primarily* motivated to retain personnel or is not in the nature of severance"); *In re Nellson Nutraceutical, Inc.*, 369 B.R. 787, 802 (Bankr. D. Del. 2007) (noting that "[a]ny payment to an employee, including regular wages, has at least a partial purpose of retaining the employee," and therefore "if the Court did not apply a materiality standard [to the 503(c)(1) analysis] all payments to insiders would be subject to 503(c)(1), which would be an absurd result").

55. Therefore, because the Performance Metrics are primarily incentivizing, as opposed to retentive, the restrictions in section 503(c)(1) of the Bankruptcy Code do not apply to the QIP. *See Velo Holdings Inc.*, 472 B.R. at 208 n.6 (noting inapplicability of section 503(c)(1) to incentivizing plans); *Nelson Nutraceutical, Inc.*, 369 B.R. at 802 (plan with primary purpose of motivating employees is not subject to section 503(c)(1)); *Dana Corp.*, 358 B.R. at 576 (applying section 503(c)(3) of the Bankruptcy Code to evaluate management incentive plan in absence of applicability of section 503(c)(1) or 501(c)(2) of the Bankruptcy Code).

56. In addition, none of the QIP Payments, ECP Incentive Payments or ECP Retention Payments are severance payments to insiders limited by section 503(c)(2) of the Bankruptcy Code. As discussed above, none of the ECP Participants are insiders, and therefore section 503(c)(2) is inapplicable to the Employee Compensation Plan. The QIP Payments are conditioned on achievement of the Performance Metrics and therefore are fundamentally distinct from severance payments. *See Dana Corp.*, 358 B.R. at 578 (pension benefits pursuant to an employment agreement, although payable upon termination of employment, were not severance subject to section 503(c)(2)). Therefore, section 503(c)(2) is inapplicable to the QIP as well.

VIII. The Compensation Programs Are Permissible Under Section 503(c)(3) of the Bankruptcy Code

57. Section 503(c)(3) of the Bankruptcy Code prohibits the Debtors from making transfers or obligations that are outside the ordinary course of business and that are not justified by the facts and circumstances of the case. 11 U.S.C. § 101(31). As previously discussed, the Compensation Programs are ordinary course transactions pursuant to section 363(b) of the Bankruptcy Code, and courts have held that the standard of review to determine what constitutes an ordinary course transaction under section 503(c)(3) of the Bankruptcy Code is no different. *See* ¶¶ 41-49. "Courts have held that the 'facts and circumstances' language of section 503(c) creates a standard no different from the business judgment standard under section 363(b)." *Velo Holdings Inc.*, 472 B.R. at 212; *Dana Corp.*, 358 B.R. at 576 (applying the "sound business judgment" test); *Glob. Home Prods.*, 369 B.R. at 783 ("If [the proposed plans are] intended to incentivize management, the analysis utilizes the more liberal business judgment review under § 363."); *Mesa Air Grp.*, 2010 WL 3810899, at *4 (proposed incentive program is an exercise of the debtors' sound business judgment under sections 363 and 503(c)(3) of the Bankruptcy Code); *compare In re Pilgrim's Pride Corp.*, 401 B.R. 229, 237 (Bankr. N.D. Tex. 2009) (holding that "even if good business reason can be articulated for a transaction, the court must still determine that the proposed transfer [under 503(c)(3)] is justified in the case before it"). Even if the Compensation Programs are not ordinary course transactions of the Debtors, they are justified by the facts and circumstances of these chapter 11 cases and satisfy section 503(c)(3) of the Bankruptcy Code. *See In re Residential Capital, LLC*, 491 B.R. 73, 85 (Bankr. S.D.N.Y. 2013) (key employee retention plan was justified by the facts and circumstances of the case under section 503(c)(3) where there was a reasonable relationship between the proposed payments and the plan's retentive goals, and the plan was reasonable in scope, cost and relation to market).

58. In examining whether compensation plans satisfy section 503(c)(3) of the Bankruptcy Code, courts generally analyze the following factors (collectively, the "*Dana* Factors"):

a. Whether there is a reasonable relationship between the plan proposed and the results to be obtained (*i.e.*, whether the key employee will stay for as long as it takes for the debtor to reorganize or market its assets, or, in the case of a performance incentive, whether the plan is calculated to achieve the desired performance);

b. Whether the cost of the plan is reasonable within the context of the debtor's assets, liabilities and earning potential;

c. Whether the scope of the plan is fair and reasonable or discriminates unfairly;

d. Whether the plan is consistent with industry standards;

e. Whether the debtor engaged in due diligence related to the need for the plan, the employees that needed to be incentivized, and what types of plans are generally applicable in a particular industry; and

f. Whether the debtor received independent counsel in performing due diligence and in creating and authorizing the incentive compensation.

See Dana Corp., 358 B.R. at 576-77. No single factor is dispositive, and a court has discretion to weigh each of these factors based on the specific facts and circumstances before it. *See, e.g.*, *In re FirstEnergy Sols. Corp.*, 591 B.R. 688, 697 (Bankr. N.D. Ohio 2018) (stating that the *Dana* Factors are "neither exhaustive nor of inherently equal weight"). As set forth below, each of the QIP and the Employee Compensation Program satisfies these factors.

A. The QIP Satisfies the Foregoing Factors and Is Justified by the Facts and Circumstances of These Chapter 11 Cases

59. The QIP satisfies the *Dana* Factors. *First*, there is a reasonable relationship between the QIP as proposed and the desired results, namely, to achieve the near-term operating performance necessary to preserve and ultimately maximize the going-concern

value of the Debtors' business. QIP Payments are contingent on the Debtors' ability to meet and exceed performance metrics related to cumulative operating margin, general and administrative expense reduction, liquidity and facility utilization, and sustainability milestones, each of which is directly tied to the stability and future success of the Debtors' present and anticipated near-term economic circumstances as described in Section III.B above. No QIP Payments will be made if threshold goals are not satisfied, and because achievement of each performance level involves the attainment of an operational or financial goal, the size of any QIP Payment is directly linked to stakeholder interests. In addition, A&M determined that achievement of the target level of performance under the Performance Targets would require significant effort by the management team in a challenging operating environment. *See* Rajcevich Decl. ¶ 14. Accordingly, the QIP is designed to achieve its desired goals for a successful chapter 11 restructuring.

60. *Second*, the cost of the QIP is reasonable. As discussed in Section III.D, A&M examined the reasonableness of the QIP as compared to other incentive plans approved by bankruptcy courts in 2015 or later for companies within the energy, utilities or mining industries and with greater than $1 billion in prepetition assets. The estimated aggregate 2020 QIP Payments at target performance levels are approximately $7.2 million, which can only be earned if the QIP Participants meet or exceed target performance across all the Performance Metrics. This target cost places the QIP for 2020 in the 70th percentile as measured against the Debtors' bankruptcy peers, in the 51st percentile if average target cost is considered, and in the 26th percentile based on target cost as a percentage of revenue. *See* Cumberland Decl. ¶ 21. This target total direct compensation range is reasonable, particularly in light of the higher cost of living applicable to the QIP Participants, who are based in California. Moreover, the cost of the QIP, the Employee Compensation Program and Supplemental Retention, in each case at the

target level of performance, as applicable, has been reflected in the debtor-in-possession financing budget. Especially given the difficulty of achieving the Performance Metrics in the current economic conditions and industry climate, the anticipated costs of and compensation opportunities under the QIP are reasonable in the context of these chapter 11 cases.

61. *Third*, the QIP Participants represent a limited group of management who are in a position to drive company performance and are critical to ensuring a successful outcome in these cases, appropriately balancing the need to incentivize the Debtors' leadership with the Debtors' need to conserve resources. The reasonableness of the scope of the QIP is further supported by A&M's analysis, which confirmed that the number of QIP Participants is at the 57th percentile of the Debtors' peer group. *See* Cumberland Decl. ¶ 21.

62. *Fourth*, as discussed above and in Section III, the QIP is consistent with incentive plans implemented by the Debtors' industry peers. In conducting its analysis, A&M gathered external market compensation data from several data sources, encompassing market compensation information for comparable industries and the labor market for executives. *See* Cumberland Decl. ¶¶ 20-22. Based on such analysis, A&M concluded that each QIP Participant's target TDC (including the QIP Payments) represents between the 50th and 75th percentiles of the market except for one QIP Participant, whose target TDC is below the 25th percentile of the market. Moreover, because the QIP Participants have waived their right to participate in the annual and long-term incentive programs ordinarily maintained by the Debtors, as opposed to the QIP serving to supplement ordinary incentive opportunities, the participants would be significantly undercompensated relative to the market without the opportunity to participate in the QIP, posing a significant retention risk. *See* Cumberland Decl. ¶ 23.

63. *Fifth*, the Debtors actively engaged and relied upon the advice of their independent advisors, including A&M, to ensure that the terms of the QIP—including the

number of participants and expected costs—were consistent with industry standards and that the Performance Metrics were designed to incentivize operational and financial performance by management. As a result of such rigorous due diligence, the Debtors concluded that implementing the QIP was critical to incentivizing the leadership team and key employees that would support the Debtors' successful operations during the pendency of these chapter 11 cases. As a result of its careful review and input from A&M, the Compensation Committee implemented changes to the Performance Metrics as originally proposed, ensuring that such metrics are challenging and that they support the appropriateness of the QIP. *See* Cumberland Decl. ¶ 14.

64. Courts in this district approve employee incentive programs like the Compensation Programs that incentivize management or other employees to achieve financial and/or operational targets to maximize value for a debtor's estate at a reasonable cost, recognizing that such programs are beneficial to all stakeholders, including the debtor's shareholders. *See, e.g.*, *In re McDermott Int'l, Inc.*, No. 20-30336 (DRJ) (Bankr. S.D. Tex. Feb. 24, 2020) (approving a key employee incentive plan with financial and operational metrics); *In re Bristow Group Inc.*, No. 19-32713 (DRJ) (Bankr. S.D. Tex. Aug. 22, 2019) (same); *In re Shoreline Energy LLC*, No. 16-35571 (DRJ) (Bankr. S.D. Tex. Jan. 26, 2017) (same); *In re CJ Holding Co.*, No. 16-33590 (DRJ) (Bankr. S.D. Tex. Nov. 4, 2016) (same). The Debtors submit that the QIP is justified by the facts and circumstances and thus, similar relief is warranted in these chapter 11 cases.

B. The Employee Compensation Program and Supplemental Retention Satisfies the Foregoing Factors and Is Justified by the Facts and Circumstances of These Chapter 11 Cases

65. The Employee Compensation Program and Supplemental Retention also satisfy the *Dana* Factors. *First*, there is a reasonable relationship between the Employee

Compensation Program and Supplemental Retention as proposed and the desired results. The Performance Metrics underlying the ECP Incentive Payments are the same as those applicable to the QIP and therefore, as discussed above, such metrics are specifically calculated to achieve the stability and near-term operating performance critical to a successful restructuring. The ECP Retention Payments and Supplemental Retention were carefully designed by the Debtors and their advisors to ensure that ECP Participants are fairly compensated and remain with the Debtors through the pendency of the chapter 11 cases. Retention of ECP Participants will avoid the Debtors needing to expend more resources to search for and hire replacements and integrate new employees into the Debtors' businesses. *Glob. Aviation Holdings Inc.*, 478 B.R. at 150 (finding that the proposed KERP bonuses had a reasonable relationship to the desired retentive results and justified the facts and circumstances of the chapter 11 cases, satisfying section 503(c)(3)).

66. *Second*, the costs of the Employee Compensation Program and Supplemental Retention are reasonable. As discussed in Section IV.D above, A&M determined that the ECP Retention Payments fell within the 21st percentile relative to peer programs based on the annualized cost per participant, which given its scale, A&M determined was the proper metric to evaluate the Employee Compensation Program. When annualized participant cost as a percentage of a participant's salary is the determining metric, the ECP Retention Payments fell within the 4th percentile relative to peer programs, which only increased to the 5th percentile when the Supplemental Retention was considered. *See* Cumberland Decl. ¶ 32. The Debtors believe that the total 2020 cost of the Employee Compensation Program (excluding the Supplemental Retention) at the target level of performance of approximately $27 million is reasonable in light of the size of the ECP Participant Pool, comprised of 1,123 Employees that are highly skilled, highly trained and necessary to the Debtors' day-to-day business operations.

In addition, the Supplemental Retention comprises only payments to a carefully selected group of non-insiders with a high retention risk and has an aggregated anticipated 2020 cost of $1.4 million.

67. *Third*, the scope of the Employee Compensation Program and Supplemental Retention is fair and reasonable. As noted above, the Employee Compensation Program was designed to replace the original 2020 variable compensation opportunities with a program that aligns with the Debtors' current priorities, and all of the ECP Participants were eligible to participate in the incentive compensation programs established by the Debtors in the first quarter of 2020. Accordingly, the scope of the Employee Compensation Program is tailored to the program's objectives and reflects the scope of the Debtor's ordinary course variable compensation program. *See* Cumberland Decl. ¶¶ 34-35. Moreover, as described above, the Supplemental Retention is limited to those non-insider employees that represent a significant retention risk and whose departure during the Debtors' restructuring would cause significant and immediate disruption to the Debtors' ongoing operations.

68. *Fourth*, the Employee Compensation Program is consistent with industry standards. Because the Performance Metrics underlying the ECP Incentive Payments are the same as those underlying the QIP, the market consistency of the program for the ECP Incentive Payments is discussed in Section VI.A above. In addition, A&M examined the reasonableness of the ECP Retention Payments and Supplemental Retention as compared to other retention programs approved by bankruptcy courts in 2015 or later for companies within the energy, utilities or mining industries with greater than $1 billion in prepetition assets and determined that the ECP Retention Payments and Supplemental Retention were consistent in both terms and structure with plans implemented by this peer group. *See* Cumberland Decl. ¶ 30.

69. *Fifth*, the Debtors actively sought the advice of their advisors, including A&M, in designing the Employee Compensation Program and the Supplemental Retention. The Debtors also paid critical attention to, and received guidance from A&M regarding, the population of employees selected to receive Supplemental Retention to ensure that non-insider employees serving essential roles in the Debtors' operations would be sufficiently compensated to avoid critical employee turnover. *See* Cumberland Decl. ¶ 12.

70. Courts in district have granted relief similar to the relief requested herein. *See, e.g.*, *In re McDermott Int'l, Inc.*, No. 20-30336 (DRJ) (Bankr. S.D. Tex. Feb. 24, 2020) (approving debtors' key employee retention plan for 1,112 non-insiders who were eligible for compensation under prepetition incentive plans); *In re Southern Foods Grp., LLC.*, No. 19-36313 (DRJ) (Bankr. S.D. Tex. Feb. 19, 2020) (approving debtors' non-insider key employee incentive and retention plans); *In re Legacy Reserves Inc.*, No. 19-33395 (MI) (Bankr. S.D. Tex. Sept. 30, 2019) (approving debtors' non-insider key employee retention plan); *In re Linn Energy, LLC*, No. 16-60040 (DRJ) (Bankr. S.D. Tex. Aug. 1, 2016) (approving debtors' non-insider incentive, executive incentive and critical employee retention plans); *In re Ultra Petroleum Corp.*, No. 16-32202 (MI) (Bankr. S.D. Tex. Jun. 23, 2016) (approving debtors' key employee retention plan); *Ultra Petroleum Corp.*, No. 16-32202 (MI) (Bankr. S.D. Tex. Jun. 28. 2016) (approving debtors' key employee incentive plan). The Debtors submit that the Employee Compensation Plan and Supplemental Retention are justified by the facts and circumstances and thus, similar relief is warranted in these chapter 11 cases.

Reservation of Rights

71. Nothing in this Motion: (a) is intended or shall be deemed to constitute an assumption of any agreement pursuant to section 365 of the Bankruptcy Code or an admission as to the validity of any claim against the Debtors or their estates; (b) shall impair, prejudice, waive,

or otherwise affect the rights of the Debtors or their estates to contest the validity, priority, or amount of any claim against the Debtors or their estates; (c) shall impair, prejudice, waive, or otherwise affect the rights of the Debtors or their estates with respect to any and all claims or causes of action against any third party; or (d) shall be construed as a promise to pay a claim or continue any applicable program postpetition, which decision shall be in the discretion of the Debtors. Any payment made pursuant to an order of the Court granting the relief requested herein is not intended to be, nor should it be construed as, an admission as to the validity of any claim or a waiver of the Debtors' rights to subsequently dispute such claim.

Notice

72. No creditors' committee, trustee or examiner has been appointed in these chapter 11 cases. Notice of this Motion has been provided to: (a) the U.S. Trustee; (b) the Debtors' 30 largest unsecured creditors (on a consolidated basis); (c) those persons who have formally appeared in these chapter 11 cases and requested service pursuant to Bankruptcy Rule 2002; (d) the Securities and Exchange Commission; (e) the Internal Revenue Service; (f) all other applicable government agencies to the extent required by the Bankruptcy Rules or the Bankruptcy Local Rules; (g) counsel to the administrative agent for the Debtors' DIP credit facility; (h) counsel to the ad hoc group of prepetition first and second lien lenders; (i) counsel to the ad hoc group of prepetition noteholders and (j) counsel to ECR Corporate Holdings L.P. The Debtors submit that, in light of the nature of the relief requested, no other or further notice need be provided.

No Prior Request

73. No prior motion for the relief requested herein has been made to this or any other Court.

Conclusion

WHEREFORE, for the reasons set forth herein, the Debtors respectfully request that the Court (a) enter the Order, substantially in the form attached hereto as Exhibit A and (b) grant such other and further relief as is just and proper.

Houston, Texas
July 23, 2020

Respectfully Submitted,

/s/ Paul E. Heath

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EXHIBIT A

Proposed Order

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re	:	Chapter 11
CALIFORNIA RESOURCES CORPORATION, *et al.*,[1]	:	Case No. 20-33568 (DRJ)
	:	Jointly Administered
Debtors.	:	

ORDER AUTHORIZING, BUT NOT DIRECTING, THE DEBTORS TO IMPLEMENT (I) THE QUARTERLY INCENTIVE PLAN, (II) THE INCENTIVE AND RETENTION PLAN AND (III) THE SUPPLEMENTAL RETENTION

Upon the motion (the "Motion")[2] of California Resources Corporation and its affiliated debtors and debtors-in-possession (collectively, the "Debtors"), for entry of an order (this "Order") authorizing, but not directing, the Debtors to implement (a) a quarterly incentive plan (the "QIP"), (b) an incentive and retention plan (the "Employee Compensation Program") and (c) the supplemental retention payments (the "Supplemental Retention" and, together with the QIP and the Employee Compensation Program, the "Compensation Programs"); and this Court having jurisdiction to consider the Motion pursuant to 28 U.S.C. § 1334; and venue of these chapter 11 cases and the Motion in this district being proper pursuant to 28 U.S.C. §§ 1408

[1] The Debtors in these chapter 11 cases and the last four digits of their U.S. taxpayer identification numbers are: California Resources Corporation (0947); California Heavy Oil, Inc. (4630); California Resources Coles Levee, L.P. (2995); California Resources Coles Levee, LLC (2087); California Resources Elk Hills, LLC (7310); California Resources Long Beach, Inc. (6046); California Resources Mineral Holdings LLC (4443); California Resources Petroleum Corporation (9218); California Resources Production Corporation (5342); California Resources Production Mineral Holdings, LLC (9071); California Resources Real Estate Ventures, LLC (6931); California Resources Royalty Holdings, LLC (6393); California Resources Tidelands, Inc. (0192); California Resources Wilmington, LLC (0263); CRC Construction Services, LLC (7030); CRC Marketing, Inc. (0941); CRC Services, LLC (6989); Monument Production, Inc. (0782); Oso Verde Farms, LLC (7436); Socal Holding, LLC (3524); Southern San Joaquin Production, Inc. (4423); Thums Long Beach Company (1774); Tidelands Oil Production Company LLC (5764). The Debtors' corporate headquarters is located at 27200 Tourney Road, Suite 200, Santa Clarita, CA 91355.

[2] Capitalized terms not otherwise defined herein are to be given the meanings ascribed to them in the Motion.

and 1409; and this matter being a core proceeding pursuant to 28 U.S.C. § 157(b); and this Court having found that proper and adequate notice of the Motion and the relief requested therein have been provided in accordance with the Bankruptcy Rules, the Bankruptcy Local Rules and the Complex Case Procedures, and that, except as otherwise ordered herein, no other or further notice is necessary; and any objections (if any) to the Motion having been withdrawn, resolved or overruled on the merits; and a hearing having been held to consider the relief requested in the Motion and upon the record of the hearing and all of the proceedings had before this Court; and this Court having found and determined that the relief sought in the Motion is in the best interests of the Debtors, their estates, their creditors and all other parties-in-interest; and that the legal and factual bases set forth in the Motion establish just cause for the relief granted herein; and after due deliberation and sufficient cause appearing therefor;

IT IS HEREBY ORDERED THAT:

1. The Motion is GRANTED as set forth herein.

2. The Debtors are authorized, but not directed, to implement the QIP, the Employee Compensation Program and the Supplemental Retention, which are hereby approved pursuant to sections 503(c)(3) and 363(b) of the Bankruptcy Code.

3. The Debtors are authorized, but not directed, to make payments under the QIP, the Employee Compensation Program and the Supplemental Retention, in each case solely pursuant to the terms of the Compensation Programs; provided that any payments related to incentive or retention payments that are not authorized by the terms of the Compensation Programs or the orders entered pursuant to the Debtors' Emergency Motion for Entry of Interim and Final Orders (I) Authorizing, But Not Directing, the Debtors to Pay Certain Prepetition Compensation Obligations, (II) Authorizing, But Not Directing, the Debtors to Pay Postpetition Compensation Obligations in the Ordinary Couse of Business and (III) Granting Related Relief

Filed by Debtor California Resources Corporation, filed on July 15, 2020 [Docket No. 7], will require further approval from the Court.

4. The Debtors are authorized, but not directed, to pay all processing, administrative and other fees associated with all costs and expenses including incidental payments under the QIP, the Employee Compensation Program and the Supplemental Retention.

5. Nothing in this Order shall impair the Debtors' ability to contest the validity or amount of any QIP Participant or ECP Participant claim to be paid hereby.

6. Nothing contained herein shall be deemed a waiver of, a determination related to or an authorization to take any action under any provision set forth in section 503(c) of the Bankruptcy Code.

7. The Debtors are authorized and empowered to execute and deliver such documents, and to take and perform all actions necessary to implement and effectuate the relief granted in this Order.

8. Nothing in the Motion or this Order, nor as a result of any payment made pursuant to this Order, shall be deemed or construed as an admission as to the validity or priority of any claim against the Debtors, an approval or assumption of any agreement, contract or lease pursuant to section 365 of the Bankruptcy Code or a waiver of the right of the Debtors, or shall impair the ability of the Debtors, to contest the validity and amount of any payment made pursuant to this Order.

9. The requirements set forth in Bankruptcy Rule 6004(a) are satisfied.

10. This Order is immediately effective and enforceable, notwithstanding the possible applicability of Bankruptcy Rule 6004(h) or otherwise.

11. This Court shall retain jurisdiction with respect to any matters, claims, rights or disputes arising from or related to the Motion or the implementation of this Order.

Dated: _____, 2020
Houston, Texas

United States Bankruptcy Judge

EXHIBIT B

Cumberland Declaration

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re	:	Chapter 11
CALIFORNIA RESOURCES CORPORATION, *et al.*,[1]	:	Case No. 20-33568 (DRJ)
	:	Jointly Administered
Debtors.	:	

DECLARATION OF BRIAN CUMBERLAND, MANAGING DIRECTOR AT ALVAREZ & MARSAL NORTH AMERICA, LLC, IN SUPPORT OF DEBTORS' MOTION FOR AN ORDER AUTHORIZING, BUT NOT DIRECTING, THE DEBTORS TO IMPLEMENT (I) THE QUARTERLY INCENTIVE PLAN, (II) THE INCENTIVE AND RETENTION PLAN AND (III) THE SUPPLEMENTAL RETENTION

I, Brian Cumberland, hereby declare under penalty of perjury:

1. I am a Managing Director at Alvarez & Marsal North America, LLC ("A&M"), a financial advisory firm that provides restructuring, crisis and turnaround management services. A&M was engaged in March 2020 to be the restructuring advisor for California Resources Corporation ("CRC") and certain of its affiliated debtors and debtors-in-possession (collectively, the "Debtors").

2. I am generally familiar with the Debtors' day-to-day operations and business and financial affairs. I submit this declaration (the "Declaration") in support of the

[1] The Debtors in these chapter 11 cases and the last four digits of their U.S. taxpayer identification numbers are: California Resources Corporation (0947); California Heavy Oil, Inc. (4630); California Resources Coles Levee, L.P. (2995); California Resources Coles Levee, LLC (2087); California Resources Elk Hills, LLC (7310); California Resources Long Beach, Inc. (6046); California Resources Mineral Holdings LLC (4443); California Resources Petroleum Corporation (9218); California Resources Production Corporation (5342); California Resources Production Mineral Holdings, LLC (9071); California Resources Real Estate Ventures, LLC (6931); California Resources Royalty Holdings, LLC (6393); California Resources Tidelands, Inc. (0192); California Resources Wilmington, LLC (0263); CRC Construction Services, LLC (7030); CRC Marketing, Inc. (0941); CRC Services, LLC (6989); Monument Production, Inc. (0782); Oso Verde Farms, LLC (7436); Socal Holding, LLC (3524); Southern San Joaquin Production, Inc. (4423); Thums Long Beach Company (1774); Tidelands Oil Production Company LLC (5764). The Debtors' corporate headquarters is located at 27200 Tourney Road, Suite 200, Santa Clarita, CA 91355.

Debtors' motion (the "Motion") for entry of an order authorizing, but not directing, the Debtors to implement the proposed Quarterly Incentive Plan (the "QIP"), the proposed Incentive and Retention Plan (the "Employee Compensation Program") and the Supplemental Retention (as defined below, and, together with the QIP and the Employee Compensation Program, the "Compensation Programs"). Capitalized terms not otherwise defined herein are to be given the meanings ascribed to them in the Motion.

3. I received my Bachelor's degree in Business Administration from the University of Texas. Thereafter, I received a Juris Doctorate from the St. Mary's School of Law and Latin Legum Magister in Taxation from the University of Denver. Prior to joining A&M, I worked in KPMG's National Tax Practice in addition to leading KPMG's Compensation and Benefits Group for the Southwest. Since my time at KPMG, I have been employed at A&M for over 14 years.

4. My responsibilities at A&M have primarily involved consulting with large companies, specifically with regard to executive compensation and the development of compensation strategies. I have worked with numerous Fortune 1000 companies and have participated in the development and design of hundreds of management and employee incentive/retention plans for companies inside and outside of bankruptcy.

5. I am frequently retained by large companies to advise them on their employee compensation strategies, programs and pay levels. I am also retained by companies performing specific searches for management personnel, for which I provide guidelines on general market practice and the level and form of current market compensation for those positions.

6. I am highly experienced in executive, management and employee compensation matters with nearly 30 years of experience in the field. During this time, I have been the lead or supporting employee compensation expert in more than 50 bankruptcy cases, and have testified as to the reasonableness of a variety of postpetition compensation arrangements. Specifically, I have been involved in the review and design of key employee incentive plans, management incentive plans, key employee retention plans, severance plan design and other similar plans in the chapter 11 cases of, among others, Abengoa Bioenergy, AF Global, Alpha Natural Resources, American Gilsonite Company, Answers Corporation, API Heat Transfer, Aralez Pharmaceuticals, Inc., Arcapita Bank B.S.C.(c), Azure Midstream Partners, LP, Bonanza Creek, Bristow Group, Inc., Bruno's Supermarkets, LLC, Cal-Dive, Castex Energy, Inc., Cenveo, Inc., Coldwater Creek, Inc., Ciber, Inc., Dean Foods, Eastman Kodak Company, Enduro Resource Partners, Energy Corporation of America, Fairway Midstream, FirstEnergy Solutions, Gulfmark Offshore Inc., Hercules Offshore Inc., Legacy Reserves, Inc., Nine West, Nortel, Pacific Drilling, Payless Shoesource, Rockport Group, Sandridge Energy, Seadrill Ltd., Seventy-Seven Energy, Sun Edison, Swift Energy, Toys R Us, Ultra Petroleum Corp., and Vanguard Natural Resources.

7. I am generally familiar with the Debtors' operations and business and restructuring challenges. I am familiar with the prepetition structure of the Debtors' compensation programs and the structure of the proposed Compensation Programs. During the course of A&M's engagement, my team and I provided input and advice on the structure of the Compensation Programs and reviewed the proposed compensation for reasonableness. I reviewed the Motion and believe that it accurately describes the development of, and justification

for, the Compensation Programs. Based on my prior experience, I believe that each of the Compensation Programs is reasonable and appropriate.

8. In forming the opinions set forth herein, I have relied upon and/or considered, among other things, the following: (a) my personal knowledge, (b) my experience with, and research relating to, employee compensation programs in chapter 11 cases, generally, and more specifically, in cases commenced by companies in the energy, utilities and mining industries, (c) the Motion, (d) the *Declaration of Todd A. Stevens in Support of the Debtors' Chapter 11 Petitions and First Day Pleadings*, filed on July 15, 2020 [Docket No. 20], the *Declaration of Mark Rajcevich in Support of the Debtors' Chapter 11 Petitions and First Day Pleadings*, filed on July 15, 2020 [Docket No. 21], and the *Declaration of Mark Rajcevich in Support of the Debtors' Motion for an Order Authorizing, but not Directing, the Debtors to Implement (I) the Quarterly Incentive Plan, (II) the Incentive and Retention Plan and (III) the Supplemental Retention*, filed concurrently herewith, (e) information obtained from, and discussions with, the Debtors' management and advisors, including the A&M restructuring team working with the Debtors concerning the Debtors' business, finances and employee compensation programs, and (f) my review of relevant documents and information concerning the Debtors' compensation programs.

9. As a professional retained by the Debtors, A&M is charging for services provided in this matter, but I am not being specifically compensated for this declaration or testimony other than through payments received by A&M in accordance with the terms of its engagement agreement, and subject to Court approval. Except as otherwise indicated, all facts set forth in this Declaration are based upon my personal knowledge and my review of relevant documents and information concerning the Debtors' operations, financial affairs and

restructuring initiatives or my opinions based upon my experience and knowledge. If I were called to testify, I could and would testify competently to the facts set forth herein.

I. Development of the Proposed Compensation Programs

10. In March 2020 the Debtors determined to engage A&M to provide compensation advice with respect to the Debtors' originally established 2020 incentive programs and potential alternatives.

11. Over the ensuing approximately two months, A&M conducted analyses to consider the cost and structure of the 2020 Previous Incentives as well as alternative compensation programs, which were discussed with and presented to the Debtors' management, the Board, the Compensation Committee and the Special Committee of the Board. In addition to designing programs that would meet the Debtors' compensation objectives in the current environment, A&M also advised the Debtors on current market practices with respect to distressed companies.

12. The Compensation Committee determined that a portion of the opportunities under the replacement Compensation Programs should include a direct retentive component. This represented, on average, 24% of the QIP participants' (the "QIP Participants") target total incentive opportunity and 50% of the target total incentive opportunity for ECP Participants. The Compensation Committee also determined that additional supplemental retention awards should be granted to a select group of non-insider employees who presented a significant retention risk. The retention awards to QIP Participants were prepaid, with a requirement that the awards be repaid in the event of a termination for "cause" or voluntary resignation before the earliest of (x) one year following the payment date, (y) the completion of a restructuring and (z) the effective date of a sale of the Debtors. The retention awards to ECP

Participants comprise quarterly cash payments for the ECP Participants' continued employment with the Debtors.

II. The QIP

13. The QIP provides for the quarterly payment of incentive-based cash awards (the "QIP Payments") for the achievement by the Debtors of the following operational and financial performance targets: (a) cumulative operating margin as measured on an accrual basis, (b) general and administrative expense reduction, (c) liquidity and facility utilization and (d) certain safety and sustainability milestones and goals, as set forth in more detail in the Motion (the "Performance Metrics") during each of the following upcoming performance periods: July 1, 2020 – September 30, 2020; October 1, 2020 – December 31, 2020; January 1, 2021 – March 31, 2021; and April 1, 2021 – June 30, 2021 (each, a "Performance Period"); *provided that* the board of directors of CRC following emergence from these chapter 11 cases may terminate the QIP earlier than June 30, 2021.

14. The Debtors' achievement of the Performance Metrics is measured on a quarterly basis, and the amount of each quarterly QIP Payment, if any, is determined by the level of performance achieved during the Performance Period with respect to each individual Performance Metric, considered independently. If the threshold performance level is not achieved for any Performance Metric during the applicable Performance Period, then no amounts will be earned as a QIP Payment in respect of that Performance Metric. For the final Performance Period, performance will be measured cumulatively on a trailing basis against cumulative Performance Metrics, and the QIP Payment for such Performance Period will be increased if, and to the extent that, the aggregate value of the QIP Payments over July 1, 2020 through the final Performance Period is less than the amount earned based on achievement of the cumulative Performance Goals. This "catch-up" feature allows the QIP Participants to earn

"missed" award amounts from prior Performance Periods on a go-forward basis, ensuring that QIP Participants are continuously incentivized to achieve maximum performance on a cumulative basis over the duration of the Performance Periods.

15. Annualized individual opportunities under the QIP were designed to be commensurate with the QIP Participants' total long-term incentive opportunities under the Previous 2020 Incentives.

16. For Performance Periods beginning July 1, 2020, QIP Payments can range from 0% of target (if threshold performance is not achieved) to 200% of target (if maximum or greater performance is achieved). The aggregate quarterly award that may be earned as QIP Payments during those Performance Periods is approximately $1,787,500 at threshold payout levels, approximately $3,575,000 at target payout levels, and approximately $7,150,000 at maximum payout levels.

17. The individual quarterly target award opportunities available to each QIP Participant are within a range of $87,500 to $1,350,000.

18. Earned QIP Payments will be paid within 60 days after the applicable Performance Period subject to the QIP Participant's continued employment. Any unearned QIP Payments are forfeited upon a QIP Participant's termination of employment with the Debtors, except for a termination of employment by the Debtors without cause or by the QIP Participant due to a material change in position or responsibilities, annual base salary or a significant relocation of primary work location (greater than 150 miles) or due to death or disability, in which case, the next QIP Payment, to the extent earned based on actual performance, will be made on a pro rata basis based on the amount of time worked during the applicable period,

subject to the QIP Participant's execution and non-revocation of a release of claims within the 30 days following termination.

III. The QIP Is Reasonable and Is Consistent With Market Practices.

19. Based on my experience and knowledge of the Debtors, I believe that (a) the QIP is reasonable as compared to other incentive plans implemented by comparable companies in chapter 11, (b) the target total direct compensation ("TDC") for QIP Participants is reasonable relative to relevant talent market pay and (c) the target TDC for QIP Participants is reasonable relative to the historical compensation established by the Debtors for their positions.

20. In assessing the reasonableness of the cost of the QIP, my team analyzed executive-focused incentive plans focused on emergence (as opposed to a sale of the company) approved by bankruptcy courts in 2015 or later for the following companies within the energy, utilities or mining industries with greater than $1 billion in prepetition assets (the "QIP Bankruptcy Peers"):

QIP Bankruptcy Peers	
Alpha Natural Resources, Inc.	McDermott International, Inc.
Breitburn Energy Partners LP	Molycorp, Inc.
Bristow Group Inc.	Pacific Drilling S.A.
C&J Energy Services Ltd.	Peabody Energy Corporation
Energy Future Holdings Corporation	Sabine Oil & Gas Corporation
FirstEnergy Solutions Corp.	Samson Resources Corporation
GenOn Energy, Inc.	Ultra Petroleum Corporation
LINN Energy, LLC	

The Debtors were in approximately the 67th percentile of this peer group based on prepetition assets.

21. As measured against the QIP Bankruptcy Peers, the QIP is at the 70th percentile and 51st percentile of market, respectively, based on target total cost and average target

cost of the unpaid portion of the QIP for 2020. Moreover, the QIP drops to the 26th percentile of the market based on target total cost as a percentage of revenues. Also, as measured against the QIP Bankruptcy Peers, the number of QIP Participants (nine) is at the 57th percentile of the market. Based on my knowledge of the Debtors' operations and financial position, as well as this placement around the median of the market, I believe that the QIP has a reasonable scope both in terms of number of participants and anticipated costs.

22. A&M also analyzed data from the Meridian Compensation Partners executive compensation report (the "Meridian Peer Group"), which uses public company proxy data to benchmark executive compensation, as well as survey data for QIP Participants in roles not positioned in the Meridian report, in order to determine the reasonableness of QIP Participants' TDC relevant to the market.[2] The Meridian Peer Group examined for this purpose comprised the following:

Meridian Peer Group		
Cabot Oil & Gas Corporation	Laredo Petroleum, Inc.	Range Resources Corporation
Callan Petroleum Corporation	Matador Resources Corporation	SM Energy Company
Carrizo Oil & Gas, Inc.	Murphy Oil Corporation	Southwestern Energy Company
Cimarex Energy Co.	Oasis Petroleum Inc.	Whiting Petroleum Corporation
Denbury Resources, Inc.	Parsley Energy, Inc.	WPX Energy Inc.
Diamondback Energy, Inc.	PDC Energy, Inc.	
Gulfport Energy Corporation	QEP Resources, Inc.	

[2] The Meridian Peer Group necessarily differs from the bankruptcy comparator group as a result of the differing objectives of the market and bankruptcy compensation reviews; namely, the purpose of the bankruptcy compensation review is to consider the appropriateness of the program as compared to other similar bankruptcy incentive plans, and the purpose of the market compensation review is to consider the appropriateness of the compensation levels as compared to the market in which the Debtors compete for talent.

Based on information provided by Meridian and publicly available in CRC's 2020 Proxy Statement, the Debtors were in approximately the 58th percentile of this peer group based on asset value and 74th percentile of this peer group based on enterprise value, in each case as of 2019. Overall, the QIP Participants' total compensation packages, including target QIP Payments, is around the median of the market as measured against the Meridian Peer Group, with each QIP Participant's target TDC falling between the 50th and 75th percentile relevant to market except for one QIP Participant whose target TDC is below the 25th percentile. This market positioning is reasonable in my experience, particularly in light of the fact that the QIP Participants are subject to a relatively high cost of living in California. In addition, the QIP Participants' proposed total compensation package represents no change from target annual opportunities available to the QIP Participants under the Debtors' prior 2020 programs.

23. Because the QIP replaces the prior 2020 incentive programs for the QIP Participants, the QIP, along with the retention awards paid to QIP Participants, provides the Debtors' key employees with target compensation opportunities commensurate with those previously available to them. Moreover, A&M reviewed the Debtors' prepetition compensation structure for the QIP Participants to identify the impact that discontinuing the Debtors' prior 2020 incentive programs would have on target TDC opportunities, and determined that such opportunities represented 61% – 88% of QIP Participants' compensation on an annual basis. Accordingly, removing these incentive and retention opportunities would reduce the QIP Participants' TDC opportunities as much as 88% if no replacement arrangements were put in place.

24. The range of payout opportunities (from 50% of target for threshold performance to 200% of target at or above maximum performance) is consistent with the ranges

developed for CRC's historical incentive programs as well as current market practices within the industry. Moreover, based on my experience, it is common for key employee incentive awards to be paid as quarterly cash payments during a restructuring. Accordingly, the terms and structure of QIP Payments accord with market compensation practices of distressed companies. Based on this review, I believe that the QIP is reasonable in design.

25. Therefore, based on the foregoing data and analysis, combined with my experience and knowledge of the Debtors' businesses, I believe that the scope and design of the QIP is reasonable, appropriate and consistent with market practice.

IV. The Employee Compensation Program and Supplemental Retention

26. As of the date on which the programs were approved by the Board, the Employee Compensation Program participants were 1,123 non-insider employees (the "ECP Participants") that perform a wide variety of functions critical to the Debtor's daily operations. All of the ECP Participants were participants in the Previous 2020 Incentives. No ECP Participants are QIP Participants.

27. The ECP provides for the payment of (a) incentive-based cash awards (the "ECP Incentive Payments") to the extent that the same Performance Metrics that apply to the QIP are achieved and on the same terms as the QIP Payments and (b) quarterly cash payments for the ECP Participants' continued employment with the Debtors (the "ECP Retention Payments").

28. The ECP Retention Payments are payable in four installments on the last day of each of the following periods: May 19, 2020 – September 30, 2020; October 1, 2020 – December 31, 2020; January 1, 2021 – March 31, 2021 and April 1, 2021 – June 30, 2021 (each, a "Retention Period"); *provided that* the board of directors of CRC following emergence from these chapter 11 cases may terminate the ECP earlier than June 30, 2021. To be eligible to earn

a ECP Retention Payment, a ECP Participant must be employed by the Debtors at the end of the applicable Retention Period. Any unearned ECP Retention Payments are forfeited upon an ECP Participant's termination of employment with the Debtors, except for a termination of employment by the Debtors without cause or due to death or disability, in which case the next ECP Retention Payment will be made on a pro rata basis based on the amount of time worked during the applicable period, subject to the ECP Participant's execution and non-revocation of a release of claims within the 30 days following termination. Earned ECP Retention Payments will be paid within 30 days after the applicable Retention Period.

29. The total aggregate cost of the ECP Incentive Payments and the ECP Retention Payments for 2020 is approximately $13.5 million and $13.5 million, respectively. In addition, the Debtors determined to grant additional retention awards to a group of 60 employees that represented a significant retention risk (the "Supplemental Retention") with an aggregate of $1.4 million payable in respect of such awards in 2020.

V. The Employee Compensation Program and Supplemental Retention Are Reasonable and Consistent With Market Practices

30. Based on my experience and knowledge of the Debtors, I believe that the ECP Retention Payments and Supplemental Retention are reasonable as compared to other retention plans approved by bankruptcy courts in 2015 or later for companies within the energy, utilities or mining industries with greater than $1 billion in prepetition assets (the "ECP Bankruptcy Peers").[3]

[3] Because available talent market compensation data are primarily dependent on publicly disclosed compensation data, which are limited to named executive officers, a market review of each ECP Participant's target TDC was not possible. Additionally, given the number of ECP Participants, such review would not be feasible even if data were available.

31. In assessing the reasonableness of the cost of the ECP Retention Payments and Supplemental Retention, A&M analyzed incentive plans implemented by the following ECP Bankruptcy Peers:

ECP Bankruptcy Peers	
Alpha Natural Resources, Inc.	LINN Energy, LLC
Basic Energy Services, Inc.	McDermott International, Inc.
Breitburn Energy Partners LP	Pacific Drilling S.A.
Bristow Group Inc.	Patriot Coal Corporation (2015)
C&J Energy Services Ltd.	Peabody Energy Corporation
Energy Future Holdings Corporation	Quicksilver Resources, Inc.
Energy XXI	Sabine Oil & Gas Corporation
FirstEnergy Solutions Corp.	Samson Resources Corporation
Legacy Reserves Inc.	Ultra Petroleum Corporation

The Debtors were in approximately the 73rd percentile of this peer group based on prepetition assets and the 43rd percentile based on number of employees.

32. Importantly, a majority of the retention programs analyzed for the ECP Bankruptcy Peers represent additional compensation opportunities to the participants. In contrast, the Employee Compensation Program replaces each ECP Participant's prior incentive opportunities. For this reason, the population of ECP Participants is necessarily broader than certain peer plans structured as additional retention programs for specific groups of employees. However, when the annualized average cost per participant of approximately $24,000 is considered, which represents a more consistent measure of comparison, the ECP Retention Payments are in the 21st percentile as measured against the ECP Bankruptcy Peers.[4] Moreover, ECP Retention Payments represent, on average, 16% of base salary, placing the program in the

[4] The analysis conducted by my team in connection with the implementation of the Employee Compensation Program reflected that there would be 1,167 participants in the program. As of the date hereof, the number of participants was lower due to awards forfeited upon employee resignations.

4th percentile as measured against the ECP Bankruptcy Peers. Including the Supplemental Retention, retention payments to ECP Participants have an average annualized cost per participant of approximately $26,000, which places such retention opportunities in the 23rd percentile as measured against the ECP Bankruptcy Peers. If measured based on average participant cost as a percentage of salary, including the Supplemental Retention places the ECP Participants' opportunities in the 5th percentile, representing, on average, 17% of base salary, as measured against the ECP Bankruptcy Peers. Accordingly, based on average per participant cost and average participant cost as a percentage of salary, retention opportunities under these programs are well in line with the low end of the market.

33. Further, the structure and terms of the Employee Compensation Program include common features of non-insider compensation programs implemented by the ECP Bankruptcy Peers. Paying postpetition quarterly cash incentive and/or retention payments to non-insiders is a common compensation arrangement for similarly situated companies during a chapter 11 proceeding.

34. In addition, the Employee Compensation Program represents a continuation of the Debtors' historical practice to supplement to the ECP Participants' fixed compensation through the variable compensation programs, which the Employee Compensation Program is designed to replace. As noted above, aggregate individual opportunities under the Employee Compensation Program are structured to provide compensation opportunities commensurate with the opportunities previously available to the same individuals under the Previous 2020 Incentives. When the Supplemental Retention is considered, the aggregate payment opportunity for ECP Participants only represents, in the aggregate, a 1% increase to the

compensation opportunities previously available to the ECP Participants under the Debtors' prior 2020 programs.

35. Accordingly, it is my view that the Employee Compensation Program and Supplemental Retention were designed to ensure that these employees are fairly compensated and remain with the Debtors through the pendency of these chapter 11 cases. Further, the structure of the Employee Compensation Program and Supplemental Retention is reasonable, appropriate and within industry norms.

Conclusion

36. For all of the foregoing reasons, and based on my experience and the facts and circumstances of these cases, I believe that the Compensation Programs are fair, reasonable and designed to maximize performance and the going-concern value of the Debtors and, for the Employee Compensation Program, promote the desired retention.

Pursuant to 28 U.S.C. § 1746, I declare under penalty of perjury that the foregoing statements are true and correct to the best of my knowledge, information and belief.

Date: July 23, 2020

/s/ Brian Cumberland
Brian Cumberland
Alvarez & Marsal North America, LLC
Managing Director

EXHIBIT C

Rajcevich Declaration

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re	:	Chapter 11
CALIFORNIA RESOURCES CORPORATION, *et al.*,[1]	:	Case No. 20-33568 (DRJ)
	:	Jointly Administered
Debtors.	:	

DECLARATION OF MARK RAJCEVICH, MANAGING DIRECTOR AT ALVAREZ & MARSAL NORTH AMERICA, LLC, IN SUPPORT OF DEBTORS' MOTION FOR AN ORDER AUTHORIZING, BUT NOT DIRECTING, THE DEBTORS TO IMPLEMENT (I) THE QUARTERLY INCENTIVE PLAN, (II) THE INCENTIVE AND RETENTION PLAN AND (III) THE SUPPLEMENTAL RETENTION

I, Mark Rajcevich, hereby declare under penalty of perjury:

1. I am a Managing Director at Alvarez & Marsal North America, LLC ("A&M"), a financial advisory firm that provides restructuring, crisis, and turnaround management services. A&M was engaged in March 2020 to be the restructuring advisor for California Resources Corporation ("CRC") and certain of its affiliated debtors and debtors-in-possession (collectively, the "Debtors").

2. I have approximately 20 years of experience in advising companies in distressed and bankruptcy-related situations. I have advised both public and private companies

[1] The Debtors in these chapter 11 cases and the last four digits of their U.S. taxpayer identification numbers are: California Resources Corporation (0947); California Heavy Oil, Inc. (4630); California Resources Coles Levee, L.P. (2995); California Resources Coles Levee, LLC (2087); California Resources Elk Hills, LLC (7310); California Resources Long Beach, Inc. (6046); California Resources Mineral Holdings LLC (4443); California Resources Petroleum Corporation (9218); California Resources Production Corporation (5342); California Resources Production Mineral Holdings, LLC (9071); California Resources Real Estate Ventures, LLC (6931); California Resources Royalty Holdings, LLC (6393); California Resources Tidelands, Inc. (0192); California Resources Wilmington, LLC (0263); CRC Construction Services, LLC (7030); CRC Marketing, Inc. (0941); CRC Services, LLC (6989); Monument Production, Inc. (0782); Oso Verde Farms, LLC (7436); Socal Holding, LLC (3524); Southern San Joaquin Production, Inc. (4423); Thums Long Beach Company (1774); Tidelands Oil Production Company LLC (5764). The Debtors' corporate headquarters is located at 27200 Tourney Road, Suite 200, Santa Clarita, CA 91355.

across various industries, including E&P (oil and gas), manufacturing, automotive, homebuilding, real estate development, retail and print and financial services. I have advised companies with regard to the assessment and preparation of financial and operational restructuring strategies, cash flow forecasts, business plans and related financial projections, and assisted companies in preparing for and operating throughout the chapter 11 process. Prior to joining A&M in 2006, I worked for four years in FTI Consulting's restructuring practice and for two years in PricewaterhouseCoopers' Business Recovery Services practice. I hold a bachelor's degree (with high honors) in Finance from the University of Illinois.

3. I am generally familiar with the Debtors' day-to-day operations, business and financial affairs and books and records. I submit this declaration (the "Declaration") in support of the Debtors' motion (the "Motion") for entry of an order authorizing, but not directing, the Debtors to implement the proposed Quarterly Incentive Plan (the "QIP"), the proposed Incentive and Retention Plan (the "Employee Compensation Program") and the Supplemental Retention (as defined below and, together with the QIP and the Employee Compensation Program, the "Compensation Programs"). Capitalized terms not otherwise defined herein are to be given the meanings ascribed to them in the Motion.

4. I am generally familiar with the Debtors' operations and unique business and restructuring challenges. I am familiar with the structure of the Compensation Programs. I was consulted in the development of the performance metrics applicable to the Compensation Programs and the establishment of the target performance measures. I reviewed the Motion and believe that it accurately describes the development of, and justification for, the performance metrics underlying the Compensation Programs. Based on my prior experience and knowledge

of the Debtors' businesses, I believe that the Performance Metrics under the Compensation Programs are appropriate.

5. In forming the opinions set forth herein, I have relied upon and/or considered, among other things, the following: (a) my personal knowledge, (b) my experience with chapter 11 cases, including cases commenced by companies in the E&P (oil and gas) industry, (c) the Motion, (d) the *Declaration of Todd A. Stevens in Support of the Debtors' Chapter 11 Petitions and First Day Pleadings*, filed on July 15, 2020 [Docket No. 20] (the "Stevens First Day Declaration") and the *Declaration of Brian Cumberland in Support of the Debtors' Motion for an Order Authorizing, but not Directing, the Debtors to Implement (I) the Quarterly Incentive Plan, (II) the Incentive and Retention Plan and (III) the Supplemental Retention*, filed concurrently herewith, (e) information obtained from, and discussions with, the Debtors' management and advisors, and (f) my review of relevant documents and information concerning the Debtors' operations, financial affairs and restructuring initiatives.

6. As a professional retained by the Debtors, A&M is charging for services provided in this matter, but I am not being specifically compensated for this declaration or testimony other than through payments received by A&M in accordance with the terms of its engagement agreement, and subject to Court approval. Except as otherwise indicated, all facts set forth in this Declaration are based upon my personal knowledge and my review of relevant documents and information concerning the Debtors' operations, financial affairs and restructuring initiatives or my opinions based upon my experience and knowledge. If I were called to testify, I could and would testify competently to the facts set forth herein.

I. The QIP

7. The QIP provides for the quarterly payment of incentive-based cash awards (the "QIP Payments") for the achievement by the Debtors of certain operational and

financial Performance Metrics (as defined below) during the following performance periods: July 1, 2020 – September 30, 2020; October 1, 2020 – December 31, 2020; January 1, 2021 – March 31, 2021; and April 1, 2021 – June 30, 2021 (each, a "Performance Period").

II. The Employee Compensation Program

8. The ECP provides, in part, for the payment of incentive-based cash awards (the "ECP Incentive Payments") to the extent that the same Performance Metrics that apply to the QIP are achieved.

III. The Performance Metrics

9. The Performance Metrics, as applicable to both the QIP and the ECP Incentive Payments, comprise the following operational and financial performance measures: (a) cumulative operating margin as measured on an accrual basis ("Cumulative Operating Margin"), (b) general and administrative expense reduction ("G&A Reduction"), (c) liquidity and facility utilization ("Utilization") and (d) certain safety and sustainability milestones and goals ("Sustainability"). More specifically:

> (a) **Cumulative Operating Margin**. Cumulative Operating Margin is calculated as the Debtors' aggregate operating income, defined as revenues (prices, production, and realizations) less production costs, as measured from April 1, 2020 through the end of the applicable Performance Period expressed as a percentage of aggregate revenues during such period. Cumulative Operating Margin was selected as a Performance Metric to incentivize the Debtors' employees to maximize value for the Debtors' stakeholders by operating efficiently within a volatile and uncertain environment. In addition, by measuring Cumulative Operating Margin on an accrual basis beginning April 1, 2020, the metric reflects the post-COVID 19 environment impact on commodity pricing and lessens the impact of volatility due to current quarter oil prices.
>
> (b) **G&A Reduction**. G&A Reduction is calculated as the total amount of reductions in the Debtors' general and administrative expenses, including payroll and non-payroll related expenses, but excluding restructuring expenses, incentive/retention compensation and severance costs, as measured on an accrual basis. Each G&A Reduction performance level is tied to different levels of oil prices and requires increasing reductions in consistently lower pricing environments. G&A Reduction was selected as a Performance Metric to

incentivize employees to cut costs and operate the Debtors efficiently to maximize value for the benefit of all stakeholders.

(c) **Utilization**. Utilization measures the capacity utilization on the "funded" portion of the Debtors' credit facility during the Debtors' restructuring on a cash basis excluding (1) any incremental new letters of credit issued under the credit sub-facility, (2) restructuring professional fees, and (3) incentive payments made under the QIP and the ECP Incentive Payments; *provided* that if the metric is measured in connection with a restructuring that is consummated prior to the 20th of the month, then the Intra-Month Measurement Goals (as set forth below) will be utilized to determine achievement. The Utilization metric is to be measured at the end of each applicable Performance Period or, if earlier, upon emergence from chapter 11 as determined by the Compensation Committee. Utilization was selected as a Performance Metric to incentivize employees to efficiently manage liquidity during the pendency of the bankruptcy in order to maximize value for the benefit of all stakeholders.

(d) **Sustainability**. The Sustainability metric includes safety and sustainability goals to promote safety and responsibility by the Debtors' employees in performing their duties, some of which I understand, based on information provided by the Debtors' management, were included as performance metrics underlying the Debtors' original 2020 program design. Moreover, achievement of the Sustainability goals continues to drive the Debtors towards their 2030 Sustainability Goals. The safety component measures injury and illness incidence rate of employees and contractors per 100 workers. The spill prevention rate measures the difference between barrels of oil equivalent (BOE) produced and the net volume of reportable spills of crude oil or condensate not recovered in liquid form. The net water supply to agriculture component measures the ratio of the volume of reclaimed water supplied to agriculture or recharge to the volume of fresh water purchased for the Debtors' statewide operations, expressed as a percentage. Based on my discussions with management, the sustainability progress milestones—tied to water recycling, methane emission reduction and carbon capture and sequestration—support the Debtors' ongoing commitment to provide sustainable, safe and reliable energy solutions. Specifically, these metrics require the Debtors to (1) design and permit the Elk Hills water recycling pipeline expansion, (2) complete the Elk Hills front-end engineering and design study for carbon capture technologies and (3) design a statewide methane capture strategy for gas-operated pneumatic valves.

10. To measure achievement on each Performance Metric, the Debtors established three levels of performance: (a) a threshold performance level, corresponding to a 50% payout (b) a target performance level, corresponding to a 100% payout, and (c) a maximum performance level, corresponding to a 200% payout (collectively, the "Performance Targets").

The Performance Metrics and associated Performance Targets with respect to each Performance Period, are set forth in the tables below:

		Payout Earned		
Performance Metric	**Weight**	**Threshold (50% Payout)**	**Target (100% Payout)**	**Maximum (200% Payout)**
Expense Reduction / Control				
Cumulative Operating Margin*	35%	*See table below*	*See table below*	*See table below*
G&A Reduction*	30%	*See table below*	*See table below*	*See table below*
Liquidity / Facility Utilization*	25%	*See table below*	*See table below*	*See table below*
Sustainability				
Safety (Workforce IIR)*	2.5%	0.60	0.50	0.40
Spill Prevention Rate*	2.5%	99.9996%	99.9997%	99.9998%
Net Water Supplied to Ag*	2.5%	240%	270%	290%
Sustainability Progress Milestones:*	2.5%	Complete 1/3	Complete 2/3	Complete 3/3
Water Recycling				
Carbon Capture				
Methane				

Cumulative Operating Margin*
(Measured April 1, 2020 through end of applicable Performance Period)

Performance Period	**Threshold (50% Payout)**	**Target (100% Payout)**	**Maximum (200% Payout)**
Q3 2020	25.1%	35.3%	43.0%
Q4 2020	27.7%	40.3%	49.0%
Q1 2021	29.0%	42.4%	51.5%
Q2 2021	29.8%	43.6%	52.8%

* Goals for final Performance Period are the Cumulative Performance Goals.

G&A Reduction*
(Measured July 1, 2020 through end of applicable Performance Period)

Quarter / Baseline Cumulative G&A Expenses ($ in 000s)	Average price / Bbl for Performance Period	Threshold (50% Payout)	Target (100% Payout)	Maximum (200% Payout)
Q3 2020 $55,153	$35 or higher	(0.7%)	(1.4%)	(2.2%)
	$25-$35	(1.4%)	(2.9%)	(4.3%)
	Less than $25	(2.2%)	(4.3%)	(6.5%)
Q4 2020 $112,627	$35 or higher	(2.0%)	(3.9%)	(5.9%)
	$25-$35	(3.9%)	(7.9%)	(11.8%)
	Less than $25	(5.9%)	(11.8%)	(17.7%)
Q1 2021 $168,940	$35 or higher	(2.4%)	(4.9%)	(7.3%)
	$25-$35	(4.9%)	(9.7%)	(14.6%)
	Less than $25	(7.3%)	(14.6%)	(21.9%)
Q2 2021 $225,254	$35 or higher	(2.7%)	(5.3%)	(8.0%)
	$25-$35	(5.3%)	(10.7%)	(16.0%)
	Less than $25	(8.0%)	(16.0%)	(24.0%)

* Goals for final Performance Period are the Cumulative Performance Goals.

Liquidity / Facility Utilization* **
(Measured during restructuring)

Month-End Measurement

Performance Period	Threshold (50% Payout)	Target (100% Payout)	Maximum (200% Payout)
Q3 2020	15.0%	5.0%	0.0%
Q4 2020	17.5%	7.5%	0.0%

Intra-Month Measurement

Performance Period	Threshold (50% Payout)	Target (100% Payout)	Maximum (200% Payout)
Q3 2020	45.0%	35.0%	<=25%
Q4 2020	45.0%	35.0%	<=25%

* Goals for final Performance Period are the Cumulative Performance Goals.

** Liquidity/facility utilization goals are subject to adjustment by the Compensation Committee in its sole discretion in connection with future credit facilities. Goals for Q1 2021 and Q2 2021 will be established by the Compensation Committee upon extension of the credit facility beyond the six-month period.

11. The Debtors' level of achievement of the Performance Targets is measured on a quarterly basis, and the amount of each quarterly QIP Payment or ECP Incentive Payment, if any, is determined based on the level of Performance Target achieved during the

Performance Period with respect to each individual Performance Metric. If the threshold Performance Target is not achieved for any Performance Metric during the applicable Performance Period, then no amounts will be earned as a QIP Payment or ECP Incentive Payment in respect of that Performance Metric. For the final Performance Period of the QIP, performance will be measured cumulatively on a trailing basis against cumulative Performance Metrics and the QIP Payment for such Performance Period will be increased if, and to the extent that, the aggregate value of the QIP Payments over July 1, 2020 through the final Performance Period is less than the amount earned based on achievement of the cumulative Performance Goals.

IV. The Performance Metrics are Challenging to Achieve.

12. Based on my experience and knowledge of the Debtors, I believe that, as established, the Performance Metrics are challenging and require meaningful performance to achieve, particularly in this operating environment.

13. Based on my experience and my knowledge of the Debtors' business and operations, I believe that there is a close nexus between employee efforts and the goals selected as Performance Metrics. The Cumulative Operating Margin, G&A Reduction and Utilization Performance Metrics are measures of operating efficiency that management actions can impact. As the leaders of the Debtors' operations, it is reasonable to conclude that incentivizing additional efforts by the QIP Participants in these areas may translate to higher margins, lower overhead and an efficient usage of debt. Similarly, incentivizing the broader employee workforce to maintain focus on, and drive improvement in, these areas of performance would be critical to the Debtors' success in these areas. Because many of these employees are paid fixed salaries, substantial cost savings can result as compared to engaging outside advisors to address operational efficiency and cost reductions. Consequently, incentivizing employees to go "above

and beyond" the normal demands of their jobs can significantly reduce expenses and preserve the Debtors' estates. Moreover, the Debtors took early action to mitigate the financial impacts of COVID-19 by reducing the salary of a large portion of its workforce, including senior management, by 37.5%, for approximately two months, at the same time at which the workload for many was increased in connection with the Debtors' restructuring efforts. I understand that the implementation of the Compensation Programs is intended to recognize that performance in addition to incentivize employees on key value-driving activities going forward. The Sustainability Performance Metrics are objectives that recognize that the Debtors' businesses must be run in a safe and responsible manner, efforts that are also within employees' control, in order to reduce operational and environmental risks and maintain the Debtors' standing with customers as a responsible corporate partner and standing with the state of California as a regulated company.

14. I reviewed a proposal for the Performance Metrics prepared by the Debtors' management team in close consultation with compensation advisors at A&M, which reflected initial feedback from the Debtors' Compensation Committee. In considering that proposal and in determining what changes to recommend, I consulted with the Debtors to analyze the Debtors' most recently available monthly financial projections. Based on my recommendations, the final Performance Metrics reflect an increased weighting for Utilization, from 10% to 25%, in recognition of the importance of the Debtors' efficient usage of their credit facility and lower weightings for the Sustainability Performance Metrics to further tie compensation outcomes to financial-based measures. The final Performance Metrics also reflect my recommendations and the feedback from the Debtors' Compensation Committee, including to make the Cumulative Operating Margin targets more challenging and require more significant

G&A reductions in future quarters than as originally proposed. Based on my knowledge of the Debtors and their businesses, achievement of the target level of performance under the Performance Targets requires significant effort by the management team in a challenging operating environment.

Conclusion

15. Therefore, based on the foregoing data and analysis, combined with my experience and knowledge of the Debtors' businesses, I believe that the Performance Metrics are challenging and difficult to achieve when the Debtors' businesses and operating environment are considered.

Pursuant to 28 U.S.C. § 1746, I declare under penalty of perjury that the foregoing statements are true and correct to the best of my knowledge, information and belief.

Date: July 23, 2020

/s/ Mark Rajcevich
Mark Rajcevich
Alvarez & Marsal North America, LLC
Managing Director

EXHIBIT D

Watts Declaration

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re	:	Chapter 11
CALIFORNIA RESOURCES CORPORATION, *et al.*,[1]	:	Case No. 20-33568 (DRJ)
	:	Jointly Administered
Debtors.	:	

DECLARATION OF DANIEL S. WATTS, VICE PRESIDENT OF COMPENSATION AND BENFITS AT CALIFORNIA RESOURCES CORPORATION, IN SUPPORT OF DEBTORS' MOTION FOR AN ORDER AUTHORIZING, BUT NOT DIRECTING, THE DEBTORS TO IMPLEMENT (I) THE QUARTERLY INCENTIVE PLAN, (II) THE INCENTIVE AND RETENTION PLAN AND (III) THE SUPPLEMENTAL RETENTION

I, Daniel S. Watts, hereby declare under penalty of perjury:

1. I am Vice President of Compensation and Benefits at California Resources Corporation ("CRC", collectively with certain of its affiliated debtors and debtors-in-possession, the "Debtors"), a position I have held since the spinoff from Occidental in 2014. Previously, I was employed as Vice President of Compensation and Benefits at Occidental Petroleum Corporation ("Occidental"), a position that I held beginning in 2009. Prior to Occidental, I was employed as an actuarial consultant with Hewitt Associates.

[1] The Debtors in these chapter 11 cases and the last four digits of their U.S. taxpayer identification numbers are: California Resources Corporation (0947); California Heavy Oil, Inc. (4630); California Resources Coles Levee, L.P. (2995); California Resources Coles Levee, LLC (2087); California Resources Elk Hills, LLC (7310); California Resources Long Beach, Inc. (6046); California Resources Mineral Holdings LLC (4443); California Resources Petroleum Corporation (9218); California Resources Production Corporation (5342); California Resources Production Mineral Holdings, LLC (9071); California Resources Real Estate Ventures, LLC (6931); California Resources Royalty Holdings, LLC (6393); California Resources Tidelands, Inc. (0192); California Resources Wilmington, LLC (0263); CRC Construction Services, LLC (7030); CRC Marketing, Inc. (0941); CRC Services, LLC (6989); Monument Production, Inc. (0782); Oso Verde Farms, LLC (7436); Socal Holding, LLC (3524); Southern San Joaquin Production, Inc. (4423); Thums Long Beach Company (1774); Tidelands Oil Production Company LLC (5764). The Debtors' corporate headquarters is located at 27200 Tourney Road, Suite 200, Santa Clarita, CA 91355.

2. I am generally familiar with the Debtors' day-to-day operations, business and financial affairs, and books and records. I submit this declaration (the "Declaration") in support of the Debtors' motion (the "Motion") for entry of an order authorizing, but not directing, the Debtors to implement the proposed Quarterly Incentive Plan (the "QIP"), the proposed Incentive and Retention Plan (the "Employee Compensation Program") and the Supplemental Retention (as defined in the Motion, and, together with the QIP and the Employee Compensation Program, the "Compensation Programs"). Capitalized terms not otherwise defined herein are to be given the meanings ascribed to them in the Motion.

3. I am generally familiar with the Debtors' operations and business and restructuring challenges. I am familiar with the prepetition structure of the Debtors' compensation programs and the development, and structures, of the Compensation Programs. I reviewed the Motion and believe that it accurately reflects the development of, and justification for, the Compensation Programs. I believe the Compensation Programs are reasonable and appropriate.

4. In forming the opinions set forth herein, I have relied upon and/or considered, among other things, the following: (a) my personal knowledge, (b) my discussions with responsible management and professionals and advisors of the Debtors, as well as members of the Board of Directors of CRC (the "Board"), (c) the Motion, (d) the *Declaration of Mark Rajcevich in Support of the Debtors' Motion for an Order Authorizing, but not Directing, the Debtors to Implement (I) the Quarterly Incentive Plan, (II) the Incentive and Retention Plan and (III) the Supplemental Retention*, and the *Declaration of Brian Cumberland in Support of the Debtors' Motion for an Order Authorizing, but not Directing, the Debtors to Implement (I) the Quarterly Incentive Plan, (II) the Incentive and Retention Plan and (III) the Supplemental*

Retention, each of which is filed concurrently herewith, and (e) my review of relevant documents and information concerning the Debtors' compensation programs.

5. Except as otherwise indicated, all facts set forth in this Declaration are based upon my personal knowledge and my review of relevant documents and information concerning the Debtors' operations, financial affairs and restructuring initiatives or my opinions based upon my experience and knowledge. If called as a witness, I would testify competently to the statements set forth in this Declaration.

I. The Debtors' Prepetition Compensation Structure

6. Since CRC's separation from Occidental Petroleum Corporation in 2014, the Debtors' annual compensation structure has included an annual, short-term incentive program and a long-term incentive program. Such programs have been an essential component of the Debtors' compensation programs both at the management and broad-based employee levels and were designed to attract, retain and incentivize talented employees to achieve financial and operational results and to align compensation opportunities with the interests of shareholders. Each year, the Compensation Committee (the "Compensation Committee") of CRC's board of directors (the "Board") reviews the Debtors' incentive compensation structure, as well as reviews and considers market data and, regularly, engages independent compensation consultants to provide recommendations.

7. Under the Debtors' short-term cash incentive program, the Annual Incentive Program (the "AIP"), eligible employees typically earn cash awards based on the Debtors' financial and operational performance and how well such employees performed against individual goals that link to and support the Debtors' strategic and financial priorities. For example, the 2020 AIP, developed by the Debtors in February 2020, included predetermined

goals for company performance tied to the "value creation index"[2] of CRC and its subsidiaries (designed to measure CRC's disciplined, consistent and effective capital allocation), EBITDAX,[3] net debt[4] and sustainability.[5] These performance criteria were set at levels determined based on expected results under CRC's business plan in February 2020 such that target performance levels would represent a successful execution of CRC's 2020 business plan. CRC's named executive officers had individual objectives under the 2019 AIP that included, among others: debt management, quality and consistency of risk management efforts, results of ongoing and planned regulatory approval processes, and stockholder relations. Participants in the AIP, which for 2020 included all QIP Participants and all ECP Participants, could earn a percentage of their base salaries as AIP awards each year based on that year's performance.

8. In addition to the AIP, the Debtors also typically grant, on an annual basis, long-term cash- or equity-settled awards that generally have a value tied to the Debtors' stock price under a long-term incentive plan (the "LTIP," and the 2020 LTIP together with the 2020 AIP referred to herein as the "Previous 2020 Incentives") in order to promote retention and the

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2 "Value creation index" or "VCI" is used for project selection and capital allocation across CRC's portfolio of opportunities. VCI is a ratio that measures the present value of the future cash flows from all development (new drills and capital workovers) in each plan year per discounted dollar of investment, calculated as A divided by B where "A" is the discounted expected future cash flows and "B" is the discounted capital invested for the plan year, excluding JV partner funding. The discounted expected future cash flows of the 2020 investments would be calculated by taking CRC's share of future revenues minus production costs and production taxes but before any general and administrative charges, interest expense, income taxes and other corporate payments. The future cash flow calculations would be based on the price for each respective year and include impacts of hedges placed within the calendar year.

3 "EBITDAX" is defined as earnings before interest expense; income taxes; depreciation, depletion and amortization; exploration expense; other unusual, out-of-period and infrequent items; and other non-cash items.

4 "Net debt" is measured as the face value of outstanding debt *less* unrestricted cash.

5 The sustainability goals measured safety, spill prevention, net water supplied to agriculture and project milestones relating to water recycling, renewable energy, methane capture, carbon capture, workforce diversity and community partnerships. Several of the sustainability goals were designed to drive progress towards CRC's "2030 Sustainability Goals".

Debtors' pay-for-performance philosophy. LTIP Awards to the Debtors' executives for 2020 consisted of a mix of time-vested restricted stock unit awards, which comprised 40% of a given executive's 2020 LTIP award, and performance-based awards, which comprised 60% of a given executive's 2020 LTIP award. Performance-based awards were granted in the form of stock options with an exercise price equal to 110% of the stock price on the grant date and performance stock units, which represented 10% and 50%, respectively, of an individual executive's annual LTIP award. The performance metrics applicable to the performance stock units were based on CRC's relative total shareholder return and VCI over a three-year performance period ending in 2022, at which time the number of performance stock units that were earned would be determined. For non-executives, the Debtors typically grant annual LTIP awards in cash-settled phantom shares.

9. The use of performance-based pay is designed to promote the creation of value, without encouraging excessive risk taking, and motivates the Debtors' skilled employees to perform their responsibilities in a way that supports the Debtors' financial and operational success. The Debtors rely on performance-based incentive compensation to remain competitive in the market for talent, as well as to retain employees. In addition, it is my view that such employees over time have come to expect and rely upon the existence of such opportunities as an expected component of their total compensation, even if the amounts payable vary from year to year based on the Debtors' financial performance and each employee's individual performance.

10. The Previous 2020 Incentives are representative of the Debtors' historical incentive compensation programs. Under the Previous 2020 Incentives, each QIP Participant's (as defined below) target incentive opportunity represented approximately 61% - 88% of his or her annual target total direct compensation opportunity. The Previous 2020 Incentives also

represented a significant portion of ECP Participants' (as defined below) total compensation opportunities, ranging from 11% to 68% of the total.

II. Development and Approval of the Proposed Compensation Programs

11. As has been widely reported, the oil industry has experienced a downturn during the past few years that has accelerated and intensified in recent months due to declines and volatility in oil prices as well as the COVID-19 global pandemic. In response to this unprecedented economic environment, in March 2020, shortly after the establishment of the Previous 2020 Incentives, the Debtors reexamined their compensation programs. Consequently, several of the metrics underpinning the Previous 2020 Incentives no longer served the intended purposes. For example, cuts to the Debtors' capital spending budget to a level that maintains the mechanical integrity of its facilitates to operate them in a safe and environmentally responsible manner meant that the VCI performance metric no longer adequately represented the Debtors' capital allocation, and the dramatic drop in oil prices made the previously-set EBITDAX goals unlikely to be reached. Moreover, stay-at-home orders and other restrictions implemented in connection with the COVID-19 pandemic meant that the Debtors had to rapidly change the way that many employees performed their job responsibilities, and meant that certain performance metrics underlying the 2020 AIP would have required activities by employees that were no longer appropriate or safe.

12. The Debtors also began to experience attrition in several key positions within the organization during the first quarter of 2020, including senior reservoir, process, data and electrical engineers, area operational managers, commercial and marketing professionals and a senior member of the accounting team, representing a loss of employees in skilled positions with knowledge and experience important to the Debtors' specialized industry. This turnover followed a reduction in force conducted by the Debtors in October and November 2019, pursuant

to which the employment of approximately 220 employees was terminated. Accordingly, because the Debtors believed that the lack of meaningful and effective incentive compensation opportunities increased the retention risks that the Debtors had already begun to face, in March 2020 the Debtors determined to engage Alvarez & Marsal ("A&M") to provide compensation advice with respect to the 2020 Previous Incentives and potential alternatives.

13. Over the ensuing approximately two months, A&M conducted analyses to consider the cost and structure of the 2020 Previous Incentives as well as alternative compensation programs, which were discussed with and presented to the Debtors' management, the Board, the Compensation Committee and the Special Committee of the Board. In addition to designing programs that would meet the Debtors' compensation objectives in the current environment, the Debtors also received advice from A&M on current market practices with respect to distressed companies.

14. This review, conducted in close coordination with A&M, resulted in the Compensation Committee's determination, in its business judgment, that the 2020 Previous Incentives were ineffective and should be replaced with alternative programs that continue the individual target compensation levels available under the 2020 Previous Incentives, subject to additional supplemental retention awards to select non-insider employees that the Debtors determined presented a significant retention risk. On May 19, 2020, the Compensation Committee approved the Compensation Programs to collectively replace the 2020 Previous Incentives. In addition, following considerable discussion and consideration among the Compensation Committee, the Debtors' management and A&M, the Compensation Committee approved the performance metrics that apply to the incentive component of the Compensation Programs on May 26, 2020. Under the Compensation Programs, the QIP participants included

the nine members of the Debtors' senior leadership team (the "QIP Participants"): President and Chief Executive Officer; Executive Vice President Public Affairs; Executive Vice President Operations and Geoscience; Senior Executive Vice President, Chief Administrative Officer and General Counsel; Senior Executive Vice President and Chief Financial Officer; Executive Vice President Operations and Engineering; Executive Vice President Corporate Development and Strategic Planning; Executive Vice President Finance; and Vice President and Controller. As a condition to participating in the QIP, each QIP Participant waived any rights under the Previous 2020 Incentives. As of May 19, 2020, the ECP participants were 1,123 non-insider employees (the "ECP Participants") that perform a wide variety of functions critical to the Debtors' daily operations. For example, ECP Participants include employees in engineering, marketing, supply chain, production operations, treasury, finance, accounting, legal, tax, corporate development, strategic planning, information technology, public relations, human resources and health, safety and environment (HSE) functions. All of the ECP Participants were participants in and waived any rights under the Previous 2020 Incentives. No ECP Participants are QIP Participants.

15. In designing the Compensation Programs, the Debtors actively sought the advice of their advisors, including A&M. Based on A&M's analysis and my experience and knowledge of the Debtors' day-to-day operations, I believe the Compensation Programs are tailored to the Debtors' strategic and financial goals both in the context of the chapter 11 cases and the Debtors' general operations. I also believe that the scope of and participants in the QIP and the Employee Compensation Program reflect the scope of the Debtors' ordinary course compensation structure, including the Previous 2020 Incentives.

Conclusion

16. For all of the foregoing reasons, and based on my experience and the facts and circumstances of these chapter 11 cases, I believe that the Compensation Programs are fair, reasonable and designed to maximize performance and the going-concern value of the Debtors and, for the Employee Compensation Program and Supplemental Retention, promote the desired retention.

Pursuant to 28 U.S.C. § 1746, I declare under penalty of perjury that the foregoing statements are true and correct to the best of my knowledge, information and belief.

Date: July 23, 2020

/s/ Daniel S. Watts
Daniel S. Watts
California Resources Corporation
Vice President of Compensation and Benefits