

Citadel Exploration, Inc.  
Form 10-Q  
November 16, 2015

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

---

**Form 10-Q**

---

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2015

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 000-54639

**CITADEL EXPLORATION, INC.**

(Exact name of registrant as specified in its charter)

**Nevada**

(State or other jurisdiction of  
incorporation or organization)

**27-1550482**

(I.R.S. Employer  
Identification No.)

**417 31<sup>st</sup> Street, Unit A, Newport Beach, CA 92663**

(Address of principal executive offices) (Zip Code)

**(949) 612-8040**

(Registrant's telephone number, including area code)

Indicate by check mark whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T

Edgar Filing: Citadel Exploration, Inc. - Form 10-Q

(§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer company	Smaller reporting company

(Do not check if a smaller reporting)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares of Common Stock, \$0.001 par value, outstanding on November 16, 2015 was 38,814,000 shares.

**CITADEL EXPLORATION, INC.**

**QUARTERLY PERIOD ENDED SEPTEMBER 30, 2015**

**Index to Report on Form 10-Q**

	<b>Page No.</b>
<b>PART I - FINANCIAL INFORMATION</b>	
Item 1. <u>Condensed Consolidated Financial Statements (Unaudited)</u>	3
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	16
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	20
Item 4T. <u>Controls and Procedures</u>	20
<b>PART II - OTHER INFORMATION</b>	
Item 1. <u>Legal Proceedings</u>	21
Item 1A. <u>Risk Factors</u>	21
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	22
Item 3. <u>Defaults Upon Senior Securities</u>	22
Item 4. <u>Mine Safety Disclosures</u>	22
Item 5. <u>Other Information</u>	22
Item 6. <u>Exhibits</u>	23
Signature	24

[\(table of contents\)](#)**PART I – FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements.****CITADEL EXPLORATION, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

	September 30, 2015 (unaudited)	December 31, 2014
<b>ASSETS</b>		
Current assets:		
Cash	\$248,536	\$270,298
Other receivable	26,133	1,209
Prepaid expenses	49,909	35,886
Product inventory	4,881	4,881
Total current assets	329,459	312,274
Deposits	9,900	4,900
Restricted cash	245,000	45,000
Oil and gas properties	3,698,800	2,042,054
Fixed asset, net	15,731	25,927
Total assets	\$4,298,890	\$2,430,155
<b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$954,708	\$604,558
Contingent liability	87,000	—
Accrued interest payable	133,594	—
Notes payable, net	3,543,810	592,533
Derivative liability	—	13,308
Total current liabilities	4,719,112	1,210,399
Asset retirement obligation	49,979	48,923
Production payment liability	300,000	300,000
Total liabilities	5,069,091	1,559,322
Stockholders' equity (deficit):		

Edgar Filing: Citadel Exploration, Inc. - Form 10-Q

Common stock, \$0.001 par value, 100,000,000 shares authorized, 38,814,000 and 31,389,000 shares issued and outstanding as of September 30, 2015 and December 31, 2014, respectively	38,814	31,389
Additional paid-in capital	5,650,007	4,673,497
Accumulated deficit	(6,459,022)	(3,836,303)
Subscription payable	—	2,250
Total stockholders' equity (deficit)	(770,201 )	870,833
Total liabilities and stockholders' equity (deficit)	\$4,298,890	\$2,430,155

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

(table of contents)**CITADEL EXPLORATION, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(unaudited)**

	For the three months ended September 30,		For the nine months ended September 30,	
	2015	2014	2015	2014
Revenue	\$20,287	\$—	\$80,428	\$19
Operating expenses:				
Lease operating expense	80,878	30,223	107,040	59,474
Geological & geophysical	—	4,154	—	2,396
General and administrative	57,084	78,340	244,799	261,828
Depreciation, amortization and accretion	4,646	3,835	12,316	11,142
Professional fees	26,514	117,563	44,749	212,615
Executive compensation	317,253	127,456	641,430	638,931
Dry hole, abandonment, impairment and exploration	1,433,570	—	1,433,570	—
Total operating expenses	1,919,045	361,572	2,483,904	1,186,386
Loss from operations	(1,898,758 )	(361,572 )	(2,403,476 )	(1,186,367 )
Other income (expenses):				
Loss – Contingency	—	—	(87,000 )	—
Gain - Other	—	—	—	8,316
Gain (Loss) - note payable settlement	—	—	(26,080 )	33,545
Gain – debt extinguishment	—	75,573	—	75,573
Interest expense	(69,928 )	(83,766 )	(106,163 )	(175,021 )
Total other expenses	(69,928 )	(10,193 )	(219,243 )	(59,587 )
Loss before provision for income taxes	(1,969,586 )	(371,765 )	(2,622,719 )	(1,245,954 )
Provision for income taxes	—	—	—	6,161
Net loss	\$(1,969,586 )	\$(374,098 )	\$(2,622,719 )	\$(1,239,793 )
Weighted average number of common shares - outstanding	34,937,077	29,812,860	33,338,309	27,484,783
- basic and diluted				
Net loss per share – basic and diluted	\$(0.06 )	\$(0.01 )	\$(0.08 )	\$(0.05 )

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

(table of contents)**CITADEL EXPLORATION, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(unaudited)**

	For the nine months ended September 30,	
	2015	2014
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net loss	\$(2,622,719)	\$(1,239,793)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation, amortization and accretion	12,316	11,142
Abandonment and impairment	1,433,570	—
Amortization of debt discount	5,217	147,103
Gain other	—	(8,316 )
Loss (gain) on settlement of note payable	26,080	(33,545 )
Gain on debt extinguishment		73,573
Stock based compensation expense	264,692	376,990
Shares issued for consulting	—	246,775
Loss contingency	87,000	—
Changes in operating assets and liabilities:		
Increase in other receivable	(24,923 )	39,451
Increase in prepaid expenses	(14,023 )	63,857
Decrease in deposits	(161,191 )	(900 )
Increase in accounts payable and accrued payables	325,126	(47,099 )
Increase in accrued interest payable	133,594	—
Net cash used in operating activities	(535,261 )	(517,908 )
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase oil and gas properties	(2,612,437)	(537,107 )
Purchase of fixed assets	—	(28,273 )
Restricted cash	—	(25,000 )
Net cash used in investing activities	(2,612,437)	(590,380 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Proceeds from sale of common stock, net of costs	239,244	271,346
Proceeds from notes payable	3,000,000	500,000
Repayments for notes payable	(113,308 )	(49,111 )
Net cash provided by financing activities	3,125,936	722,235
<b>NET DECREASE IN CASH</b>	(21,762 )	(386,053 )

Edgar Filing: Citadel Exploration, Inc. - Form 10-Q

CASH AT BEGINNING OF YEAR	270,298	402,649
CASH AT END OF PERIOD	\$248,536	\$16,596
SUPPLEMENTAL INFORMATION:		
Interest paid	\$(651)	\$(4,969)
Income taxes paid	\$—	\$—
NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Conversion of debt to equity	\$25,494	\$—
Asset retirement obligation	\$—	\$17,516
Issuance of common stock as part of oil and gas property acquisition	\$480,000	
Issuance of common stock for settlement of note payable and accrued interest	\$127,657	\$307,501
Financing of insurance		\$70,268
Accounts payable related to properties traded		\$97,491
Other receivables related to properties traded		\$22,507

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.



(table of contents)

**CITADEL EXPLORATION, INC.**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Basis of presentation

The interim condensed consolidated financial statements included herein, presented in accordance with United States generally accepted accounting principles and stated in US dollars, have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading.

These statements reflect all adjustments, consisting of normal recurring adjustments, which in the opinion of management, are necessary for fair presentation of the information contained therein. It is suggested that these interim condensed consolidated financial statements be read in conjunction with the financial statements of the Company for the year ended December 31, 2014 and notes thereto included in the Company's 10-K annual report and all amendments. The Company follows the same accounting policies in the preparation of interim reports.

Results of operations for the interim period are not indicative of annual results.

Principles of consolidation

The condensed consolidated financial statements include the accounts of Citadel Exploration, Inc., Citadel Exploration, LLC and Citadel Kern Bluff, LLC, the Company's wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated. Citadel Exploration, Inc., Citadel Exploration, LLC and Citadel Kern Bluff, LLC will be collectively referred herein to as the "Company".

Nature of operations

Currently, the Company is focused on the acquisition and development of oil and gas properties in California.

Revenue Recognition

Sales of oil are recognized when the product has been delivered to a custody transfer point, persuasive evidence of a sales arrangement exists, the rights and responsibility of ownership pass to the purchaser upon delivery, collection of revenue from the sale is reasonably assured, and the sales price is fixed or determinable.

Impairment

The Company evaluates the impairment of its proved oil and natural gas properties on a field-by-field basis whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The carrying values of proved properties are reduced to fair value when the expected undiscounted future cash flows are less than net book value. The fair values of proved properties are measured using valuation techniques consistent with the income approach, converting future cash flows to a single discounted amount. Significant inputs used to determine the fair values of proved properties include estimates of: (i) reserves; (ii) future operating and development costs; (iii) future commodity prices; and (iv) a market-based weighted average cost of capital rate.

Use of estimates

(table of contents)

**CITADEL EXPLORATION, INC.**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED**

The preparation of condensed consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ significantly from those estimates.

Fair value of financial instruments

The carrying value of the Company's financial instruments, including cash, due to shareholders/related parties and accounts and other payables approximate their fair values due to the immediate or short-term maturity of these instruments. It is management's opinion that the Company is not exposed to significant interest, price or credit risks arising from these financial instruments.

Cash and cash equivalents

The Company considers all highly liquid instruments with maturity of three months or less at the time of issuance to be cash equivalents. The Company had no cash equivalents as of September 30, 2015 and December 31, 2014.

Earnings per share

The Company follows ASC Topic 260 to account for the earnings per share. Basic earnings per common share ("EPS") calculations are determined by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per common share calculations are determined by dividing net income by the weighted average number of common shares and dilutive common share equivalents outstanding. During periods when common stock equivalents, if any, are anti-dilutive they are not considered in the computation.

Recent pronouncements

The Company has evaluated the recent accounting pronouncements through September 30, 2015 and believes that none of them will have a material effect on the company's condensed consolidated financial statements.

**NOTE 2 – GOING CONCERN**

The accompanying unaudited condensed consolidated financial statements have been prepared assuming that the Company will continue as a going concern, which contemplates the recoverability of assets and the satisfaction of liabilities in the normal course of business. Since its inception, the Company has been engaged substantially in financing activities and developing its business plan and incurring startup costs and expenses. As a result, the Company incurred an accumulated deficit in the amount of \$6,459,022 as of September 30, 2015. In addition, the Company's development activities since inception have been financially sustained through debt and equity financing.

The ability of the Company to continue as a going concern is dependent upon its ability to raise additional capital from the sale of common stock and, ultimately, the achievement of significant operating revenues. These condensed consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts, or amounts and classification of liabilities that might result from this uncertainty.

(table of contents)**CITADEL EXPLORATION, INC.****Notes to Condensed Consolidated Financial Statements****(Unaudited)****NOTE 3 – OIL AND GAS PROPERTIES**

The costs capitalized in oil and gas properties as of September 30, 2015 and December 31, 2014 are as follows:

	2015	2014
Exploration	\$3,698,800	\$2,042,054

The following table reflects the net changes in capitalized exploratory well costs that have been capitalized for a period of one year or less since completion of drilling as of September 30, 2015:

	2015
Beginning balance at January 1, 2015	\$2,042,054
Additions to capitalized exploratory well costs pending the determination of proved reserves	3,090,316
Deletions to capitalized exploratory well costs due impairments/dry-hole	(1,433,570)
Asset retirement obligation	—
Ending balance at September 30, 2015	\$3,698,800
<u>Project Indian</u>	

Project Indian is located in the Bitterwater sub-basin of the Salinas Basin, north of the giant San Ardo Field. Citadel currently owns a 100% working interest at Project Indian. In July of 2014 Citadel ended its prior joint venture with Sojitz Energy Ventures. There is a 20% royalty on the property owned by Vintage Petroleum, a wholly owned subsidiary of Occidental Petroleum Inc. In November of 2014 Occidental Petroleum Inc. spun off its California assets into a new public company called California Resources Corporation, which is listed on the New York Stock Exchange under the ticker CRC. CRC is now the mineral owner at Project Indian.

In January of 2014, Citadel drilled and completed the first well at Project Indian, the Indian #1-15, and conducted a successful steam cycle in June of 2014. The Indian #1-15 then produced 3 to 7 barrels per day over several weeks before production halted because the well was shut-in by an order of the Superior Court of the State of California-County of Monterey entitled *Center for Biological Diversity v. San Benito County* Case no. M123956 (hereinafter the “Case”).

In the Case, the Center for Biological Diversity, a non-governmental entity, petitioned the Court over the approval of Project Indian by the County of San Benito on a unanimous, 5-0 vote. Specifically, it argued that Project Indian required an Environmental Impact Report and not a Mitigated Negative Declaration which was the standard of environmental due diligence required by the County before its unanimous approval of the Project. The Court approved the petition in a judgment entered on September 4, 2014, and ruled that Citadel was required to obtain an environmental impact report before commencing further at Project Indian .

(table of contents)

**CITADEL EXPLORATION, INC.**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**NOTE 3 – OIL AND GAS PROPERTIES - CONTINUED**

Then, on November 4, 2014 Measure J was passed by a majority of participating, registered voters in the County of San Benito. Measure J bans hydraulic fracturing and other stimulation techniques defined as “high intensity petroleum operations” by the Measure, including cyclic steam injection. Citadel believes the passing of Measure J constitutes a regulatory taking of property and is preempted by the State of California. At this time there is no certainty that we will be able to develop Project Indian.

Management has determined to shift capital resources to concentrate on drill ready projects that will immediately produce revenue. Consequently, the Company has suspended future capital expenditures related to Project Indian. Management has therefore chosen to impair Project Indian in the third quarter of 2015 with a value of \$1,433,570. The Company maintains its lease rights, takings claims, and no waiver of any right is intended by taking the foregoing impairment. Any action taken by the Company with respect to Project Indian in the near future, if any, will likely only be taken to preserve or advance the Company’s aforementioned legal rights and interests.

Per ASC 932, these wells qualify as exploratory wells and review of the capitalized costs incurred to prove up reserves must be evaluated in the period of one year after the completion of the drilling date .

Yowlumne

In May 2013, we leased approximately 2,800 acres from AERA Energy, LLC (“Aera”). This acreage has been mapped using a combination of both 2D and 3D seismic, and is in close proximity to the Yowlumne oil field in Kern County, California. The Company is obligated to pay a 20% royalty to Aera. In August of 2013, the Company entered into an agreement to sell 55% of the interest in the Yowlumne lease, recouping approximately 85% of its cost, while retaining a 25% interest in the lease and operatorship. In July of 2014 the Company ended its joint venture with Sojitz Energy Ventures retaining Sojitz’s 55% interest in the Yowlumne lease, therefore increasing Citadel’s ownership to 75% in the Yowlumne lease.

Additionally, as part of this transaction, the Company retained 100% interest in the Yowlumne #2-26 well, and the 160 acres surrounding the well bore. The Yowlumne #2-26 was first drilled in 2008 under supervision of Citadel CEO, Armen Nahabedian, during his previous tenure with his family's oil company. Although the well tested oil at that time, the well was left idle for 5 years as lease issues prevented operations on the well until the appropriate curative measures could be taken.

In December of 2014, Citadel began a work-over on the Yowlumne #2-26 well including installation of a new pump in February of 2015. The well has been producing approximately 20- 25 barrels per day (32 degree API quality) since the beginning of March. In June the well's pump had a mechanical issue, the company performed well maintenance operations on the #2-26 well in August, which returned the well to production at approximately 20-25 barrels per day. Citadel is in the final stages of the CEQA process to permit two additional exploration wells on the Yowlumne acreage. Recent regulatory changes, including SB4 the State of California's bill on fracking have delayed the final approval of our CEQA application. As such we do not expect to have these prospects permitted until 2016, at which time we will determine when to drill. Both of these exploration wells will be targeting the Stephens Sands at a depth of 12,000 to 15,000 feet. Citadel currently has a 75% working interest in these exploration prospects and is the operator.



(table of contents)

**CITADEL EXPLORATION, INC.**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**NOTE 3 – OIL AND GAS PROPERTIES - CONTINUED**

Kern Bluff Oil Field

In July of 2015, Citadel purchased approximately 1,100 acres encompassing the Kern Bluff Oil Field for \$2,000,000 in cash and 6,000,000 shares of its common stock valued at \$480,000. The seller also retained a royalty that varies on a lease by lease basis; Citadel has 100% working interest in the field with an 80% net revenue interest.

In the first 60 days of operation, Citadel has re-entered 7 idle well bores, and began to return those wells to production. Production as of September 30, 2015 had increased from 8 barrels of oil per day (BOPD) to 50 BOPD. The field had 29 idle well bores upon acquisition, Citadel plans to re-enter each of these well bores over the next 90-180 days and attempt to return them to production. In 2016, Citadel plans to begin drilling new wells the pace and timing of which will be dictated by the price of oil and access to capital.

**NOTE 4 – RESTRICTED CASH**

Restricted cash consists of three bonds totaling \$245,000. The bonds are required in the normal course of business in the oil and gas industry. The two bonds totaling \$45,000 were purchased in November 2013. A third bond totaling \$200,000 was purchased in August 2015 following the acquisition of the Kern Bluff Oil Field. This was a blanket bond, which will cover 50 wells. As such, the Company is in the process of releasing the first two bonds totaling \$45,000.

**NOTE 5 – DEPOSITS**

The Company had deposits at December 31, 2014 and September 30, 2015 totaling \$4,900.



(table of contents)**CITADEL EXPLORATION, INC.****Notes to Condensed Consolidated Financial Statements****(Unaudited)****NOTE 6 – NOTES PAYABLE**

Notes payable consists of the following at:

	September 30, 2015 (unaudited)	December 31, 2014
Note payable to an entity for the financing of insurance premiums, unsecured; 7.44% interest, due March 2016	\$43,810	\$—
Term loan with investor executed July 30, 2015, unsecured, 10% interest; due July 30, 2016	\$3,000,000	—
Two notes payable to investors, unsecured, 10% interest; due October 31, 2015	\$500,000	500,000
Promissory note to an entity; 10% interest, due December 2015	—	100,000
Three note payables to an entity for the financing of insurance premiums, unsecured; 8.63% interest, due April 2015; 14% interest, due February 2014; 11% interest, due August 2014	—	7,771
Debt discount for 25,000 shares issued relating to note payable	—	(1,930 )
Debt discount for derivative liability embedded in note payable	—	(13,308 )
	<b>\$3,543,810</b>	<b>\$592,533</b>

During the quarter ended March 31, 2015, the Company settled the \$100,000 note payable with 681,100 shares valued at \$102,164. Interest expense on the note payable was \$2,164.

Interest expense for the quarter ended September 30, 2015 was \$69,928. Of that amount, \$52,020 relates to the Kern Bluff financing, \$3,496 relates to notes payable and insurance financing; \$14,412 relates to interest accrued on the bridge loans. Interest expense for the quarter ended September 30, 2014 was \$83,766.

In March 2014, the Company closed on a \$500,000 bridge loan from two individuals. These notes have a 180 day term and bear interest of 10%. The \$500,000 of notes are due on October 31, 2015. Additionally, the investors received 500,000 warrants to purchase the Company's stock at \$0.34 per share for a term of two years.

**NOTE 7 – STOCKHOLDERS' EQUITY (DEFICIT)**

Edgar Filing: Citadel Exploration, Inc. - Form 10-Q

The Company is authorized to issue 100,000,000 shares of its \$0.001 par value common stock.

In January 2014, the Company issued 205,085 shares of common stock for services rendered and prepaid expenses with a value of \$114,338.

In January 2014, the Company issued 559,092 shares of common stock to settle three notes payable and accrued interest totaling \$306,849. The shares were recorded at fair value of \$273,304, resulting in a gain of \$33,545.

-11-

(table of contents)

**CITADEL EXPLORATION, INC.**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**NOTE 7 – STOCKHOLDERS' EQUITY (DEFICIT) - CONTINUED**

In March of 2014, the Company closed on a \$500,000 bridge loan from two individuals. These notes have a 180 day term and bear interest of 10%. Additionally investors received 500,000 warrants to purchase the Company's stock at \$1.00 per share for a term of two years, valued at \$147,102 in total. In September of 2014, the maturity date of this bridge loan was extended by 30 days; in return the exercise price of the warrant was reduced to \$0.34 per share, with the original two year term remaining. Due to the change in the terms of the warrants, the Company recalculated the value of the warrants to be \$85,325. Accordingly, the Company recognized a gain on the extinguishment of \$73,573.

In July of 2014, investors owning warrants for the company's stock, converted early at a reduced price. The first tranche of warrants equaled 500,000 shares at \$0.55, which were reduced to \$0.34 resulting in the issuance of 500,000 common stock shares for \$170,000 or \$0.34 per share. The second tranche of warrants equaled 100,000 warrants at \$1.00 per share. These warrants were exchanged for the issuance of 300,000 shares at \$0.34 for \$102,000 in cash.

In August of 2014, the Company issued 400,000 shares of common stock valued at \$136,000 to various parties for accounting, legal and marketing services.

At December 2014, the company was obligated to issue 25,000 shares of common stock in connection with a note payable. On the date the agreement was executed, the price per share of the Company's stock was \$0.09. As the shares have not been issued as of December 31, 2014, the Company recorded a stock payable with a value of \$2,250.

During the year ended December 31, 2014, the Company issued 875,000 shares of common stock valued at \$183,500 to various parties for accounting, legal, and marketing services.

In March of 2015, the Company approved the issuance of 1,400,000 common stock shares for the conversion of a \$100,000 promissory note, plus accrued interest of \$2,164 and an additional capital investment of \$107,836, all at \$0.15 per share.

In March of 2015, the Company issued 25,000 shares of common stock to settle the stock payable of \$2,250 recorded as of December 31, 2014.

In July of 2015, the Company issued 6,000,000 shares of common stock and paid \$1,900,000 in cash for the Kern Bluff Oil Field. The Company had paid a \$100,000 deposit on the property in May of 2015, upon execution of a letter of intent (LOI) on the field.

#### NOTE 8 – STOCK OPTION PLAN

On September 1, 2012, the Board of Directors of the Company ratified, approved, and adopted a Stock Option Plan for the Company allowing for the grant of up to 10,000,000 shares of common stock or stock options to acquire common shares. In the event an optionee ceases to be employed by or to provide services to the Company for reasons other than cause, any Stock Option that is vested and held by such optionee may be exercisable within up to thirty days after the effective date that his position ceases. No Stock Option granted under the Stock Option Plan is transferable. Any Stock Option held by an optionee at the time of his death may be exercised by his estate within six months of his death or such longer period as the Board of Directors may determine.

(table of contents)

**CITADEL EXPLORATION, INC.**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**NOTE 8 – STOCK OPTION PLAN - CONTINUED**

As approved by the Board of Directors, on September 4, 2012, the Company granted 4,000,000 stock options to two officers of the Company at \$0.20 per share for terms of seven years. Of the total stock options, 1,000,000 vested immediately and the remaining vest equally over the next 3 years at the anniversary date of the employment agreements. The total fair value of these options at the date of grant was estimated to be \$599,974 and was determined using the Black-Scholes option pricing model with an expected life of 7 years, a risk free interest rate of 1.01%, a dividend yield of 0% and expected volatility of 254%. During the years ended December 31, 2014 and 2013, \$149,995 and \$113,888, respectively, was recorded as a stock based compensation expense.

For the three months and nine months ended September 30, 2015, the Company recorded \$189,696 and \$264,693, respectively, as a stock based compensation expense. The Company expects to incur an additional \$37,498 as a stock based compensation expense during 2015.

On June 18, 2014 as approved by the Board of Directors, the Company granted 800,000 stock options to four members of the Board of Directors, which vested immediately, at \$0.55 per share for terms of seven years. The total fair value of these options at the date of grant was estimated to be \$264,495 and was determined using the Black-Scholes option pricing model with an expected life of 7 years, a risk free interest rate of 0.45%, dividend yield of 0%, and expected volatility of 235%. During the year ended December 31, 2014, \$264,494 was recorded as a stock based compensation expense.

On July 29, 2015 as approved by the Board of Directors, the Company granted 4,700,000 stock options to three members of management and to one member of the Board of Directors. These options vest over a three year period, at \$0.15 per share for a term of seven years. The total fair value of these options at the date of grant was estimated to be \$376,490 and was determined using the Black Scholes option pricing model with an expected life of 7 years, risk free interest rate of 1.872%, dividend yield of 0%, and expected volatility of 333%. During the 3 month period ended September 30, 2015, \$152,198 was recorded as a stock based compensation expense.

The following is a summary of the status of all of the Company's stock options as of September 30, 2015 and changes during the period ended on that date:

Edgar Filing: Citadel Exploration, Inc. - Form 10-Q

	Number	Weighted-Average	Weighted-Average
	of Options	Exercise Price	Remaining Life (Years)
Outstanding at January 1, 2015	4,800,000	\$ 0.26	4.46
Granted on July 29, 2015	4,700,000	\$ 0.15	6.90
Exercised	-	\$ 0.00	-
Cancelled	-	\$ 0.00	-
Outstanding at September 30, 2015	9,500,000	\$ 0.20	5.51
Exercisable at September 30, 2015	5,964,000	\$ 0.21	4.80

-13-



(table of contents)

**CITADEL EXPLORATION, INC.**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**NOTE 9 – WARRANTS**

In September 2013, we closed on a \$200,000 90-day bridge loan with two investors. The loans bear interest of 10%. Additionally each investor was granted 100,000 stock warrants to purchase stock at \$1.00 per share for a period of one year. The total fair value of these warrants at the date of grant was estimated to be \$56,283 and was determined using the Black-Scholes option pricing model with an expected life of 2 years, a risk free interest rate of 0.1%, a dividend yield of 0% and expected volatility of 197%. An additional \$100,000 note payable with the same terms and warrants which were issued in October 2013. The total fair value of these warrants at the date of grant was estimated to be \$37,467 and was determined using the Black-Scholes option pricing model with an expected life of 2 years, a risk free interest rate of 0.1%, a dividend yield of 0% and expected volatility of 197%. During the year ended December 31, 2013, \$21,297 was recorded as amortization of debt discount and included in interest expense. During the year ended December 31, 2014, \$63,892 was recorded as amortization of debt discount and included in interest expense.

In March 2014, the Company closed on a \$500,000 180-day bridge loan with two investors. The loans bear interest of 10%. Additionally, the investors were granted a total of 500,000 stock warrants to purchase stock at \$1.00 per share for a period of two years valued at \$147,102. The total fair value of these warrant at the date of grant was determined using the Black-Scholes option pricing model with an expected life of 2 years, a risk free interest rate of 0.45%, a dividend yield of 0% and expected volatility of 333%. In September of 2014, the maturity date of this bridge loan was extended by 30 days, in return the exercise price of the warrant was reduced to \$0.34 per share, with the original two year term remaining. Due to the change in the terms of the warrants, the Company recalculated the value of the warrants to be \$85,325. Accordingly, the Company recognized a gain on the extinguishment of \$73,573.

In September of 2014, the 500,000 warrants issued on November 15, 2012 and 100,000 warrants issued in September 2013 were exercised early at a reduced price of \$0.34 per share.

The following is a summary of the status of all of the Company’s stock warrants as of September 30, 2015 and changes during the period ended on that date:

Number of Warrants	Weighted-Average Exercise Price	Weighted-Average Remaining Life (Years)
-----------------------	------------------------------------	--

Edgar Filing: Citadel Exploration, Inc. - Form 10-Q

Outstanding at January 1, 2015	500,000	\$ 0.34	0.50
Granted	-	\$ 0.00	-
Exercised	-	\$ 0.00	-
Cancelled	-	\$ 0.00	-
Total Outstanding at September 30, 2015	500,000	\$ 0.34	0.50
Exercisable at September 30, 2015	500,000	\$ 0.34	0.50

**NOTE 10 – SUBSEQUENT EVENTS**

None.

-14-

(table of contents)

## FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements and involves risks and uncertainties that could materially affect expected results of operations, liquidity, cash flows, and business prospects. These statements include, among other things, statements regarding:

- o exploration risks such as drilling unsuccessful wells;
  - o our ability to operate profitably;
  - o our ability to efficiently and effectively finance our operations;
  - o inability to achieve future sales levels or other operating results;
  - o inability to raise additional financing for working capital;
  - o inability to efficiently manage our operations;
  - o inability to hire or retain sufficient qualified operating field personnel;
  - o the inability of management to effectively implement our strategies and business plans;
  - o the unavailability of funds for capital expenditures and/or general working capital;
  - o deterioration in general or regional economic conditions;
- the fact that our accounting policies and methods are fundamental to how we report our financial condition and results of operations, and they may require management to make estimates about matters that are inherently uncertain;
- o changes in U.S. GAAP or in the legal, regulatory and legislative environments in the markets in which we operate;
- o adverse state or federal legislation or regulation that increases the costs of compliance, or adverse findings by a regulator with respect to existing operations;

As well as other statements regarding our future operations, financial condition and prospects, and business strategies. These forward-looking statements are subject to certain risks and uncertainties that could cause our actual results to differ materially from those reflected in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this Quarterly Report on Form 10-Q, and in particular, the risks discussed under the heading “Risk Factors” in Part II, Item 1A and those discussed in other documents we file with the Securities and Exchange Commission. We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

*References in the following discussion and throughout this quarterly report to “we”, “our”, “us”, “Citadel”, “the Company”, and similar terms refer to Citadel Exploration, Inc. and its subsidiary, unless otherwise expressly stated or the context otherwise requires.*

## AVAILABLE INFORMATION

Edgar Filing: Citadel Exploration, Inc. - Form 10-Q

We file annual, quarterly and other reports and other information with the SEC. You can read these SEC filings and reports over the Internet at the SEC's website at [www.sec.gov](http://www.sec.gov) or on our website at [www.citadelexploration.com](http://www.citadelexploration.com). You can also obtain copies of the documents at prescribed rates by writing to the Public Reference Section of the SEC at 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm. Please call the SEC at (800) SEC-0330 for further information on the operations of the public reference facilities. We will provide a copy of our annual report to security holders, including audited financial statements, at no charge upon receipt to of a written request to us at Citadel Exploration, Inc., 417 31<sup>st</sup> Street, Unit A, Newport Beach, California 92663.

(table of contents)

## **Item 2. Management's Discussion And Analysis Of Financial Condition And Results Of Operations.**

### **Overview**

Citadel is an energy company engaged in the exploration and development of oil and natural gas properties. Our properties are located in the San Joaquin Basin of California. Subject to availability of capital, we strive to implement an accelerated development program utilizing capital resources, a regional operating focus, an experienced management and technical team, and enhanced recovery technologies to attempt to increase production and increase returns for our stockholders. Our corporate strategy is to build value in the Company through the acquisition of oil and gas leases with significant upside potential, successful exploration and exploitation and the efficient development of these assets.

Our revenues, profitability and future growth depend substantially on prevailing prices for oil and natural gas and our ability to find, develop and acquire oil and gas reserves that are economically recoverable.

### **Our Operations**

Our principal strategy is to focus on the acquisition of oil and natural gas mineral leases that have known hydrocarbons or are in close proximity to known hydrocarbons that have been underdeveloped. Once acquired, we strive to implement an accelerated development program utilizing capital resources, a regional operating focus, an experienced management and technical team, and enhanced recovery technologies to attempt to increase production and increase returns for our stockholders. Our oil and natural gas acquisition and development activities are currently focused in the State of California.

In December of 2014, Citadel began a work-over on the Yowlumne #2-26 well including installation of a new pump in February of 2015. The well has been producing approximately 20- 25 barrels per day (32 degree API quality) since the beginning of March. In June the well's pump had a mechanical issue, the company performed well maintenance in August returning the well to its previous production level. Citadel is in the final stages of the CEQA process to permit two additional exploration wells on the Yowlumne acreage. Recent regulatory changes, including SB4 the State of California's bill on fracking have delayed the final approval of our CEQA application. As such we do not expect to have these prospects permitted until 2016, at which time we will determine when to drill. Both of these exploration wells will be targeting the Stephens Sands at a depth of 12,000 to 15,000 feet. Citadel currently has a 75% working interest in these exploration prospects and is the operator.

On November 4, 2014 voters in the County of San Benito passed Measure J which bans hydraulic fracturing and other stimulation techniques defined as "high intensity petroleum operations" by the Measure, including cyclic steam injection. The initiative was passed by a count of 8,034 to 5,605. In advance of the initiative passing, the County

preemptively passed an ordinance allowing for exemptions from the application of the Measure in the event the Measure would result in a taking. A regulatory taking is a situation in which a government regulation limits the uses of private property to such a degree that the regulation effectively deprives the property owners of economically reasonable use or value of their property right to such an extent that it deprives them of utility or value of that property right, even though the regulation does not formally divest them of title to it. Accordingly, Citadel Exploration Inc. will provide the County of San Benito the ability to compensate the company for the diminished value at the Indian Oil Field based on the reasonable Unrisked Resource Potential the property would ultimately yield, or allow Citadel to proceed with full field development and cyclic steam injection under the exemption ordinance. At this time Citadel has preserved its rights regarding Project Indian, however in light of the Company's recent acquisition, capital spending has been shifted from Project Indian to Kern Bluff Oil Field and the development of the field seems highly unlikely. Therefore management has determined to impair the costs associated with the project.

(table of contents)

On July 31, 2015 Citadel acquired approximately 1,100 acres of leases, production facilities and equipment that encompassed the Kern Bluff Oil Field. As consideration for this acquisition Citadel issued 6,000,000 shares of common stock and paid \$2,000,000 in cash. The transaction was financed via a \$3,000,000 one year term loan from Cibolo Creek Partners, of Midland Texas. At the end of September, Citadel had returned 4 wells back onto production, with 3 more wells expected to be completed in October. At the time of acquisition, one well was producing approximately 8 barrels of oil per day (BOPD). Production at the end of the quarter, was approximately 50 BOPD, and is estimated to increase to over 100 BOPD once all 8 wells are on production. Thus far operations have exceeded expectations; as such the Company needs to increase the capacity of its production facilities. The previous operator was utilizing rental facilities, which had a maximum capacity of 50 BOPD. During the next 60-90 days, the Company will focus on remediating the fields existing facilities to accommodate 300-500 BOPD of production. Once the facilities are complete, the Company will begin workover operations on the next 10 identified idle well bores. At acquisition the field had 29 idle well bores, of which 7 have been returned to production. The Company anticipates its workover activities to continue into 2016 and will then move to drill new vertical and horizontal wells.

**Going Concern**

The condensed consolidated financial statements included in this filing have been prepared in conformity with generally accepted accounting principles that contemplate the continuance of the Company as a going concern, which contemplates the realization of assets and liquidation of liabilities in the normal course of business. However, the Company is in the exploration stage and, accordingly, has not generated revenues from operations. As shown on the accompanying condensed consolidated financial statements, the Company has incurred an accumulated deficit in the amount of \$6,459,022 as of September 30, 2015. These conditions raise substantial doubt about the Company's ability to continue as a going concern.

The future of the Company is dependent upon its ability to obtain financing and upon future profitable operations from the development of its oil and gas business opportunities.

**RESULTS OF OPERATIONS**

***Results of Operations for the Three Months and Nine Months Ended September 30, 2015 and September 30, 2014***

For the three months and nine months ended September 30, 2015, revenue totaled \$20,287 and \$80,428, respectively. Revenue was minimal during these same periods in 2014.

Edgar Filing: Citadel Exploration, Inc. - Form 10-Q

For the three months and nine months ended September 30, 2015, operating expenses totaled \$1,919,045 and \$2,483,904, respectively. For the three months and nine months ended September 30, 2014, the Company's operating expenses totaled \$361,572 and \$1,186,386, respectively. Operating expenses consisted of general and administrative costs, amortization and depreciation, professional fees, and executive compensation. During the 3 months ended September 30, 2015, a one-time impairment expense was incurred in the amount of \$1,433,570 which significantly increased operating expenses compared to the three months ended September 30, 2014.

For the three months and nine months ended September 30, 2015, general and administrative expenses totaled \$57,084 and \$244,799, respectively. For the three months and nine months ended September 30, 2014, general and administrative expenses totaled \$78,340 and \$261,828, respectively. This decrease from the prior period was primarily due to a reduction in marketing and insurance expenses.



(table of contents)

For the three months and nine months ended September 30, 2015, professional fees totaled \$26,514 and \$44,749, respectively. For the three months and nine months ended September 30, 2014, professional fees totaled \$117,563 and \$212,615, respectively. The decrease from the prior period was primarily due to services provided to the Company for accounting, consulting and legal.

For the three months and nine months ended September 30, 2015, executive compensation totaled \$317,253 and \$641,430, respectively. For the three months and nine months ended September 30, 2014, executive compensation totaled \$127,456 and \$638,931, respectively.

**Liquidity and Capital Resources**

The Company recently revised its 2015 capital budget to approximately \$4,000,000 for the acquisition and development of the Kern Bluff Oil Field, Yowlumne and additional lease acquisitions. We may revise our capital budget during the year as a result of acquisitions and/or drilling outcomes or significant changes in cash flows.

As of September 30, 2015, we had \$329,459 of current assets; of this amount \$248,536 was cash. The following table provides detailed information about the net cash flow for the quarters ended September 30, 2015 and September 30, 2014 as presented in this quarterly report. To date, we have financed our operations through the issuance of stock and borrowings from related parties and an unrelated third party.

The following table sets forth a summary of our cash flows for the nine months ended September 30, 2015 and 2014:

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	2015	2014
Net cash used in operating activities	\$(535,261 )	\$(517,908)
Net cash used in investing activities	(2,612,437)	(590,380)
Net cash provided by financing activities	3,125,936	722,235
Net change in cash	(21,762 )	(386,053)
Cash, beginning of period	270,298	402,649
Cash, end of period	\$248,536	\$16,596

***Operating activities***

The net loss in the period was greater than the non-cash adjustments to reconcile the changes in the balance sheet and statement of operations, which is the reason cash used in operating activities was negative.

***Investing activities***

The net cash used in investing activities consisted of purchases of oil and gas properties totaling \$2,000,000 and payment for drilling expenses on oil and gas properties of \$612,437 on the Company's properties.

***Financing activities***

The net cash provided by financing activities consisted of proceeds from a \$3,000,000 note, note repayments totaling \$113,308, and common stock proceeds, net of offering costs, of \$239,244.

(table of contents)

As of September 30, 2015, we continue to use traditional and/or debt financing as well as through the issuance of stock to provide the capital we need to run our business.

Without cash flow from operations we will require additional cash resources, including the sale of equity or debt securities, to meet our planned capital expenditures and working capital requirements for the next 12 months. We will require additional cash resources due to changed business conditions, implementation of our strategy to successfully develop our Kern Bluff Oil Field, exploration drilling at Yowlumne and or acquisitions we may decide to pursue. If our own financial resources and then current cash-flows from operations are insufficient to satisfy our capital requirements, we may seek to sell additional equity or debt securities or obtain a credit facility. The sale of additional equity securities will result in dilution to our stockholders. The incurrence of indebtedness will result in increased debt service obligations and could require us to agree to operating and financial covenants that could restrict our operations or modify our plans to grow the business. Financing may not be available in amounts or on terms acceptable to us, if at all. Any failure by us to raise additional funds on terms favorable to us, or at all, will limit our ability to expand our business operations and could harm our overall business prospects.

Our ability to obtain additional capital through additional equity and/or debt financing, and Joint Venture or Working Interest partnerships will also be important to our expansion plans. In the event we experience any significant problems assimilating acquired assets into our operations or cannot obtain the necessary capital to pursue our strategic plan, we may have to reduce the growth of our operations. This may materially impact our ability to increase revenue and develop our assets.

### **Contractual Obligations**

An operating lease for rental office space was entered into beginning March 1, 2013 for two years at \$2,150 per month. The original lease was amended to include additional space at a price of \$1,100 per month for the same term. The company has not yet renewed this lease and is currently renting office space on month to month basis at the previous rate of \$3,250 per month; we plan to enter into a new lease in the coming quarter.

### **Off-Balance Sheet Arrangements**

As of the date of this report, we did not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

## **Operation Plan**

Our plan is to focus on the acquisition and drilling of prospective oil and natural gas mineral leases. Once we have tested a prospect as productive, subject to availability of capital, we will implement a development program with a regional operating focus in order to increase production and increase returns for our stockholders. Exploration, acquisition and development activities are currently focused in California. Depending on availability of capital, and other constraints, our goal is to increase stockholder value by finding and developing oil and natural gas reserves at costs that provide an attractive rate of return on our investments.

(table of contents)

We expect to achieve these results by:

- Investing capital in exploration and development drilling and in secondary and tertiary recovery of oil as well as natural gas;
- Using the latest technologies available to the oil and natural gas industry in our operations;
- Finding additional oil and natural gas reserves on the properties we acquire.

In addition to raising additional capital we plan to take on Joint Venture (JV) or Working Interest (WI) partners who may contribute to the capital costs of drilling and completion and then share in revenues derived from production. This economic strategy may allow us to utilize our own financial assets toward the growth of our leased acreage holdings, pursue the acquisition of strategic oil and gas producing properties or companies and generally expand our existing operations.

Our future financial results will depend primarily on: (i) the ability to continue to source and screen potential projects; (ii) the ability to discover commercial quantities of natural gas and oil; (iii) the market price for oil and natural gas; and (iv) the ability to fully implement our exploration and development program, which is dependent on the availability of capital resources. There can be no assurance that we will be successful in any of these respects, that the prices of oil and gas prevailing at the time of production will be at a level allowing for profitable production, or that we will be able to obtain additional funding to increase our currently limited capital resources.

**Item 3. Quantitative and Qualitative Disclosure About Market Risk.**

This item is not applicable as we are currently considered a smaller reporting company.

**Item 4T. Controls and Procedures.**

***Evaluation of Disclosure Controls and Procedures***

Our Chief Executive Officer, Armen Nahabedian, and our Chief Financial Officer, Philip McPherson evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) as of the end of the period covered by this Report. Based on that evaluation and assessment, Mr. Armen Nahabedian and Mr. Philip McPherson concluded that our disclosure controls and procedures are not designed at a reasonable assurance level and are not effective to provide reasonable assurance that information we are required to disclose in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the

time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

***Changes in Internal Control Over Financial Reporting***

There were no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

***Limitations on Effectiveness of Controls and Procedures***

In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

(table of contents)

## **PART II—OTHER INFORMATION**

### **Item 1. Legal Proceedings.**

From time to time, we may become involved in various lawsuits and legal proceedings which arise in the ordinary course of business. However, litigation is subject to inherent uncertainties, and an adverse result in these or other matters may arise from time to time that may harm our business. We received notice on or about July 10, 2013 that the Center for Biological Diversity (“CBD”) had filed a law suit against the County of San Benito regarding the approval of Project Indian which is described more fully, above, as the “Case”. The Board of Supervisors voted 5-0 in favor of our application to drill 15 exploration wells on our Project Indian lease. The Court approved the petition in a judgment entered on September 4, 2014, and ruled that Citadel was required to obtain an environmental impact report before commencing Project Indian. Thereafter, the Court awarded the petitioner \$347,969 as attorney’s fees and costs against the County of San Benito and Citadel, jointly and severally. The Company has requested a dismissal of its appeal of this decision which was granted as the Court required the Company to post a bond in which it was unable to qualify for. As such, the Company based upon its best estimate, has booked a contingent liability of \$87,000 for this case.

On November 4, 2014 voters in the County of San Benito passed Measure J which bans hydraulic fracturing and other stimulation techniques defined as “high intensity petroleum operations” by the Measure, including steam injection. The initiative was passed by a count of 8,034 to 5,605. In advance of the initiative passing, the County preemptively passed an ordinance allowing for exemptions from the application of the Measure in the event the Measure would result in a taking. A regulatory taking is a situation in which a government regulation limits the uses of private property to such a degree that the regulation effectively deprives the property owners of economically reasonable use or value of their property right to such an extent that it deprives them of utility or value of that property right, even though the regulation does not formally divest them of title to it. Accordingly, Citadel Exploration Inc. will provide the County of San Benito the ability to compensate the company for the diminished value at the Indian Oil Field based on the reasonable Unrisked Resource Potential the property would ultimately yield, or allow Citadel to proceed with full field development and steam injection under the exemption ordinance.

On February 27<sup>th</sup>, 2015, Citadel sued the County of San Benito on the basis that Measure J and its enabling ordinance are preempted by the law of the State of California. Specifically, the complaint alleges that the power and authority to regulate the down-hole operations of oil and gas exploration and production is vested exclusively in the Division of Oil, Gas, and Geothermal Resources of the Department of Conservation. It further alleges that the County’s Measure and its ordinance are preempted by State law as the regulation of down-hole operations is exclusively a State function, and that the County lacks the power and authority to regulate down-hole operations. On April 3, 2015 Citadel dismissed the complaint, without prejudice. At this time Citadel has reserved its rights, with respect to the Indian Oil Field, including claims for inverse condemnation.

### **Item 1A. Risk Factors.**

Our significant business risks are described in Item 1A. to Part I of Form 10-K for the year ended December 31, 2014 (filed April 15, 2015) to which reference is made herein.

-21-



(table of contents)

## **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

### ***Stock Issuances pursuant to Subscription Agreements***

In December 2014, the Company approved the issuance of 500,000 common stock shares for engineering, legal, accounting and marketing services performed in the fourth quarter of 2014.

In March of 2015, the Company approved the issuance of 1,400,000 common stock shares and issued 25,000 shares recorded as a stock payable at December 31, 2014, for the conversion of a \$100,000 promissory note, plus accrued interest of \$2,164 and an additional capital investment of \$107,835, all at \$0.15 per share.

In July of 2015, the Company approved the issuance of 6,000,000 common stock shares as partial consideration for the purchase of the Kern Bluff Oil Field.

We believe that the issuance and sale of the above securities were exempt from the registration and prospectus delivery requirements of the Securities Act of 1933 by virtue of Section 4(2), Regulation D and/or Regulation S. The securities were issued directly by us and did not involve a public offering or general solicitation. The recipient of the securities was afforded an opportunity for effective access to files and records of our company that contained the relevant information needed to make her investment decision, including our financial statements and 34 Act reports. We reasonably believed that the recipient, immediately prior to issuing the securities, had such knowledge and experience in our financial and business matters that she was capable of evaluating the merits and risks of its investment. The recipient had the opportunity to speak with our management on several occasions prior to her investment decision. There were no commissions paid on the issuance and sale of the shares.

### ***Option Grants***

Our option grants are described in Form 10-K for the year ended December 31, 2014 (filed April 15, 2015) to which reference is made herein.

### ***Subsequent Stock Issuances***

None.

**Issuer Purchases of Equity Securities**

We did not repurchase any of our equity securities from the time of our inception on November 6, 2006 through the period ended September 30, 2015

**Item 3. Defaults Upon Senior Securities.**

None.

**Item 4. Mine Safety Disclosures.**

Not applicable.

**Item 5. Other Information.**

***2012 Stock Incentive Plan***

On September 1, 2012, we adopted the 2012 Stock Incentive Plan. We have reserved for issuance an aggregate of 10,000,000 shares of common stock under our 2012 Stock Incentive Plan. To date 9,500,000 options and no shares of common stock have been granted under this plan.

Our employment agreements with executive officers are described in Form 10-K for the year ended December 31, 2014 (filed April 15, 2015) to which reference is made herein.

(table of contents)**Item 6. Exhibits.**

<b>Exhibit No.</b>	<b>Description</b>
10.4	2012 Stock Incentive Plan
31.1	<u>Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
31.2	<u>Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
32.1	<u>Certifications of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
32.2	<u>Certifications of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase
101.DEF*	XBRL Taxonomy Extension Definition Linkbase
101.LAB*	XBRL Taxonomy Extension Label Linkbase
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase

*XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.*

(table of contents)

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**CITADEL EXPLORATION, INC.**

Date: November 16, 2015 By: /S/ Armen Nahabedian  
Armen Nahabedian  
Chief Executive Officer  
(Principal Executive Officer and duly authorized signatory)

-24-

