TESTIMONY BY ROCK ZIERMAN, CEO OF THE CALIFORNIA INDEPENDENT PETROLEUM ASSOCIATION BEFORE THE HOUSE OVERSIGHT & REFORM COMMITTEE ON MAY 6, 20011 IN BAKERSFIELD, CA

Thank you Mr. Chairman, members of the committee for this opportunity to address the potential of increased domestic production of oil and natural gas in the state of California. My name is Rock Zierman and I am the CEO of the California Independent Petroleum Association. CIPA represents over 470 independent oil and gas producers, royalty owners, and service and supply companies with operations in California. Of those companies, approximately 160 are producers ranging in size from operators of a single well to large multi-national corporations with tens of thousands of barrels of daily production.

An independent producer is not defined by size, but rather the fact that they simply get oil and natural gas out of the ground and do not refine, transport, market, or have retail sales of petroleum products. Independents produce 70% of California's domestic crude and 90% of its natural gas. 38% of what our state's refineries and citizens consume each day is produced in-state. All the rest must be tankered into our ports since there are no interstate crude oil pipelines. 14% is tankered in from Alaska and 48% from foreign countries, mainly Saudi Arabia, Iraq, and Ecuador. The Alaska portion, just like in-state production is declining. Foreign imports are on the rise.

Independents are the main driving force behind exploring for new oil and natural gas reserves. 95% of domestic oil and gas wells are drilling by independents. And their role is increasing. In 1999, major oil companies invested $31 billion in new drilling programs. Independents invested $18 billion. By 2007, the role had reversed. Majors invested $49 billion and independents $77 billion, for a total of $126 billion. That was four years ago. Today, those numbers are even larger.

This leads us to another important point. Drilling for oil and natural gas is expensive and getting more expensive every day. In 1999, it cost $100 per foot on average to drill a well in the U.S. By 2008, that had risen six fold to $600 per foot. A recent study concluded that on average, independents reinvest 150% of their net revenues each year back into drilling programs. That means they must get equity partners with capital or borrow money to continue to grow their operations.

Capital budgets, by definition, are driven by how much capital is available. Obviously, the market price of oil plays a significant role in determining how much capital is available. But other factors such as risk and return on investment also contribute. Oil and gas operations, as with all mining operations, are producing a finite resource. Therefore, producers are basically going out of business every day. So in order to survive, producers have to drill to find new resources or employ new technology to better extract an existing field. That takes money.

So if your goal is to increase domestic oil and gas production, you can't hamper the availability of capital. Unfortunately, that is precisely what the President has proposed in his last three budgets. The administration claims that "Big Oil" is receiving subsidies from the government. Nothing could be further from the truth.

Intangible Drilling Costs (IDC)—IDCs are non-salvageable items that can be expensed in the year that they were incurred, just like every other business on the face of the earth. If a shoe salesman buys a shoe for $10 and sells it for $20, he doesn't depreciate the shoe over 7 years, he expenses it. Similarly, there are a host of temporary, non-salvageable items called IDCs that some oil and gas companies can expense such as drilling services, mud, cement, testing services, things that are done before a well is

completed and producing any oil or gas. A shopping center developer does the exact same thing. He can expense items incurred is the planning and preparing for a shopping mall like grading, planning, etc. This is not a subsidy. It is a tax treatment. Once a well is completed and producing, all the surface equipment associated with that well is capitalized and depreciated as a salvageable item. Furthermore, only independent producers can fully expense IDC on American production. Therefore, if you eliminate IDC expensing, there would be less capital available is the current year to reinvest in new drilling operations. This equals less production, period.

Percentage Depletion—All natural resource minerals are eligible for a percentage depletion income tax deduction. Percentage depletion for natural gas and oil has been in the tax code since 1926. Unlike percentage depletion for all other resources, however, oil and gas percentage depletion is highly limited. It is available only for American production, only available to independent producers, and only available for the first 1000 barrels per day of production. Below this level, you can depreciate over a two year period. Again, major oil companies are not eligible for this tax treatment.

Passive Loss Exception for Working Interests in Oil and Gas Properties—The Tax Reform Act of 1986 deemed that a loss incurred by a working interest in natural gas and oil projects to be an active loss that could be offset by other active income. If the income/loss arising from natural gas and oil working interests is treated as passive income/loss, the primary income tax incentive for taxpayers to risk an investment in oil and natural gas development would be significantly diminished, and there would be less capital available. Worse yet, the only way this would lead to a net increase in tax revenue is if people were discouraged from reinvesting in oil and gas projects. If they aren't, then they have the ability to deduct their passive loss against future passive losses, and the government won't realize any additional revenue. New tax revenue is only created if those with a loss DON"T reinvest in oil and gas projects and can't deduct their loss against future gains.

There are five other tax treatments that I will include in the record but for the sake of time won't mention them individually now, but would be happy to answer any questions you may have about them.

The bottom line is it takes capital, a LOT of capital, to drill for new oil and gas production. Let's not hamper the access to that capital by raising taxes on our domestic independent petroleum producers. Independent oil and natural gas producers operating onshore in the U.S. accounted for nearly four million American jobs in 2010, a number that represents more than three percent of the total U.S. workforce. Very few industries have the potential to create as many better than average paying jobs as quickly and effectively as we do. Let's let this sector continue to create jobs and meet the energy needs of our citizens.

Thank You.