

PLAINS RESOURCES INC
Form 10-K/A
March 28, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-K/A

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

For the fiscal year ended December 31, 2001

OR

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

Commission file number: 0-9808

PLAINS RESOURCES INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

13-2898764
(I.R.S. Employer
Identification No.)

500 Dallas Street, Suite 700
Houston, Texas 77002
(Address of principal executive offices)
(Zip Code)

(713) 739-6700
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class ----- | Name of each exchange on which registered ----- |
|--|--|
| Common Stock, par value \$0.10 per share | New York Stock Exchange |

Securities registered pursuant to Section 12(g) of the Act: none

Indicate by check mark whether the registrant (1) has 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

On February 28, 2002, there were 23,649,537 shares of the registrant's
Common Stock outstanding. The aggregate value of the Common Stock held by non-
affiliates of the registrant (treating all executive officers and directors of

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the registrant, for this purpose, as if they may be affiliates of the registrant) was approximately \$498,176,000 on February 28, 2002 (based on \$22.50 per share, the last sale price of the Common Stock as reported on the New York Stock Exchange on such date).

DOCUMENTS INCORPORATED BY REFERENCE: The information required in Part III of the Annual Report on Form 10-K is incorporated by reference to the registrant's definitive proxy statement to be filed pursuant to Regulation 14A for the registrant's 2002 Annual Meeting of Stockholders.

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. []

We are amending our annual report on Form 10-K to revise the Condensed Consolidating Statement of Cash Flows for the Year Ended December 31, 2001 included in Note 22--"Consolidating Financial Statements" of the Notes to our Consolidated Financial Statements (located on page F-45). The revision consists of correcting the classification of \$131,785,000 of acquisition, exploration and development costs from the "Nonguarantor Subsidiaries" column to the "Guarantor Subsidiaries" column and a corresponding correction in advances from (payments to) affiliates.

Except as noted above, no other information included in our original report on Form 10-K has been amended by this Form 10-K/A.

PLAINS RESOURCES INC.

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All other schedules are omitted because they are not applicable or the

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required information is shown in the financial statements or notes thereto.

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REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and
Stockholders of Plains Resources Inc.

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Plains Resources Inc. and its subsidiaries at December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the consolidated financial statements, the Company changed its method of accounting for its crude oil inventories in connection with its adoption of Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements", effective January 1, 2000.

As discussed in Note 3 to the consolidated financial statements, the Company changed its method of accounting for derivative instruments and hedging activities in connection with its adoption of Statement of Financial Accounting Standards No. 133 "Accounting for Derivative Instruments and Hedging Activities", as amended, effective January 1, 2001.

PricewaterhouseCoopers LLP

Houston, Texas
March 13, 2002

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PLAINS RESOURCES INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (in thousands of dollars)

| December 31, | |
|--------------|-------|
| 2001 | 2000 |
| ----- | ----- |

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ASSETS

| | | |
|---|------------|-------------|
| Current Assets | | |
| Cash and cash equivalents..... | \$ 1,179 | \$ 5,080 |
| Accounts receivable..... | 20,039 | 357,790 |
| Commodity hedging contracts and other derivatives..... | 23,257 | 6,033 |
| Inventory..... | 6,721 | 54,844 |
| Other current assets..... | 1,527 | 11,662 |
| | ----- | ----- |
| | 52,723 | 435,409 |
| | ----- | ----- |
| Property and Equipment, at cost | | |
| Oil and natural gas properties--full cost method | | |
| Subject to amortization..... | 900,898 | 762,245 |
| Not subject to amortization..... | 40,506 | 42,581 |
| Crude oil pipeline, gathering and terminal assets..... | -- | 470,460 |
| Other property and equipment..... | 4,003 | 6,453 |
| | ----- | ----- |
| | 945,407 | 1,281,739 |
| | ----- | ----- |
| Less allowance for depreciation, depletion and amortization..... | (437,982) | (437,465) |
| | ----- | ----- |
| | 507,425 | 844,274 |
| | ----- | ----- |
| Investment in Plains All-American Pipeline, L.P..... | 64,626 | -- |
| | ----- | ----- |
| Other Assets..... | 24,014 | 114,646 |
| | ----- | ----- |
| | \$ 648,788 | \$1,394,329 |
| | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities | | |
| Accounts payable and other current liabilities..... | \$ 53,895 | \$ 399,773 |
| Interest payable..... | 8,286 | 13,536 |
| Notes payable..... | 511 | 1,811 |
| | ----- | ----- |
| | 62,692 | 415,120 |
| | ----- | ----- |
| Long-Term Debt | | |
| Bank debt..... | 11,500 | 27,300 |
| Bank debt of subsidiary..... | -- | 320,000 |
| Subordinated debt..... | 269,539 | 277,543 |
| Other..... | 1,022 | 1,533 |
| | ----- | ----- |
| | 282,061 | 626,376 |
| | ----- | ----- |
| Other Long-Term Liabilities..... | 4,889 | 3,422 |
| | ----- | ----- |
| Deferred Income Taxes..... | 44,294 | -- |
| | ----- | ----- |
| Commitments and Contingencies (Note 15) | | |
| Minority Interest in Plains All American Pipeline, L.P..... | -- | 162,271 |
| | ----- | ----- |
| Cumulative Convertible Preferred Stock, stated at liquidation preference..... | -- | 50,000 |
| | ----- | ----- |
| Non-redeemable Preferred Stock, Common Stock and Other Stockholders' Equity | | |
| Series D Cumulative Convertible Preferred Stock, \$1.00 par value, 46,600 shares authorized, issued and outstanding, at stated value..... | 23,300 | 23,300 |
| Series H Cumulative Convertible Preferred Stock, \$1.00 | | |

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| | | |
|--|------------|-------------|
| par value, 175,000 shares authorized; nil and 169,571 shares issued and outstanding, at stated value..... | -- | 84,785 |
| Common Stock, \$0.10 par value, 50,000,000 shares authorized; 27,677,411 and 18,746,612 shares issued for 2001 and 2000..... | 2,768 | 1,875 |
| Additional paid-in capital..... | 268,520 | 139,203 |
| Retained earnings (deficit)..... | 37,676 | (88,410) |
| Accumulated other comprehensive income..... | 13,930 | -- |
| Treasury stock, at cost..... | (91,342) | (23,613) |
| | ----- | ----- |
| | 254,852 | 137,140 |
| | ----- | ----- |
| | \$ 648,788 | \$1,394,329 |
| | ===== | ===== |

See notes to consolidated financial statements.

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PLAINS RESOURCES INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

| | Year Ended December 31, | | |
|---|-------------------------|------------|------------|
| | 2001 | 2000 | 1999 |
| | ----- | ----- | ----- |
| Revenues | | | |
| Crude oil and liquids..... | \$186,476 | \$ 133,325 | \$ 111,128 |
| Natural gas..... | 28,771 | 16,017 | 5,095 |
| Marketing, transportation, storage and terminalling..... | -- | 6,425,644 | 10,796,998 |
| Gain on sale of assets..... | -- | 48,188 | 16,457 |
| Other operating revenues..... | 473 | | |
| | ----- | ----- | ----- |
| | 215,720 | 6,623,174 | 10,929,678 |
| | ----- | ----- | ----- |
| Costs and Expenses | | | |
| Production expenses..... | 71,192 | 62,140 | 55,645 |
| General and administrative..... | 21,293 | 50,776 | 31,402 |
| Marketing, transportation, storage and terminalling..... | -- | 6,292,615 | 10,689,308 |
| Unauthorized trading losses and related expenses..... | -- | 7,963 | 166,440 |
| Depreciation, depletion and amortization.... | 28,921 | 47,221 | 36,998 |
| | ----- | ----- | ----- |
| | 121,406 | 6,460,715 | 10,979,793 |
| | ----- | ----- | ----- |
| Income (Loss) from Operations..... | 94,314 | 162,459 | (50,115) |
| Other Income (Expense) | | | |
| Equity in earnings of Plains All American Pipeline, L.P..... | 18,540 | -- | -- |
| Gains on Plains All American Pipeline, L.P. unit transactions and public offerings..... | 170,157 | -- | 9,787 |

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| | | | |
|--|-----------|-----------|-------------|
| Interest expense..... | (26,385) | (55,828) | (46,378) |
| Interest and other income..... | 151 | 7,411 | 1,237 |
| | ----- | ----- | ----- |
| Income (Loss) Before Income Taxes, Minority Interest, Extraordinary Items and Cumulative Effect of Accounting Changes..... | 256,777 | 114,042 | (85,469) |
| Minority interest in Plains All American Pipeline, L.P..... | -- | (42,535) | 40,203 |
| Income tax (expense) benefit: | | | |
| Current..... | (9,947) | (1,020) | 7 |
| Deferred..... | (91,513) | (24,563) | 20,472 |
| | ----- | ----- | ----- |
| Income (Loss) Before Extraordinary Items and Cumulative Effect of Accounting Changes..... | 155,317 | 45,924 | (24,787) |
| Extraordinary items, net of tax benefit and minority interest..... | -- | (4,988) | (544) |
| Cumulative effect of accounting changes, net of tax benefit..... | (1,986) | (121) | -- |
| | ----- | ----- | ----- |
| Net Income (Loss)..... | 153,331 | 40,815 | (25,331) |
| Cumulative preferred dividends..... | (27,245) | (14,725) | (10,026) |
| | ----- | ----- | ----- |
| Income (Loss) Available to Common Stockholders..... | \$126,086 | \$ 26,090 | \$ (35,357) |
| | ===== | ===== | ===== |
| Basic Earnings Per Share | | | |
| Income (loss) before extraordinary items and cumulative effect of accounting changes.... | \$ 6.07 | \$ 1.75 | \$ (2.02) |
| Extraordinary items..... | -- | (0.28) | (0.03) |
| Cumulative effect of accounting changes..... | (0.09) | (0.01) | -- |
| | ----- | ----- | ----- |
| Net income (loss)..... | \$ 5.98 | \$ 1.46 | \$ (2.05) |
| | ===== | ===== | ===== |
| Diluted Earnings Per Share | | | |
| Income (loss) before extraordinary items and cumulative effect of accounting changes.... | \$ 4.82 | \$ 1.56 | \$ (2.02) |
| Extraordinary items..... | -- | (0.17) | (0.03) |
| Cumulative effect of accounting changes..... | (0.07) | -- | -- |
| | ----- | ----- | ----- |
| Net income (loss)..... | \$ 4.75 | \$ 1.39 | \$ (2.05) |
| | ===== | ===== | ===== |

See notes to consolidated financial statements.

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PLAINS RESOURCES INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

| | Year Ended December 31, | | |
|--|-------------------------|-------|-------|
| | 2001 | 2000 | 1999 |
| | ----- | ----- | ----- |

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| | | | |
|---|-----------|-------------|------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Net income (loss)..... | \$153,331 | \$ 40,815 | \$(25,331) |
| Items not affecting cash flows from operating activities: | | | |
| Depreciation, depletion and amortization.... | 28,921 | 47,221 | 36,998 |
| Equity in earnings of Plains All American Pipeline, L.P..... | (18,540) | -- | -- |
| Distributions received from Plains All American Pipeline, L.P..... | 31,553 | -- | -- |
| Noncash gains..... | (170,157) | (48,188) | (26,244) |
| Minority interest in income of a subsidiary..... | -- | 35,566 | (40,203) |
| Loss on early extinguishment of debt, net of tax..... | -- | -- | -- |
| Deferred income taxes..... | 91,513 | 21,297 | (20,472) |
| Cumulative effect of adoption of SFAS 133... | 1,986 | -- | -- |
| Change in derivative fair value..... | 1,227 | -- | -- |
| Noncash compensation expense..... | 4,514 | 2,682 | 1,013 |
| Allowance for doubtful accounts..... | -- | 5,000 | -- |
| Other noncash items..... | 1,626 | 10,925 | (61) |
| Change in assets and liabilities from operating activities: | | | |
| Accounts receivable and other..... | 21,023 | 102,651 | (226,438) |
| Inventory..... | 1,133 | (13,977) | 33,930 |
| Accounts payable and other current liabilities..... | (29,636) | (143,453) | 171,974 |
| Pipeline linefill..... | -- | (16,679) | (3) |
| Other long-term liabilities..... | 1,634 | (8,000) | 18,873 |
| | ----- | ----- | ----- |
| Net cash provided by (used in) operating activities..... | 120,128 | 35,860 | (75,964) |
| | ----- | ----- | ----- |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | |
| Acquisition, exploration and developments costs..... | (131,785) | (78,726) | (77,899) |
| Additions to other property and assets..... | (561) | (3,133) | (2,472) |
| Plains All American Pipeline, L.P. acquisitions and assets..... | -- | (12,219) | (189,425) |
| Proceeds from the sale of Plains All American Pipeline, L.P. units..... | 106,941 | -- | -- |
| Investment in Plains All American Pipeline, L.P..... | (3,978) | -- | -- |
| Proceeds from asset sales..... | -- | 224,261 | 3,400 |
| | ----- | ----- | ----- |
| Net cash provided by (used in) investing activities..... | (29,383) | 130,183 | (266,396) |
| | ----- | ----- | ----- |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | |
| Proceeds from long-term debt..... | 204,900 | 1,698,575 | 744,971 |
| Proceeds from short-term debt..... | -- | 51,300 | 131,119 |
| Proceeds from sale of common stock..... | 9,169 | 2,301 | 5,542 |
| Proceeds from issuance of preferred stock..... | -- | -- | 50,000 |
| Proceeds from issuance of common units, net... | -- | -- | 50,759 |
| Purchase of senior subordinated notes..... | (7,550) | -- | -- |
| Principal payments of long-term debt..... | (221,211) | (1,799,186) | (449,332) |
| Principal payments of short-term debt..... | -- | (108,719) | (82,150) |
| Purchase of common stock..... | (67,729) | (23,613) | -- |
| Costs incurred in connection with financing arrangements..... | -- | (6,748) | (19,448) |
| Preferred stock dividends..... | (8,698) | (13,409) | (4,245) |
| Distributions to Plains All American Pipeline, L.P. unitholders..... | -- | (29,432) | (22,201) |

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| | | | |
|---|----------|-----------|-----------|
| Other..... | (102) | (260) | (971) |
| | ----- | ----- | ----- |
| Net cash provided by (used in) financing activities..... | (91,221) | (229,191) | 404,044 |
| | ----- | ----- | ----- |
| Net increase (decrease) in cash and cash equivalents..... | (476) | (63,148) | 61,684 |
| Decrease in cash due to deconsolidation of Plains All American Pipeline, L.P..... | (3,425) | -- | -- |
| Cash and cash equivalents, beginning of year.. | 5,080 | 68,228 | 6,544 |
| | ----- | ----- | ----- |
| Cash and cash equivalents, end of year..... | \$ 1,179 | \$ 5,080 | \$ 68,228 |
| | ===== | ===== | ===== |

See notes to consolidated financial statements.

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PLAINS RESOURCES INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)

| | Year Ended December 31, | | |
|--|-------------------------|----------|------------|
| | 2001 | 2000 | 1999 |
| | ----- | ----- | ----- |
| Net Income (Loss)..... | \$153,331 | \$40,815 | \$(25,331) |
| Other Comprehensive Income: | | | |
| Unrealized gains on derivatives: | | | |
| Cumulative effect of accounting change, net of taxes of \$4,383..... | 6,856 | -- | -- |
| Unrealized gains arising during the year, net of taxes of \$8,329..... | 12,803 | -- | -- |
| Reclassification adjustment for gains realized in net income, net of tax benefit of \$1,921..... | (2,989) | -- | -- |
| | ----- | ----- | ----- |
| | 16,670 | -- | -- |
| Minimum pension liability adjustment, net of tax benefit of \$272..... | (421) | -- | -- |
| | ----- | ----- | ----- |
| | 16,249 | -- | -- |
| | ----- | ----- | ----- |
| Equity in other comprehensive income changes of Plains All American Pipeline, L.P. | | | |
| Cumulative effect of accounting change, net of tax benefit of \$1,496..... | (2,340) | -- | -- |
| Change in fair value of open hedging positions, net of taxes of \$5..... | 21 | -- | -- |
| | ----- | ----- | ----- |
| | (2,319) | -- | -- |
| | ----- | ----- | ----- |
| Other Comprehensive Income..... | 13,930 | -- | -- |
| | ----- | ----- | ----- |

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| | | | |
|----------------------------------|-----------|----------|------------|
| Comprehensive Income (Loss)..... | \$167,261 | \$40,815 | \$(25,331) |
| | ===== | ===== | ===== |

See notes to consolidated financial statements.

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PLAINS RESOURCES INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN NON-REDEEMABLE PREFERRED STOCK, COMMON STOCK AND OTHER STOCKHOLDERS' EQUITY
(in thousands)

| | 2001 | | 2000 | | 1999 | |
|---|--------|-----------|--------|-----------|--------|-----------|
| | Shares | Amount | Shares | Amount | Shares | Amount |
| Series D Cumulative Convertible Preferred Stock | | | | | | |
| Balance, beginning of year..... | 47 | \$ 23,300 | 47 | \$ 23,300 | 47 | \$ 21,946 |
| Preferred stock dividends..... | -- | -- | -- | -- | -- | 1,354 |
| Balance, end of year.... | 47 | 23,300 | 47 | 23,300 | 47 | 23,300 |
| Series H Cumulative Convertible Preferred Stock | | | | | | |
| Balance, beginning of year..... | 170 | 84,785 | -- | -- | -- | -- |
| Shares issued upon conversion of redeemable preferred stock..... | -- | -- | 170 | 84,785 | -- | -- |
| Conversion of preferred stock into common..... | (170) | (84,785) | -- | -- | -- | -- |
| Balance, end of year.... | -- | -- | 170 | 84,785 | -- | -- |
| Common Stock | | | | | | |
| Balance, beginning of year..... | 18,747 | 1,875 | 17,924 | 1,792 | 16,882 | 1,688 |
| Common stock issued upon exercise of options, warrants and other..... | 1,041 | 103 | 557 | 56 | 943 | 94 |
| Conversion of preferred stock into common..... | 7,889 | 790 | 266 | 27 | 99 | 10 |
| Balance, end of year.... | 27,677 | 2,768 | 18,747 | 1,875 | 17,924 | 1,792 |
| Additional Paid-in Capital | | | | | | |

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| | | | |
|---|-----------|-----------|-----------|
| Balance, beginning of year..... | 139,203 | 130,027 | 124,679 |
| Common stock issued upon exercise of options, warrants and other..... | 18,429 | 5,223 | 3,583 |
| Conversion of preferred stock into common..... | 110,888 | 3,958 | 1,765 |
| Redemption of preferred stock..... | -- | (5) | -- |
| | ----- | ----- | ----- |
| Balance, end of year.... | 268,520 | 139,203 | 130,027 |
| | ----- | ----- | ----- |
| Retained Earnings | | | |
| (Deficit) | | | |
| Balance, beginning of year..... | (88,410) | (114,500) | (79,143) |
| Preferred stock dividends..... | (27,245) | (14,725) | (10,026) |
| Net income (loss)..... | 153,331 | 40,815 | (25,331) |
| | ----- | ----- | ----- |
| Balance, end of year.... | 37,676 | (88,410) | (114,500) |
| | ----- | ----- | ----- |
| Accumulated Other | | | |
| Comprehensive Income | | | |
| Balance, beginning of year..... | -- | -- | -- |
| Other comprehensive income..... | 13,930 | -- | -- |
| | ----- | ----- | ----- |
| Balance, end of year.... | 13,930 | -- | -- |
| | ----- | ----- | ----- |
| Treasury Stock | | | |
| Balance, beginning of year..... | (1,291) | (23,613) | -- |
| Purchase of common stock..... | (2,830) | (67,729) | (1,291) |
| | ----- | ----- | ----- |
| Balance, end of year.... | (4,121) | (91,342) | (1,291) |
| | ===== | ===== | ===== |
| Total..... | \$254,852 | \$137,140 | \$ 40,619 |
| | ===== | ===== | ===== |

See notes to consolidated financial statements.

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1--Organization and Significant Accounting Policies

Organization

The consolidated financial statements of Plains Resources Inc. ("Plains", "our", or "we") include the accounts of all wholly owned subsidiaries and for periods prior to January 1, 2001, Plains All American Pipeline, L.P. ("PAA"). As discussed in Note 2, in June 2001 we reduced our interest in PAA from 54%

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to 33% and as a result we no longer have the ability to exercise control over the operations of PAA. Accordingly, effective January 1, 2001, our minority interest investment in PAA is accounted for using the equity method of accounting. Under the equity method, we no longer consolidate the assets, liabilities and operating activities of PAA, but instead record our proportionate share of PAA's net assets and results of operations. For periods prior to January 1, 2001 the assets, liabilities and results of operations of PAA are consolidated in our financial statements.

All significant intercompany transactions have been eliminated. Certain reclassifications have been made to the prior year statements to conform to the current year presentation.

We are an independent energy company that is currently engaged in the "Upstream" oil and gas business. The Upstream business acquires, exploits, develops, explores for and produces crude oil and natural gas. Our Upstream activities are all located in the United States. Prior to the reduction in our interest in PAA, we also participated directly in the "Midstream" oil and gas business, which consists of the marketing, transportation and terminalling of crude oil. We continue to participate indirectly in the Midstream oil and gas business through our minority interest in PAA. All of PAA's Midstream activities are conducted in the United States and Canada.

Significant Accounting Policies

Oil and Gas Properties. We follow the full cost method of accounting whereby all costs associated with property acquisition, exploration, exploitation and development activities are capitalized. Such costs include internal general and administrative costs such as payroll and related benefits and costs directly attributable to employees engaged in acquisition, exploration, exploitation and development activities. General and administrative costs associated with production, operations, marketing and general corporate activities are expensed as incurred. These capitalized costs along with our estimate of future development and abandonment costs, net of salvage values and other considerations, are amortized to expense by the unit-of-production method using engineers' estimates of proved oil and natural gas reserves. The costs of unproved properties are excluded from amortization until the properties are evaluated. Interest is capitalized on oil and natural gas properties not subject to amortization and in the process of development. Proceeds from the sale of oil and natural gas properties are accounted for as reductions to capitalized costs unless such sales involve a significant change in the relationship between costs and the estimated value of proved reserves, in which case a gain or loss is recognized. Unamortized costs of proved properties are subject to a ceiling which limits such costs to the present value of estimated future cash flows from proved oil and natural gas reserves of such properties (including the effect of any related hedging activities) reduced by future operating expenses, development expenditures and abandonment costs (net of salvage values), and estimated future income taxes thereon.

Other Property and Equipment. Other property and equipment is recorded at cost and consists primarily of office furniture and fixtures and computer hardware and software. Acquisitions, renewals, and betterments are capitalized; maintenance and repairs are expensed. Depreciation is provided using the straight-line method over estimated useful lives of three to seven years. Net gains or losses on property and equipment disposed of are included in interest and other income in the period in which the transaction occurs.

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Use of Estimates. The preparation of 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates made by management include (1) crude oil and natural gas reserves, (2) depreciation, depletion and amortization, including future abandonment costs, (3) income taxes and related valuation allowance, (4) allowance for doubtful accounts receivable and (5) accrued liabilities. Although management believes these estimates are reasonable, actual results could differ from these estimates.

Cash and Cash Equivalents. Cash and cash equivalents consist of all demand deposits and funds invested in highly liquid instruments with original maturities of three months or less. At December 31, 2001 and 2000, the majority of cash and cash equivalents is concentrated in two institutions and at times may exceed federally insured limits. We periodically assess the financial condition of the institutions and believe that any possible credit risk is minimal.

Accounts Receivable, Net. At December 31, 2000, PAA had an allowance for doubtful accounts receivable of \$5.0 million that is reflected in the consolidated balance sheet as a reduction of certain accounts receivable which are included in Other Assets. At December 31, 2001 the allowance is reflected in our investment in PAA.

Inventory. Plains' crude oil inventories are carried at cost. Materials and supplies inventory is stated at the lower of cost or market with cost determined on an average cost method. PAA's crude oil inventories are carried at the lower of cost, adjusted for deferred gains or losses, or market value using an average cost method.

Inventory consists of the following (in thousands):

| | December 31, | |
|-----------------------------|--------------|----------|
| | 2001 | 2000 |
| | | |
| Plains, excluding PAA | | |
| Crude oil..... | \$ 1,467 | \$ 3,347 |
| Materials and supplies..... | 5,254 | 4,716 |
| | 6,721 | 8,063 |
| | | |
| PAA | | |
| Crude oil..... | -- | 45,914 |
| Materials and supplies..... | -- | 867 |
| | -- | 46,781 |
| | \$ 6,721 | \$54,844 |

PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Other Assets. Other assets consists of the following (in thousands):

| | December 31, | |
|--|---------------|---------------|
| | ----- 2001 | 2000 ----- |
| Plains, excluding PAA | | |
| Deferred tax asset..... | \$ -- | \$ 47,974 |
| Land..... | 8,853 | 8,853 |
| Commodity hedging contracts and other derivatives..... | 5,661 | -- |
| Debt issue costs, net..... | 3,566 | 7,249 |
| Other..... | 5,934 | 3,318 |
| | ----- | ----- |
| | 24,014 | 67,394 |
| | ----- | ----- |
| PAA | | |
| Pipeline linefill, at cost..... | -- | 34,312 |
| Debt issue costs, net..... | -- | 7,259 |
| Long-term receivable, net..... | -- | 5,000 |
| Other..... | -- | 681 |
| | ----- | ----- |
| | -- | 47,252 |
| | ----- | ----- |
| | \$24,014 | \$114,646 |
| | ===== | ===== |

Costs incurred in connection with the issuance of long-term debt are capitalized and amortized using the straight-line method over the term of the related debt. Use of the straight-line method does not differ materially from the "effective interest" method of amortization.

Federal and State Income Taxes. Income taxes are accounted for in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes ("SFAS 109"). SFAS 109 requires recognition of deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax liabilities and assets are determined based on the difference between the financial statement and tax bases of assets and liabilities using tax rates in effect for the year in which the differences are expected to reverse. A valuation allowance is established to reduce deferred tax assets if it is more than likely than not that the related tax benefits will not be realized.

Revenue Recognition. Oil and gas revenue from our interests in producing wells is recognized when the production is delivered and the title transfers. Transportation costs incurred in connection with such operations, which are immaterial, are reflected as a reduction of sales revenues.

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PAA's gathering and marketing revenues are accrued at the time title to the product sold transfers to the purchaser, which occurs upon receipt of the product by the purchaser, and purchases are accrued at the time title to the product purchased transfers to PAA, which occurs upon our receipt of the product. PAA's terminalling and storage revenues are recognized at the time service is performed and revenues for the transportation of crude oil are recognized based upon regulated and non-regulated tariff rates and the related transported volumes.

Derivative Financial Instruments (Hedging). We utilize various derivative instruments to reduce our exposure to decreases in the market price of crude oil. The derivative instruments consist primarily of crude oil swap and option contracts entered into with financial institutions. We also utilize interest rate swaps to manage the interest rate exposure on our long-term debt.

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Stock Options. We have elected to follow Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ("APB 25") and related interpretations in accounting for our employee stock options. Under APB 25, no compensation expense is recognized when the number of options to be issued is known and the exercise price of the options equals the fair value (market price) of the underlying stock on the date of grant.

Sale of Units by PAA. When PAA sells additional units to a third party, resulting in a change in our percentage ownership interest, we recognize a gain or loss in our consolidated statement of operations if the selling price per unit is more or less than our average carrying amount per unit.

Recent Accounting Pronouncements. The following Statements of Financial Accounting Standards ("SFAS's") were issued in June 2001: SFAS No. 141, Business Combinations, SFAS No. 142, Goodwill and Other Intangible Assets, and SFAS No. 143, Accounting for Asset Retirement Obligations. In August 2001, SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets was also issued. SFAS No. 141 requires the use of the purchase method of accounting for all business combinations. It applies to all business combinations initiated after June 30, 2001 and to all business combinations accounted for by the purchase method that are completed after June 30, 2001. SFAS No. 142 requires that goodwill as well as other intangible assets with indefinite lives not be amortized but be tested annually for impairment and is effective for fiscal years beginning after December 15, 2001. SFAS No. 144 addresses financial accounting and reporting for the impairment of long-lived assets and long-lived assets to be disposed of. It supersedes, with exceptions, SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of and is effective for fiscal years beginning after December 15, 2001. SFAS No. 141, No. 142 and No. 144 had no effect on our financial statements. We will account for all future business combinations and any related goodwill in accordance with the provisions of SFAS No. 141 and SFAS No. 142.

SFAS No. 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred and a corresponding increase in the carrying amount of the related long-lived asset. Subsequently, the asset retirement cost should be allocated to expense using a

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systematic and rational method. SFAS No. 143 is effective for fiscal years beginning after June 15, 2002. The Company is currently assessing the impact of SFAS No. 143 and at this time cannot reasonably estimate the effect of this statement on its consolidated financial position, results of operations or cash flows.

In the fourth quarter of 2000, we adopted Securities and Exchange Commission ("SEC") Staff Accounting Bulletin 101, "Revenue Recognition in Financial Statements" ("SAB 101"). As a result, we record revenue from crude oil production in the period it is sold as opposed to when it is produced and carry any unsold production as inventory valued at historical cost. The total effect of implementing SAB 101 was to reduce reported sales volumes by 144,000 barrels for 2000 and net income for the year by \$175,000, including a \$121,000 reduction for the cumulative effect of prior years. The effect of this change in accounting for crude oil inventories on prior periods was de minimus.

Note 2--Investment in Plains All American Pipeline, L.P.

In a series of transactions on June 8, 2001, we sold a portion of our interest in PAA to a group of investors and certain members of PAA management for aggregate consideration of approximately \$155.2 million (consisting of \$110.0 million in cash and \$45.2 million in Series F Cumulative Convertible Preferred Stock [the "Series F Preferred Stock"]) and recognized a pre-tax gain of \$128.3 million in connection with this sale. In addition, certain holders of the Series F Preferred Stock and

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Series H Convertible Preferred Stock (the "Series H Preferred Stock") converted their shares into shares of our common stock. We sold (i) 5.2 million Subordinated Units of PAA (the "Subordinated Units") for \$69.5 million in cash and the redemption of 23,108 shares of Series F Preferred Stock, valued at \$45.2 million; and (ii) an aggregate 54% ownership interest in the general partner of PAA for \$40.5 million in cash. In addition, the investor group and certain other stockholders converted 26,892 shares of Series F Preferred Stock and 132,022 shares of Series H Preferred Stock into a total of 6.6 million shares of our common stock. On September 5, 2001, pursuant to an option granted as part of the June 8, 2001 transactions, certain members of the executive management of PAA acquired an aggregate additional 2% ownership interest in the general partner of PAA for \$1.5 million in cash and notes, further reducing our ownership in the general partner of PAA to 44%. We recognized a gain of \$1.1 million as a result of this transaction. These transactions in the aggregate are hereinafter referred to as "the Transactions".

As a result of the Transactions, all of the Series F Preferred Stock and all but approximately 36,000 shares of the Series H Preferred Stock were retired or converted. The remaining outstanding shares of the Series H Preferred Stock converted to 1.2 million shares of our common stock during the third quarter. Also as a result of the Transactions, certain of our employees received transaction-related bonuses and other payments and vested in benefits in accordance with the terms of certain of our employee benefit plans.

The excess of the fair value of the Series F Preferred stock as consideration for the PAA Units over the carrying value of the Series F

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Preferred Stock (\$21.4 million) is deemed to be a dividend to preferred stockholders and is deducted in determining the income available to common stockholders for the purpose of determining basic and fully diluted earnings per share. In connection with the conversion of the Series F Preferred Stock into common stock, we made a \$2.5 million inducement payment representing a 20% premium to the amount of dividends that would accrue on the Series F Preferred Stock between the closing of the Transactions and the first date we could potentially cause such conversion. Such amounts are included in preferred dividends.

The Subordinated Units are subordinated in right to distributions from PAA and are not publicly traded. However, PAA's partnership agreement provides that, if certain financial tests are met, the Subordinated Units (including those retained by us) will convert into common units on a one-for-one basis commencing in 2003. In connection with the Transactions, we entered into Value Assurance Agreements with such purchasers of the Subordinated Units under the terms of which we will pay the purchasers an amount per fiscal year, payable on a quarterly basis, equal to \$1.85 per unit less the actual amount distributed during that year. The Value Assurance Agreements expire upon the earlier of (a) the conversion of the Subordinated Units to common units or (b) June 8, 2006. In the first quarter of 2002 PAA paid a distribution of \$0.5125 per unit (\$2.05 annualized).

Also in connection with the Transactions, we entered into a separation agreement with PAA pursuant to which, among other things, (a) we agreed to indemnify PAA, the general partner of PAA, and the subsidiaries of PAA against any losses or liabilities resulting from (i) the operation of the upstream business or (ii) federal or state securities laws, or the regulations of any self-regulatory authority, or other similar claims resulting from acts or omissions by us, our subsidiaries, PAA, or PAA's subsidiaries on or before the closing of the Transactions; and (b) PAA agreed to indemnify us and our subsidiaries against any losses or liabilities resulting from the operation of the midstream business. We also entered into a pension and employee benefits assumption and transition agreement pursuant to which the general partner of PAA and us agreed to the transition of certain employees to such general partner, the provision of certain benefits with respect to such transfer, and the provision of other transition services by us.

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

In addition, we agreed to contribute 287,500 of our Subordinated Units to PAA's general partner to be used for option grants to officers and key employees. These Subordinated Units are considered to be a contribution to the general partner and we will receive no reimbursement for such units. Also, at the time of the Transactions, certain of our employees, who are now employees of PAA's general partner, held "in-the-money" but unvested Plains stock options which were subject to forfeiture due to the transfer of employment. We agreed to substitute, based on the present value of such options, a contingent grant of 51,000 Subordinated Units that vest on the same schedule the stock options were to vest. In connection with these substitute options, we recognized \$0.5 million in noncash compensation expense in 2001.

In May 2001, PAA issued 4.0 million common units in a public equity offering. We recognized a gain of \$19.6 million resulting from the increase in

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the book value of our equity in PAA to reflect our proportionate share of the increase in the underlying net assets of PAA due to the sale of the units. In October 2001, PAA issued 4.5 million Common Units in a public offering. As a result of the offering, we made a general partner capital contribution of approximately \$1.0 million, and our aggregate ownership interest in PAA was reduced to approximately 29%. We recognized a gain of approximately \$19.2 million resulting from the increase in book value of our equity in PAA to reflect our proportionate share of the increase in the underlying net assets of PAA resulting from this public offering.

At March 31, 2001, our aggregate ownership interest in PAA was approximately 54%. Following the sale of common units by PAA in the aforementioned public equity offerings and the Transactions, our aggregate ownership interest in PAA was approximately 29%. At December 31, 2001, our aggregate 29% ownership in PAA consisted of: (i) a 44% ownership interest in the 2% general partner interest and incentive distribution rights, (ii) 45%, or approximately 4.5 million, of the Subordinated Units and (iii) 24% or approximately 7.9 million of the common units (including approximately 1.3 million Class B common units).

The following table presents summarized financial statement information of PAA (in thousands of dollars):

| | Year Ended December 31, 2001 ----- |
|---|---|
| Revenues..... | \$6,868,215 |
| Cost of sales and operations..... | 6,725,954 |
| Gross margin..... | 142,261 |
| Operating income..... | 71,368 |
| Income before cumulative effect of accounting change..... | 43,671 |
| Net income..... | 44,179 |
| | At December 31, 2001 ----- |
| Current assets..... | \$ 558,082 |
| Property and equipment, net..... | 604,919 |
| Other assets..... | 98,250 |
| Total assets..... | 1,261,251 |
| Current liabilities..... | 505,160 |
| Long-term debt..... | 351,677 |
| Other long-term liabilities..... | 1,617 |
| Partners' capital..... | 402,797 |
| Total liabilities and partners' capital..... | 1,261,251 |

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

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Note 3--Derivative Instruments and Hedging Activities

On January 1, 2001, we adopted Statement of Financial Accounting Standards ("SFAS") No. 133 "Accounting for Derivative Instruments and Hedging Activities" as amended by SFAS 137 and SFAS 138 ("SFAS 133"). Under SFAS 133, all derivative instruments are recorded on the balance sheet at fair value. If the derivative does not qualify as a hedge or is not designated as a hedge, the gain or loss on the derivative is recognized currently in earnings. To qualify for hedge accounting, the derivative must qualify either as a fair value hedge, cash flow hedge or foreign currency hedge. Currently, we use only cash flow hedges and the remaining discussion will relate exclusively to this type of derivative instrument. If the derivative qualifies for hedge accounting, the gain or loss on the derivative is deferred in accumulated Other Comprehensive Income ("OCI"), a component of Stockholders' Equity to the extent the hedge is effective.

The relationship between the hedging instrument and the hedged item must be highly effective in achieving the offset of changes in cash flows attributable to the hedged risk both at the inception of the contract and on an ongoing basis. Hedge accounting is discontinued prospectively when a hedge instrument becomes ineffective. Gains and losses deferred in OCI related to cash flow hedges that become ineffective remain unchanged until the related product is delivered. If it is determined that it is probable that a hedged forecasted transaction will not occur, deferred gains or losses on the hedging instrument are recognized in earnings immediately.

We formally document all relationships between hedging instruments and hedged items, as well as our risk management objectives and strategy for undertaking the hedge. Hedge effectiveness is measured on a quarterly basis. This process includes specific identification of the hedging instrument and the hedge transaction, the nature of the risk being hedged and how the hedging instrument's effectiveness will be assessed. Both at the inception of the hedge and on an ongoing basis, we assess whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items. No amounts were excluded from the computation of hedge effectiveness. At December 31, 2001, all open positions qualified for hedge accounting.

Unrealized gains and losses on hedging instruments reflected in OCI and adjustments to carrying amounts on hedged volumes are included in oil and gas revenues in the period that the related volumes are delivered. Gains and losses from hedging instruments, which represent hedge ineffectiveness as well as any amounts excluded from the assessment of hedge effectiveness, are recognized currently in oil and gas revenues. Effective October 2001, we implemented Derivatives Implementation Group ("DIG") Issue G20, "Cash Flow Hedges: Assessing and Measuring the Effectiveness of a Purchased Option Used in a Cash Flow Hedge", which provides guidance for assessing the effectiveness on total changes in an option's cash flows rather than only on changes in the option's intrinsic value. Implementation of this DIG issue will reduce earnings volatility since it allows us to include changes in the time value of purchased options and collars in the assessment of hedge effectiveness. Time value changes were previously recognized in current earnings since we excluded time value changes from the assessment of hedge effectiveness. Oil and gas revenues for the year ended December 31, 2001 include a \$3.4 million non-cash loss related to the ineffective portion of the cash flow hedges representing the fair value change in the time value of options for the nine months prior to the implementation of DIG Issue G20.

We utilize various derivative instruments to hedge our exposure to price fluctuations on crude oil sales. The derivative instruments consist primarily of cash-settled crude oil option and swap contracts entered into with

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financial institutions. We do not currently have any natural gas hedges. We also utilize interest rate swaps and collars to manage the interest rate exposure on our long-term debt. In October

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

2001 we entered into a three-year interest rate swap agreement, fixing at 5.29% the interest rate on \$7.5 million of borrowing under our revolving credit facility. At December 31, 2001, we had the following open crude oil hedge positions:

| | Barrels Per Day | |
|--------------------------------|--------------------|-------|
| | 2002 | 2003 |
| Puts | | |
| Average price \$20.00/bbl..... | 2,000 | -- |
| Calls | | |
| Average price \$35.17/bbl..... | 9,000 | -- |
| Swaps | | |
| Average price \$24.00/bbl..... | 17,000 | -- |
| Average price \$23.16/bbl..... | -- | 7,500 |

On January 1, 2001, in accordance with the transition provisions of SFAS 133, we recorded a gain of \$4.5 million in OCI, representing the cumulative effect of an accounting change to recognize at fair value all cash flow derivatives, including our equity in the cash flow derivatives of PAA. We recorded cash flow hedge derivative assets and liabilities of \$20.6 million and \$18.1 million, respectively, and a net-of-tax non-cash charge of \$2.0 million was recorded in earnings as a cumulative effect adjustment.

For the year ended December 31, 2001, net unrealized gains of \$9.8 million were added to OCI and the fair value of open positions increased \$16.2 million. At December 31, 2000, we had an interest rate swap arrangement to protect interest rate fluctuations on a portion of our outstanding debt. The position was terminated prior to maturity and as a result \$0.6 million related to such position was relieved from OCI when the debt was repaid in June 2001.

At December 31, 2001, net unrealized gains on our option and swap contracts included in OCI was \$16.7 million. The related assets and liabilities were included in commodity hedging contracts and other derivatives (\$21.8 million), other assets (\$5.7 million), and deferred income taxes (\$10.8 million). Additionally, OCI includes our \$2.3 million net of tax equity in the unrealized OCI losses of PAA. As of December 31, 2001, \$13.2 million of deferred net gains on derivative instruments recorded in OCI are expected to be reclassified to earnings during the next twelve-month period.

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Note 4--Long-Term Debt and Credit Facilities

Short-term debt and long-term debt consists of the following at December 31, 2001 and 2000 (in thousands):

| | 2001 | | 2000 | |
|---|---------|-----------|---------|-----------|
| | Current | Long-Term | Current | Long-Term |
| Plains | | | | |
| Revolving credit facility, bearing interest at 4.2% and 8.4%, at December 31, 2001 and 2000, respectively..... | \$ -- | \$ 11,500 | \$ -- | \$ 27,300 |
| 10.25% Senior Subordinated Notes, due 2006, net of repurchased notes of \$7.55 million and nil, and unamortized premium of \$2.1 million and \$2.5 million at December 31, 2001 and 2000, respectively..... | -- | 269,539 | -- | 277,543 |
| Other long-term debt..... | 511 | 1,533 | 511 | 2,044 |
| | 511 | 282,572 | 511 | 306,887 |
| PAA | | | | |
| Letter of credit facility and hedged inventory facility, bearing interest at a weighted average interest rate of 8.4%..... | -- | -- | 1,300 | -- |
| Plains Marketing, L.P. revolving credit facility, bearing interest at 9.2%, at December 31, 2000..... | -- | -- | -- | 320,000 |
| | \$511 | \$282,572 | \$1,811 | \$626,887 |

Aggregate total maturities of long-term debt in the next five years are as follows: 2002--\$0.5 million; 2003--\$1.9 million; 2004--\$6.3 million; 2005--\$4.3 million; and 2006--\$267.5 million.

Plains Long-Term Debt and Credit Facilities

Revolving Credit Facility

We have a \$225.0 million revolving credit facility with a group of banks. The revolving credit facility is guaranteed by all of our upstream subsidiaries and is collateralized by our upstream oil and natural gas properties and those of the guaranteeing subsidiaries and the stock of all the upstream subsidiaries. The borrowing base under the revolving credit facility at December 31, 2001, is \$225.0 million and is subject to redetermination from time to time by the lenders in good faith, in the exercise of the lenders' sole discretion, and in accordance with customary practices and standards in effect from time to time for crude oil and natural gas loans to borrowers

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similar to our company. Our borrowing base may be affected from time to time by the performance of our oil and natural gas properties and changes in oil and natural gas prices. We incur a commitment fee of 3/8% per annum on the unused portion of the borrowing base. In addition, we pay a fee of 1 3/8% per annum of the face amount of letters of credit that are issued under our revolving credit facility. The revolving credit facility, as amended, terminates on July 1, 2003, at which time the remaining outstanding balance converts to a term loan, repayable in eight equal quarterly installments commencing October 1, 2003, with a final maturity of July 1, 2005. The revolving credit facility bears interest, at our option, of either LIBOR plus 1 3/8% or the Base Rate (as defined therein). At December 31, 2001, letters of credit of \$0.6 million were outstanding under the revolving credit facility.

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

The revolving credit facility contains covenants which, among other things, limit the payment of cash dividends on common stock, limit repurchases of common stock, limit the amount of consolidated debt, limit our ability to make certain loans and investments and provide that we must maintain a specified relationship between current assets and current liabilities. At December 31, 2001 we were in compliance with such covenants and could have borrowed the full \$225.0 million available under the facility.

Under the terms of the revolving credit facility we can purchase any combination of our own common stock, our senior subordinated notes and PAA common units and pay cash dividends on our common stock (up to \$30.0 million) up to a total of \$150.0 million. At December 31, 2001 we had \$117.5 million remaining under this limit. The Board of Directors, subject to the \$150.0 million limit, has authorized the purchase of up to eight million shares of our common stock, our senior subordinated notes and PAA units in the open market from time to time as market conditions are deemed favorable.

In October 2001 we entered into a three-year interest rate swap agreement, fixing the interest rate on \$7.5 million of borrowing under our revolving credit facility at 5.29%

10.25% Senior Subordinated Notes Due 2006

At December 31, 2001 we had \$267.5 million principal amount of 10.25% Senior Subordinated Notes Due 2006 (the "10.25% Notes") outstanding, bearing a coupon rate of 10.25%. In 1996 we issued \$150.0 million principal amount at 99.38% of par to yield 10.35%. In 1997 \$50.0 million principal amount was issued at approximately 107% of par and in 1999 \$75.0 million principal amount was issued at approximately 101% of par. In 2001 we repurchased \$7.5 million principal amount at 99.5% of par.

The 10.25% Notes are redeemable, at our option at 105.13% of the principal amount through March 15, 2002, at 103.42% on or after March 15, 2002, at 101.71% on or after March 15, 2003 and at 100% on or after March 15, 2004 plus, in each case, accrued interest to the date of redemption.

The Indenture contains covenants that include, but are not limited to, covenants that: (1) limit the incurrence of additional indebtedness; (2) limit certain investments; (3) limit restricted payments; (4) limit the disposition

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of assets; (5) limit the payment of dividends and other payment restrictions affecting subsidiaries; (6) limit transactions with affiliates; (7) limit the creation of liens; and (8) restrict mergers, consolidations and transfers of assets. In the event of a Change of Control and a corresponding Rating Decline, as both are defined in the Indenture, we will be required to make an offer to repurchase the 10.25% Notes at 101% of the principal amount thereof, plus accrued and unpaid interest to the date of the repurchase.

The 10.25% Notes are unsecured general obligations and are subordinated in right of payment to all our existing and future senior indebtedness and are guaranteed by certain of our Upstream subsidiaries on a full, unconditional, joint and several basis.

PAA Credit Facilities

At December 31, 2000, PAA's bank credit agreements consisted of a \$400.0 million senior secured revolving credit facility and a \$300.0 million senior secured letter of credit and borrowing facility, both of which were secured by substantially all of PAA's assets. PAA's credit facilities were nonrecourse to us.

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Note 5--Unauthorized Trading Losses

In November 1999, we discovered that a former employee of PAA had engaged in unauthorized trading activity, resulting in losses of approximately \$174.0 million, including estimated associated costs and legal expenses. Approximately \$7.1 million of the unauthorized trading losses were recognized in 1998 and the remainder in 1999. In 2000, we recognized an additional \$8.0 million charge for litigation related to the unauthorized trading losses.

Note 6--PAA Acquisitions and Dispositions

Scurlock Acquisition

On May 12, 1999, PAA completed the acquisition of Scurlock Permian LLC ("Scurlock") and certain other pipeline assets from Marathon Ashland Petroleum LLC. Including working capital adjustments and closing and financing costs, the cash purchase price was approximately \$141.7 million.

Financing for the Scurlock acquisition was provided through: (i) borrowings of approximately \$92.0 million under a PAA bank facility; (ii) the sale to the general partner of 1.3 million Class B common units of PAA for a total cash consideration of \$25.0 million, or \$19.125 per unit, the price equal to the market value of PAA's common units on May 12, 1999; and (iii) a \$25.0 million draw under PAA's existing revolving credit agreement.

The funds for the purchase of the Class B units by the general partner were provided by a capital contribution from us. We financed our capital contribution through our revolving credit facility.

The assets, liabilities and results of operations of Scurlock are included in our consolidated financial statements effective May 1, 1999. The Scurlock

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acquisition has been accounted for using the purchase method of accounting and the purchase price was allocated in accordance with Accounting Principles Board Opinion No. 16, Business Combinations ("APB 16") as follows (in thousands):

| | |
|--|-----------|
| Crude oil pipeline, gathering and terminal assets..... | \$125,120 |
| Other property and equipment..... | 1,546 |
| Pipeline linefill..... | 16,057 |
| Other assets (debt issue costs)..... | 3,100 |
| Other long-term liabilities (environmental accrual)..... | (1,000) |
| Net working capital items..... | (3,090) |
| | ----- |
| Cash paid..... | \$141,733 |
| | ===== |

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Pro Forma Results for the Scurlock Acquisition

The following unaudited pro forma data is presented to show pro forma revenues, net loss and basic and diluted net loss per share for the year ended December 31, 1999 as if the Scurlock acquisition, which was effective May 1, 1999, had occurred on January 1, 1999 (in thousands, except per share data):

| | |
|--|--------------|
| Revenues..... | \$11,323,577 |
| | ===== |
| Net loss..... | \$ (27,147) |
| | ===== |
| Net loss per share available to common stockholders: | |
| Basic and diluted..... | \$ (2.15) |
| | ===== |

All American Pipeline Linefill Sale and Asset Disposition

In March 2000, PAA sold the segment of the All American Pipeline that extends from Emidio, California to McCamey, Texas to a unit of El Paso Corporation for \$129.0 million. PAA realized net proceeds of approximately \$124.0 million after the associated transaction costs and estimated costs to remove some equipment. The proceeds from the sale were used to reduce the outstanding debt of PAA. PAA recognized a gain of approximately \$20.1 million in connection with the sale.

PAA had suspended shipments of crude oil on this segment of the pipeline in November 1999. At that time, PAA owned approximately 5.2 million barrels of crude oil in the segment of the pipeline. PAA sold this crude oil from November 1999 to February 2000 for net proceeds of approximately \$100.0 million and recognized gains of approximately \$28.1 million and \$16.5 million in 2000 and 1999, respectively, in connection with the sale of the linefill.

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Note 7--Redeemable Preferred Stock

Series F Cumulative Convertible Preferred Stock

On December 14, 1999, we sold in a private placement 50,000 shares of Series F Preferred Stock for \$50.0 million. As discussed in Note 2, in conjunction with the Transactions we redeemed 23,108 shares of the Series F Preferred Stock and the remaining 26,892 shares were converted into 2.2 million shares of our common stock. Each share of the Series F Preferred Stock had a stated value of \$1,000 per share and bore a dividend of 10% per annum. Dividends were payable semi-annually in either cash or additional shares of Series F Preferred Stock at our option and were cumulative from the date of issue. Dividends paid in additional shares of Series F Preferred Stock were limited to an aggregate of six dividend periods. Each share of Series F Preferred Stock was convertible into 81.63 shares of common stock (an initial effective conversion price of \$12.25 per share). At December 31, 2000 there were 50,000 shares of Series F Preferred Stock outstanding.

The Series F Preferred Stock is stated at liquidation preference on the consolidated balance sheet at December 31, 2000. Liquidation preference represents the number of shares outstanding multiplied by the stated value of the shares. Any unpaid cash dividends are accrued in accounts payable and other current liabilities on the consolidated balance sheet.

Series E and Series G Convertible Preferred Stock

In July 1998 we issued \$85.0 million of Series E Cumulative Convertible Preferred Stock (the "Series E Preferred Stock"). Each share of the Series E Preferred Stock had a stated value of \$500 per share and bore a dividend of 9.5% per annum. Dividends were payable semi-annually in either

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

cash or additional shares of Series E Preferred Stock at our option and were cumulative from the date of issue. Each share of Series E Preferred Stock was convertible into 27.78 shares of common stock (an initial effective conversion price of \$18.00 per share). In February 2000 each outstanding share of the Series E Preferred Stock was exchanged for a share of a new Series G Cumulative Convertible Preferred Stock (the "Series G Preferred Stock") which had a conversion price of \$15.00 per share. Other than the reduced conversion price, the terms of the Series G Preferred Stock were substantially identical to those of the Series E Preferred Stock.

In December 2000, we exchanged or redeemed all of the shares of Series G Preferred Stock that had not been previously converted into shares of common stock. We exchanged 169,571 shares of Series G Preferred Stock for 169,571 shares of Series H Preferred Stock and in connection therewith paid \$2.0 million, the amount equal to accrued dividends, and converted 1,825 shares of Series G Preferred Stock into 62,226 shares of common stock. The remaining 213 shares of the Series G Preferred Stock were redeemed at 105% of stated value in accordance with the original terms. In connection with that redemption, we paid \$114,000 consisting of \$112,000 for stated value and \$2,000 for accrued and unpaid dividends.

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Note 8--Common Stock and Non-Redeemable Preferred Stock

Common and Preferred Stock

We have authorized capital stock consisting of 50.0 million shares of common stock, \$0.10 par value, and 2 million shares of preferred stock, \$1.00 par value. At December 31, 2001 and 2000, there were 23.6 million shares and 17.5 million shares of common stock outstanding (net of treasury shares), respectively, and 46,600 and 266,171 shares of preferred stock outstanding.

Stock Warrants and Options

At December 31, 2001, we had a warrant outstanding which entitles the holder thereof to purchase an aggregate 150,000 shares of common stock at \$25.00 per share expiring in 2002. We have various stock option plans for our employees and directors (see Note 14).

Series D Cumulative Convertible Preferred Stock

In November 1997, we issued 46,600 shares of Series D Cumulative Convertible Preferred Stock (the "Series D Preferred Stock"). The Series D Preferred Stock has an aggregate stated value of \$23.3 million and is redeemable at our option at 140% of stated value. If not previously redeemed or converted, the Series D Preferred Stock will automatically convert into 932,000 shares of common stock in 2012. Each share of the Series D Preferred Stock has a stated value of \$500 and is convertible into common stock at a ratio of \$25.00 of stated value for each share of Common Stock to be issued. The Series D Preferred Stock bears an annual dividend of \$30.00 per share.

Series H Convertible Preferred Stock

In December 2000, we exchanged 169,571 shares of Series G Preferred Stock for 169,571 shares of Series H Preferred Stock. The Series H Preferred Stock was convertible into the same number of shares of common stock as the Series G Preferred Stock (33.33 shares of common), but did not bear a dividend and did not contain a mandatory redemption feature. As discussed in Note 2, in conjunction with the Transactions, 132,022 shares of the Series H Preferred Stock were converted into 4.4 million shares of our common stock. In the third quarter of 2001 the remaining outstanding shares were converted into 1.2 million common shares.

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Treasury Stock

Our Board of Directors has authorized the repurchase of up to eight million shares of our common stock. In 2001, we repurchased 2.8 million common shares at a cost of \$67.7 million, and in 2000 we repurchased 1.3 million common shares at a cost of \$23.6 million.

Note 9--Earnings Per Share

The following is a reconciliation of the numerators and the denominators of the basic and diluted earnings per share computations for income (loss) from continuing operations before extraordinary items and the cumulative effect of

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accounting change for the years ended December 31, 2001, 2000 and 1999 (in thousands, except per share amounts):

| | For the Year Ended December 31, | | | | | | |
|--|---------------------------------|-------------------------|------------------------|-----------------------|-------------------------|------------------------|-----------------------|
| | 2001 | | | 2000 | | | |
| | Income (Numerator) | Shares (Denominator) | Per Share Amount | Income (Numerator) | Shares (Denominator) | Per Share Amount | Income (Numerator) |
| Income (loss) before extraordinary item and cumulative effect of accounting change.. | \$155,317 | | | \$45,924 | | | \$ (24,787) |
| Less: preferred stock dividends.... | (27,245) | | | (14,725) | | | (10,026) |
| Income (loss) available to common stockholders..... | 128,072 | 21,090 | \$6.07 | 31,199 | 17,845 | \$1.75 | (34,813) |
| Effect of dilutive securities: | | | | | | | |
| Preferred Stock conversion..... | 3,365 | 5,280 | | 14,725 | 10,673 | | |
| Employee stock options and warrants..... | -- | 874 | | -- | 855 | | -- |
| Income (loss) available to common stockholders assuming dilution.. | \$131,437 | 27,244 | \$4.82 | \$45,924 | 29,373 | \$1.56 | \$ (34,813) |

In 1999, we recorded a net loss and our options and warrants were not included in the computations of diluted earnings per share because their assumed conversion was antidilutive. In addition, our preferred stock that was outstanding at December 31, 1999 was convertible into 7.0 million shares of common stock but was not included in the computation of diluted earnings per share in 1999 because the effect was antidilutive. See Note 14 for additional information concerning outstanding options and warrants.

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Note 10--Income Taxes

Our deferred income tax assets and liabilities at December 31, 2001 and 2000 consist of the tax effect of income tax carryforwards and differences

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related to the timing of recognition of certain types of costs as follows (in thousands):

| | December 31, | |
|---|--------------|----------|
| | 2001 | 2000 |
| U.S. Federal | | |
| Deferred tax assets: | | |
| Net operating losses..... | \$ 18,142 | \$64,370 |
| Percentage depletion..... | 2,450 | 2,450 |
| Tax credit carryforwards..... | 8,988 | 4,662 |
| Excess outside tax basis over outside book basis..... | 9,979 | 24,504 |
| Other..... | 4,926 | 1,669 |
| | 44,485 | 97,655 |
| Deferred tax liabilities: | | |
| Net oil & gas acquisition, exploration and development costs..... | (63,693) | (42,946) |
| Commodity hedging contracts and other | (9,028) | -- |
| Net deferred tax asset (liability)..... | (28,236) | 54,709 |
| Valuation allowance..... | (2,450) | (2,555) |
| | (30,686) | 52,154 |
| Foreign | | |
| Excess outside tax basis over outside book basis..... | 466 | -- |
| States | | |
| Deferred tax liability..... | (14,074) | (4,180) |
| Net deferred tax assets (liability)..... | \$ (44,294) | \$47,974 |

At December 31, 2001, we have carryforwards of approximately \$51.8 million of regular tax net operating losses ("NOL"), \$7.0 million of statutory depletion, \$5.1 million of alternative minimum tax credits and \$3.8 million of enhanced oil recovery credits. At December 31, 2001, we also had approximately \$34.1 million of alternative minimum tax NOL carryforwards available as a deduction against future alternative minimum tax income. The NOL carryforwards expire in 2019.

Set forth below is a reconciliation between the income tax provision (benefit) computed at the United States statutory rate on income (loss) before income taxes and the income tax provision in the accompanying consolidated statements of operations (in thousands):

| | Year Ended December 31, | | |
|--|-------------------------|----------|------------|
| | 2001 | 2000 | 1999 |
| U.S. federal income tax provision at statutory rate..... | \$ 89,872 | \$25,028 | \$(15,842) |
| State income taxes, net of federal benefit..... | 10,050 | 2,018 | (1,298) |

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| | | | |
|--|-----------|----------|------------|
| Foreign income taxes, net of federal benefit..... | 916 | -- | -- |
| Full cost ceiling test limitation..... | -- | -- | (3,617) |
| Other..... | 622 | (1,463) | 278 |
| | ----- | ----- | ----- |
| Income tax expense (benefit) on income before extraordinary item..... | 101,460 | 25,583 | (20,479) |
| Income tax benefit allocated to extraordinary item..... | -- | (3,190) | (293) |
| Income tax benefit allocated to cumulative effect of accounting change..... | (1,270) | (76) | -- |
| | ----- | ----- | ----- |
| Income tax (benefit) provision..... | \$100,190 | \$22,317 | \$(20,772) |
| | ===== | ===== | ===== |

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

In accordance with certain provisions of the Tax Reform Act of 1986, a change of greater than 50% of our beneficial ownership within a three-year period (an "Ownership Change") will place an annual limitation on our ability to utilize our existing tax carryforwards. Under the Final Treasury Regulations issued by the Internal Revenue Service, we do not believe that an Ownership Change has occurred as of December 31, 2001.

Note 11--Early Extinguishment of Debt

In 2000, PAA recognized a \$15.2 million extraordinary loss (\$5.0 million net of minority interest of \$7.0 million and deferred income taxes of \$3.2 million) consisting primarily of unamortized debt issue costs related to the refinancing of PAA's credit facilities. In addition, interest and other income for 2000 includes \$4.4 million of previously deferred net gains from interest rate swaps terminated as a result of the debt extinguishment. In 1999, PAA recognized a \$1.5 million extraordinary loss (\$0.5 million net of minority interest of \$0.7 million and deferred tax of \$0.3 million) related to the write-off of certain debt issue costs and penalties associated with the prepayment of debt.

Note 12--Related Party Transactions

Reimbursement of Expenses of the General Partner and Its Affiliates

Prior to the Transactions, the general partner of PAA was a wholly-owned subsidiary of Plains. As a result of the Transactions another entity was named general partner and our ownership in that entity is 44%. Previously, we had sole responsibility for conducting PAA's business and managing its operations. We did not receive any management fee or other compensation in connection with the management of PAA's business, but were reimbursed for all direct and indirect expenses incurred on its behalf. For the period from January 1, 2001 to June 8, 2001, and for the years ended December 31, 2000 and 1999, we were reimbursed approximately \$31.2 million, \$63.8 million and \$44.7 million, respectively, for direct and indirect expenses on PAA's behalf. The reimbursed costs consisted primarily of employee salaries and benefits. PAA does not employ any persons to manage its business. These functions are provided by employees of the general partner.

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Crude Oil Marketing Agreement

PAA is the exclusive marketer/purchaser for all of our equity crude oil production. The marketing agreement provides that PAA will purchase for resale at market prices all of our equity crude oil production for which PAA charges a fee of \$0.20 per barrel. For the years ended December 31, 2001, 2000 and 1999, we paid approximately \$223.1 million, \$244.9 million and \$131.5 million, respectively, for the purchase of crude oil under the agreement, including the royalty share of production.

Financing

In December 1999, we loaned PAA \$114.0 million, which was repaid in May 2000. Interest on the notes was \$3.3 million and \$0.6 million for the years ended December 31, 2000 and 1999, respectively.

Transaction Grant Agreements

In 1998, at no cost to PAA, we agreed to grant 400,000 of our PAA common units (including distribution equivalent rights attributable to such units) to certain key officers and employees of the general partner and its affiliates. The grants vested over a three year period subject to PAA paying

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

distributions on common and subordinated units. Of these grants, 69,000 vested in 1999 and 133,000 vested in 2000. The remaining grants vested in 2001 as a result of the Transactions. PAA recognized noncash compensation expense related to the transaction grants of approximately \$4.8 million, \$2.7 million and \$1.0 million in the years ended December 31, 2001, 2000, and 1999, respectively, and we reflected capital contributions of a similar amount. The noncash compensation is included in general and administrative expense in the Consolidated Statements of Operations for the years ended December 31, 2000 and 1999. Our share of this expense is included in our equity in the earnings of PAA in 2001.

Note 13--Benefit Plans

We have a nonqualified retirement plan (the "Plan") for certain of our officers. Benefits under the Plan are based on salary at the time of adoption, vest over a 15-year period and are payable over a 15-year period commencing at age 60. The Plan is unfunded.

Net pension expense for the years ended December 31, 2001, 2000 and 1999 is comprised of the following components (in thousands):

| | Year Ended December 31, | | |
|--|----------------------------|-------|-------|
| | 2001 | 2000 | 1999 |
| | ---- | ---- | ---- |
| Service cost--benefits earned during the period..... | \$156 | \$ 99 | \$109 |
| Interest on projected benefit obligation..... | 131 | 96 | 83 |
| Amortization of prior service cost..... | 31 | 37 | 37 |

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| | | | |
|--------------------------|-------|-------|-------|
| Unrecognized loss..... | 17 | -- | 6 |
| | ---- | ---- | ---- |
| Net pension expense..... | \$335 | \$232 | \$235 |
| | ==== | ==== | ==== |

Summarized information of our retirement plan for the periods indicated is as follows (in thousands):

| | December 31, | |
|--|--------------|------------|
| | 2001 | 2000 |
| | ----- | ----- |
| Change in benefit obligation: | | |
| Benefit obligation at beginning of year..... | \$ 1,821 | \$ 1,233 |
| Service cost..... | 155 | 99 |
| Interest cost..... | 131 | 96 |
| Settlement losses..... | 271 | -- |
| Special termination benefits..... | -- | 175 |
| Benefits paid..... | (67) | -- |
| Settlement payments..... | (1,159) | -- |
| Actuarial (gains) losses..... | 755 | 218 |
| | ----- | ----- |
| Benefit obligation at end of year..... | \$ 1,907 | \$ 1,821 |
| | ===== | ===== |
| Amounts recognized in the consolidated balance sheets: | | |
| Projected benefit obligation for service rendered to date..... | \$ 1,907 | \$ 1,821 |
| Plan assets at fair value..... | -- | -- |
| | ----- | ----- |
| Benefit obligation in excess of fair value of plan assets..... | (1,907) | (1,821) |
| Unrecognized (gain) loss..... | 720 | 185 |
| Unrecognized prior service costs..... | 310 | 508 |
| Adjustment to recognize minimum liability..... | (1,030) | (693) |
| | ----- | ----- |
| Net amount recognized..... | \$ (1,907) | \$ (1,821) |
| | ===== | ===== |

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

The weighted-average discount rate used in determining the projected benefit obligation was 7.25% and 7.5% for the years ended December 31, 2001 and 2000, respectively.

We also maintain a 401(k) defined contribution plan whereby we match 100% of an employee's contribution (subject to certain limitations in the plan). Matching contributions are made 50% in cash and 50% in common stock of the Company, with the number of shares for the stock match based on the market value of the common stock at the time the shares are granted. For the years ended December 31, 2001, 2000 and 1999, defined contribution plan expense was

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\$0.3 million, \$1.4 million and \$1.0 million, respectively. Such expense for 2000 and 1999 includes amounts attributable to employees of the general partner of PAA.

Note 14--Stock Compensation Plans

Stock Options

Historically, we have used stock options as a long-term incentive for our employees, officers and directors under various stock option plans. We have options outstanding under our 2001 and 1996 plans, under which a maximum of 5.6 million shares of common stock were reserved for issuance. Generally, the options are granted: (i) at an exercise price equal to or greater than the market price of the underlying stock on the date of grant; and (ii) with a pro rata vesting period of two to five years and an exercise period of five to ten years. Certain options have vesting provisions related to the market price of our common stock. If such options do not vest under such provisions, they vest at the end of a five-year period.

Performance options to purchase a total of 500,000 shares of common stock were granted to two executive officers in 1996. Terms of the options provided for an exercise price of \$13.50, the market price on the date of grant, and were to vest if shares of our common stock traded at or above \$24.00 per share for any 20 trading days in any 30 consecutive trading day period prior to August 2001, or upon a change in control if certain conditions were met. The performance options vested in the second quarter of 2001 and we recognized \$4.0 million of noncash compensation expense, which is included in general and administrative expense.

In May 2001 we granted options on 2,250,000 shares under the terms of our 2001 plan subject to the approval of such plan by our board of directors. The market price of our common stock at the time the plan was approved in July 2001 exceeded the exercise price with respect to 1,450,000 of such options and, accordingly, we recognized noncash compensation with respect to such options. During 2001, \$0.3 million in compensation expense with respect to such options is included in general and administrative expense.

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

A summary of the status of our stock options as of December 31, 2001, 2000, and 1999, and changes during the years ending on those dates are presented below (shares in thousands):

| | 2001 | | 2000 | | 1999 | |
|--|--------|--|--------|--|--------|--|
| | Shares | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price |
| Fixed Options | | | | | | |
| Outstanding at beginning of year..... | 2,749 | \$12.11 | 2,811 | \$11.06 | 2,749 | \$10.53 |

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| | | | | | | |
|---|---------|---------|--------|---------|--------|---------|
| Granted..... | 2,464 | 24.02 | 419 | 13.91 | 237 | 15.09 |
| Exercised..... | (1,431) | 11.51 | (444) | 6.96 | (158) | 7.94 |
| Forfeited..... | (115) | 14.06 | (37) | 14.37 | (17) | 9.93 |
| | ----- | | ----- | | ----- | |
| Outstanding at end of year..... | 3,667 | \$20.30 | 2,749 | \$12.11 | 2,811 | \$11.06 |
| | ===== | | ===== | | ===== | |
| Options exercisable at year-end..... | 1,084 | \$13.32 | 1,708 | \$11.07 | 1,836 | \$ 9.50 |
| | ===== | | ===== | | ===== | |
| Weighted-average fair value of options granted during the year..... | \$10.12 | | \$5.39 | | \$5.40 | |

In October 1995, the Financial Accounting Standards Board issued SFAS 123, which established financial accounting and reporting standards for stock-based employee compensation. SFAS 123 defines a fair value based method of accounting for an employee stock option or similar equity instrument. SFAS 123 also allows an entity to continue to measure compensation cost for those instruments using the intrinsic value-based method of accounting prescribed by APB 25. We have elected to follow APB 25 and related interpretations in accounting for our employee stock options because, as discussed below, the alternative fair value accounting provided for under SFAS 123 requires the use of option valuation models that were not developed for use in valuing employee stock options. Under APB 25, because the exercise price of our employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense has been recognized in the accompanying financial statements.

Pro forma information regarding net income (loss) and earnings per share is required by SFAS 123 and has been determined as if we had accounted for our employee stock options under the fair value method as provided therein. The fair value for the options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions for grants in 2001, 2000 and 1999: risk-free interest rates of 2.5% for 2001, 6.3% for 2000, and 5.1% for 1999; a volatility factor of the expected market price of our common stock of .0.50 for 2001, 0.50 for 2000 and 0.50 for 1999; no expected dividends; and weighted average expected option lives of 5.3 years in 2001, 2.6 years in 2000 and 2.7 years in 1999. For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period.

The Black-Scholes option valuation model and other existing models were developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of and are highly sensitive to subjective assumptions including the expected stock price volatility. Because our employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not provide a reliable single measure of the fair value of its employee stock options.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

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Set forth below is a summary of our net income (loss) before extraordinary item and earnings per share as reported and pro forma as if the fair value based method of accounting defined in SFAS 123 had been applied (in thousands, except per share data).

| | Year Ended December 31, | | |
|---|-------------------------|----------|------------|
| | 2001 | 2000 | 1999 |
| As Reported: | | | |
| Net income (loss) before extraordinary item and cumulative effect of accounting change..... | \$155,317 | \$45,924 | \$(24,787) |
| Net income (loss) per common share, basic..... | 6.07 | 1.75 | (2.02) |
| Net income (loss) per common share, diluted..... | 4.82 | 1.56 | (2.02) |
| Pro Forma: | | | |
| Net income (loss) before extraordinary item and cumulative effect of accounting change..... | \$152,335 | \$45,132 | \$(25,125) |
| Net income (loss) per common share, basic..... | 5.93 | 1.70 | (2.04) |
| Net income (loss) per common share, diluted..... | 4.72 | 1.54 | (2.04) |

The following table summarizes information about stock options outstanding at December 31, 2001 (share amounts in thousands):

| Range of Exercise Price | Number Outstanding at 12/31/01 | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Number Exercisable at 12/31/01 | Weighted Average Exercise Price |
|----------------------------|--------------------------------------|---|--|--------------------------------------|--|
| \$ 6.25 to \$14.19 | 702 | 2.4 years | \$10.08 | 542 | \$ 8.97 |
| 14.31 to 21.12 | 508 | 1.9 years | 16.39 | 461 | 16.43 |
| 23.00 to 23.00 | 1,000 | 9.4 years | 23.00 | -- | -- |
| 23.74 to 25.30 | 1,457 | 5.0 years | 24.74 | 81 | 24.73 |
| \$ 6.25 to \$25.30 | 3,667 | 5.3 years | \$20.30 | 1,084 | \$13.32 |

Share Grant

In May 2001, an officer was granted the right to receive an amount, payable in our common stock, equal to the excess of the "fair market value" (as defined in our 2001 plan) of a share of common stock on the effective date and \$22.00, multiplied by one million. On the effective date, May 8, 2001, the closing price of our common stock was \$23.00 and accordingly, the employee will receive \$1.0 million, to be paid in five annual installments as of each anniversary of the effective date, in the form of a direct grant of shares of common stock. The number of shares is determined by dividing the annual installment by the fair market value of a share on the applicable anniversary date. We will recognize \$1.0 million of noncash compensation expense ratably over the five-year period. General and administrative expense for 2001 includes \$0.3 million in compensation expense with respect to this share grant.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Note 15--Commitments, Contingencies and Industry Concentration

Commitments and Contingencies

We lease certain real property, equipment and operating facilities under various operating leases. Future non-cancelable commitments related to these items at December 31, 2001, are summarized below (in thousands):

| | |
|-----------------|-------|
| 2002..... | \$616 |
| 2003..... | 593 |
| 2004..... | 595 |
| 2005..... | 573 |
| 2006..... | 143 |
| Thereafter..... | -- |

Total expenses related to these commitments for the years ended December 31, 2001, 2000 and 1999 were \$0.7 million, \$7.3 million and \$9.3 million, respectively. Such amounts for 2000 and 1999 include \$6.7 million and \$8.8 million, respectively, attributable to PAA.

Under the amended terms of an asset purchase agreement with respect to certain of our onshore California properties, commencing with the year beginning January 1, 2000, and each year thereafter, we are required to plug and abandon 20% of the then remaining inactive wells, which currently aggregate approximately 149. To the extent we elect not to plug and abandon the number of required wells, we are required to escrow an amount equal to the greater of \$25,000 per well or the actual average plugging cost per well in order to provide for the future plugging and abandonment of such wells. In addition, we are required to expend a minimum of \$600,000 per year in each of the ten years beginning January 1, 1996, and \$300,000 per year in each of the succeeding five years to remediate oil contaminated soil from existing well sites, provided there are remaining sites to be remediated. In the event we do not expend the required amounts during a calendar year, we are required to contribute an amount equal to 125% of the actual shortfall to an escrow account. We may withdraw amounts from the escrow account to the extent we expend excess amounts in a future year. Through December 31, 2001, we have not been required to make contributions to an escrow account.

In connection with the acquisition of our interest in the Point Arguello field, offshore California, we assumed our 26% share of (1) plugging and abandoning all existing well bores, (2) removing conductors, (3) flushing hydrocarbons from all lines and vessels and (4) removing/abandoning all structures, fixtures and conditions created subsequent to closing. The seller retained the obligation for all other abandonment costs, including but not limited to (1) removing, dismantling and disposing of the existing offshore platforms, (2) removing and disposing of all existing pipelines and (3) removing, dismantling, disposing and remediation of all existing onshore facilities.

Although we obtained environmental studies on our properties in California, Florida and Illinois and we believe that such properties have been operated in accordance with standard oil field practices, certain of the fields have been in operation for more than 90 years, and current or future local, state and federal environmental laws and regulations may require substantial

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expenditures to comply with such rules and regulations. In connection with the purchase of certain of our onshore California properties, we received a limited indemnity for certain conditions if they violate applicable local, state and federal environmental laws and regulations in effect on the date of such agreement. We believe that we do not have any material obligations for operations conducted prior to our acquisition of the properties, other than our obligation to plug existing wells and those normally associated with

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customary oil field operations of similarly situated properties, there can be no assurance that current or future local, state or federal rules and regulations will not require us to spend material amounts to comply with such rules and regulations or that any portion of such amounts will be recoverable under the indemnity.

Consistent with normal industry practices, substantially all of our crude oil and natural gas leases require that, upon termination of economic production, the working interest owners plug and abandon non-producing wellbores, remove tanks, production equipment and flow lines and restore the wellsite. We have estimated that the costs to perform these tasks is approximately \$17.0 million, net of salvage value and other considerations. Such estimated costs are amortized to expense through the unit-of-production method as a component of accumulated depreciation, depletion and amortization. Results from operations for 2001, 2000 and 1999 each include \$0.5 million of expense associated with these estimated future costs. For valuation and realization purposes of the affected crude oil and natural gas properties, these estimated future costs are also deducted from estimated future gross revenues to arrive at the estimated future net revenues and the Standardized Measure disclosed in Note 19.

As is common within the industry, we have entered into various commitments and operating agreements related to the exploration and development of and production from proved crude oil and natural gas properties and the marketing, transportation, terminalling and storage of crude oil. It is management's belief that such commitments will be met without a material adverse effect on our financial position, results of operations or cash flows.

Industry Concentration

Financial instruments which potentially subject us to concentrations of credit risk consist principally of accounts receivable with respect to our oil and gas operations and derivative instruments related to our hedging activities. PAA is the exclusive marketer/purchaser for all of our equity oil production. This concentration has the potential to impact our overall exposure to credit risk, either positively or negatively, in that PAA may be affected by changes in economic, industry or other conditions. We do not believe the loss of PAA as the exclusive purchaser of our equity production would have a material adverse effect on our results of operations. We believe PAA could be replaced by other purchasers under contracts with similar terms and conditions. The contract counterparties for our derivative commodity contracts are all major financial institutions with Standard & Poor's ratings of A or better. Three of the financial institutions are participating lenders in our revolving credit facility, with one such counterparty holding contracts that represent approximately 37% of the fair value of all open positions at December 31, 2001.

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There are a limited number of alternative methods of transportation for our production. Substantially all of our oil and gas production is transported by pipelines, trucks and barges owned by third parties. The inability or unwillingness of these parties to provide transportation services to us for a reasonable fee could result in our having to find transportation alternatives, increased transportation costs or involuntary curtailment of a significant portion of our oil and gas production which could have a negative impact on future results of operations or cash flows.

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Note 16--Litigation

Texas Securities Litigation. In November and December of 1999, class action lawsuits were filed in the United States District Court for the Southern District of Texas alleging that PAA, and certain of the general partner's officers and directors violated federal securities laws, primarily in connection with unauthorized trading by a former employee. The consolidated class action filed by purchasers of our common stock and options is captioned *Koplovitz v. Plains Resources Inc., et al.* The consolidated action filed by purchasers of PAA's common units is captioned *Di Giacomo v. Plains All American Pipeline, L.P., et al.*

We and PAA reached an agreement with representatives for the plaintiffs for the settlement of all of the class actions, and in January 2001, PAA deposited approximately \$30.0 million under the terms of the settlement agreement. The total cost of the settlement to us and PAA, including interest and expenses, and after insurance reimbursements, was \$14.9 million. Of that amount, \$1.0 million was allocated to us by agreement between special independent committees of our board of directors and the board of directors of Plains Holdings Inc. (formerly known as Plains All American Inc.), the then general partner of PAA. The settlement has received final approval by the court. The settlement agreement does not affect the Texas Derivative Litigation and Delaware Derivative Litigation described below.

Delaware Derivative Litigation. Beginning December 3, 1999 derivative lawsuits were filed in the Delaware Chancery Court, New Castle County naming Plains Holdings Inc., the then general partner of PAA, its directors and certain of its officers as defendants, alleging that the defendants breached the fiduciary duties they owed to PAA and its unitholders by failing to monitor properly the activities of its employees. The court has consolidated all of the cases under the caption *In Re Plains All American Inc. Shareholders Litigation*. A motion to dismiss was filed on behalf of the defendants on August 11, 2000.

An agreement has been reached with the plaintiffs to settle the Delaware litigation by PAA making an aggregate payment of approximately \$1.1 million. On March 6, 2002 the Delaware court approved this settlement.

Texas Derivative Litigation. On July 11, 2000, a derivative lawsuit was filed in the United States District Court for the Southern District of Texas entitled *Fernandez v. Plains All American Inc., et al.*, naming Plains Holdings Inc., the then general partner of PAA, its directors and certain of its officers as defendants. This lawsuit contains the same claims and seeks the

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same relief as the Delaware derivative litigation described above. A motion to dismiss was filed on behalf of the defendants on August 14, 2000. PAA has reached an agreement in principle to settle the Texas derivative litigation. The settlement, which is subject to court approval, contemplates a payment of \$112,500 by PAA and does not contemplate any payment by the Company.

We, in the ordinary course of business, are a claimant and/or defendant in various other legal proceedings. Management does not believe that the outcome of these legal proceedings, individually and in the aggregate, will have a materially adverse effect on our financial condition, results of operations or cash flows.

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Note 17--Financial Instruments

The following disclosure of the estimated fair value of financial instruments is made in accordance with the requirements of Statement of Financial Accounting Standards No. 107, Disclosures About Fair Value of Financial Instruments ("SFAS 107"). The estimated fair value amounts have been determined using available market information and valuation methodologies described below. Considerable judgment is required in interpreting market data to develop the estimates of fair value. The use of different market assumptions or valuation methodologies may have a material effect on the estimated fair value amounts.

The carrying values of items comprising current assets and current liabilities approximate fair values due to the short-term maturities of these instruments. Derivative financial instruments included in other assets are stated at fair value. The carrying amounts and fair values of our other financial instruments are as follows (in thousands):

| | December 31, | | | |
|---------------------------|-----------------|------------|-----------------|------------|
| | 2001 | | 2000 | |
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Long-Term Debt: | | | | |
| Bank debt..... | \$11,500 | \$11,500 | \$27,300 | \$27,300 |
| Subordinated debt..... | 269,539 | 272,130 | 277,543 | 274,313 |
| Other long-term debt..... | 1,022 | 1,022 | 1,533 | 1,533 |

The carrying value of bank debt approximates its fair value, as interest rates are variable, based on prevailing market rates. The fair value of subordinated debt is based on quoted market prices based on trades of subordinated debt.

Note 18--Supplemental Disclosures of Cash Flow Information

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Selected cash payments and noncash activities were as follows (in thousands):

| | Year Ended December 31, | | |
|---|-------------------------|----------|-----------|
| | 2001 | 2000 | 1999 |
| Cash paid for interest (net of amount capitalized)..... | \$27,939 | \$56,154 | \$44,329 |
| Cash paid for taxes..... | \$ 7,048 | \$ 987 | \$ 548 |
| Noncash sources and (uses) of investing and financing activities: | | | |
| Series D Preferred Stock dividends..... | \$ -- | \$ -- | \$(1,354) |
| Exchange of preferred stock for common stock.... | \$ -- | \$ 62 | \$ 71 |
| Series E Preferred Stock dividends..... | \$ -- | \$ -- | \$(2,030) |
| Tax benefit from exercise of employee stock options..... | \$ 6,990 | \$ 1,901 | \$ 440 |

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Note 19--Crude Oil and Natural Gas Activities

Costs Incurred

Our oil and natural gas acquisition, exploration, exploitation and development activities are conducted in the United States. The following table summarizes the costs incurred during the last three years (in thousands).

| | Year Ended December 31, | | |
|---|-------------------------|----------|----------|
| | 2001 | 2000 | 1999 |
| Property acquisitions costs: | | | |
| Unproved properties..... | \$ 44 | \$ 73 | \$ 879 |
| Proved properties..... | 1,798 | 2,433 | 2,880 |
| Exploration costs..... | 329 | 872 | 4,101 |
| Exploitation and development costs..... | 134,304 | 77,550 | 65,119 |
| | 136,475 | \$80,928 | \$72,979 |

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Capitalized Costs

The following table presents the aggregate capitalized costs subject to amortization relating to our crude oil and natural gas acquisition, exploration, exploitation and development activities, and the aggregate related accumulated DD&A (in thousands).

| | December 31, | |
|------------------------|--------------|-----------|
| | 2001 | 2000 |
| Proved properties..... | \$900,898 | \$762,245 |
| Accumulated DD&A..... | (435,269) | (408,337) |
| | ----- | ----- |
| | \$465,629 | \$353,908 |
| | ===== | ===== |

The DD&A rate per equivalent unit of production was \$2.75, \$2.25, and \$2.13 for the years ended December 31, 2001, 2000, and 1999, respectively.

Costs Not Subject to Amortization

The following table summarizes the categories of costs comprising the amount of unproved properties not subject to amortization (in thousands).

| | December 31, | | |
|---------------------------|--------------|----------|----------|
| | 2001 | 2000 | 1999 |
| Acquisition costs..... | \$30,038 | \$34,087 | \$42,261 |
| Exploration costs..... | 3,579 | 4,456 | 4,842 |
| Capitalized interest..... | 6,890 | 4,038 | 4,928 |
| | ----- | ----- | ----- |
| | \$40,507 | \$42,581 | \$52,031 |
| | ===== | ===== | ===== |

Unproved property costs not subject to amortization consist mainly of acquisition and lease costs and seismic data related to unproved areas. We will continue to evaluate these properties over the

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

lease terms; however, the timing of the ultimate evaluation and disposition of a significant portion of the properties has not been determined. Costs associated with seismic data and all other costs will become subject to amortization as the prospects to which they relate are evaluated. Approximately 13%, 11% and 16% of the balance in unproved properties at December 31, 2001, related to additions made in 2001, 2000 and 1999,

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respectively.

During 2001, 2000 and 1999, we capitalized \$3.6 million, \$4.4 million and \$4.4 million, respectively, of interest related to the costs of unproved properties in the process of development.

Supplemental Reserve Information (Unaudited)

The following information summarizes our net proved reserves of crude oil (including condensate and natural gas liquids) and natural gas and the present values thereof for the three years ended December 31, 2001. The following reserve information is based upon reports of the independent petroleum consulting firms of Netherland, Sewell & Associates, Inc., and Ryder Scott Company in 2001, and H.J. Gruy and Associates, Inc., Netherland, Sewell & Associates, Inc., and Ryder Scott Company in 2000 and 1999. The estimates are in accordance with regulations prescribed by the SEC.

In management's opinion, the reserve estimates presented herein, in accordance with generally accepted engineering and evaluation principles consistently applied, are believed to be reasonable. However, there are numerous uncertainties inherent in estimating quantities and values of proved reserves and in projecting future rates of production and timing of development expenditures, including many factors beyond our control. Reserve engineering is a subjective process of estimating the recovery from underground accumulations of crude oil and natural gas that cannot be measured in an exact manner, and the accuracy of any reserve estimate is a function of the quality of available data and of engineering and geological interpretation and judgment. Because all reserve estimates are to some degree speculative, the quantities of crude oil and natural gas that are ultimately recovered, production and operating costs, the amount and timing of future development expenditures and future crude oil and natural gas sales prices may all differ from those assumed in these estimates. In addition, different reserve engineers may make different estimates of reserve quantities and cash flows based upon the same available data. Therefore, the Standardized Measure shown below represents estimates only and should not be construed as the current market value of the estimated crude oil and natural gas reserves attributable to our properties. In this regard, the information set forth in the following tables includes revisions of reserve estimates attributable to proved properties included in the preceding year's estimates. Such revisions reflect additional information from subsequent exploitation and development activities, production history of the properties involved and any adjustments in the projected economic life of such properties resulting from changes in product prices.

Decreases in the prices of crude oil and natural gas have had, and could have in the future, an adverse effect on the carrying value of our proved reserves and our revenues, profitability and cash flow. Almost all of our reserve base (approximately 94% of year-end 2001 reserve volumes) is comprised of crude oil properties that are sensitive to crude oil price volatility.

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Estimated Quantities of Crude Oil and Natural Gas Reserves (Unaudited)

The following table sets forth certain data pertaining to our proved and

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proved developed reserves for the three years ended December 31, 2001 (in thousands).

| | As of or for the Year Ended December 31, | | | | | |
|---|--|---------------|---------------|---------------|---------------|---------------|
| | 2001 | | 2000 | | 1999 | |
| | Oil (MBbl) | Gas (MMcf) | Oil (MBbl) | Gas (MMcf) | Oil (MBbl) | Gas (MMcf) |
| Proved Reserves | | | | | | |
| Beginning balance..... | 223,162 | 93,486 | 218,922 | 90,873 | 120,208 | 86,781 |
| Revision of previous estimates..... | (15,457) | (5,485) | (9,834) | (3,597) | 62,895 | (8,234) |
| Extensions, discoveries, improved recovery and other additions..... | 42,210 | 11,571 | 22,429 | 9,252 | 37,393 | 15,488 |
| Sale of reserves in-place..... | -- | -- | -- | -- | -- | -- |
| Purchase of reserves in-place..... | -- | -- | -- | -- | 6,442 | -- |
| Production..... | (9,279) | (3,355) | (8,355) | (3,042) | (8,016) | (3,162) |
| Ending balance..... | 240,636 | 96,217 | 223,162 | 93,486 | 218,922 | 90,873 |
| Proved Developed Reserves | | | | | | |
| Beginning balance..... | 123,532 | 52,184 | 120,141 | 49,255 | 73,264 | 58,445 |
| Ending balance..... | 134,704 | 59,101 | 123,532 | 52,184 | 120,141 | 49,255 |

Standardized Measure of Discounted Future Net Cash Flows (Unaudited)

The Standardized Measure of discounted future net cash flows relating to proved crude oil and natural gas reserves is presented below (in thousands):

| | December 31, | | |
|---|--------------|-------------|-------------|
| | 2001 | 2000 | 1999 |
| Future cash inflows..... | \$3,833,456 | \$6,057,344 | \$4,837,010 |
| Future development costs..... | (329,393) | (275,862) | (231,914) |
| Future production expense..... | (1,826,634) | (2,875,301) | (1,758,572) |
| Future income tax expense..... | (511,040) | (887,107) | (845,133) |
| Future net cash flows..... | 1,166,389 | 2,019,074 | 2,001,391 |
| Discounted at 10% per year..... | (742,981) | (1,099,413) | (1,073,591) |
| Standardized measure of discounted future net cash flows..... | \$ 423,408 | \$ 919,661 | \$ 927,800 |

The Standardized Measure of discounted future net cash flows (discounted at 10%) from production of proved reserves was developed as follows:

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1. An estimate was made of the quantity of proved reserves and the future periods in which they are expected to be produced based on year-end economic conditions.

2. In accordance with SEC guidelines, the engineers' estimates of future net revenues from our proved properties and the present value thereof are made using crude oil and natural gas sales prices in effect as of the dates of such estimates and are held constant throughout the life of the properties, except where such guidelines permit alternate treatment, including the use of

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

fixed and determinable contractual price escalations. We have entered into various arrangements to fix or limit the NYMEX crude oil price for a significant portion of our crude oil production. Arrangements in effect at December 31, 2001 are discussed in Note 3. Such arrangements are not reflected in the reserve reports. The overall average year-end prices used in the reserve reports as of December 31, 2001, were \$14.91 per barrel of crude oil and \$2.56 per Mcf of natural gas. Such prices as of December 31, 2000 were \$21.02 per barrel of crude oil and \$14.63 per Mcf of natural gas.

3. The future gross revenue streams were reduced by estimated future operating costs (including production and ad valorem taxes) and future development and abandonment costs, all of which were based on current costs.

4. The reports reflect the pre-tax Present Value of Proved Reserves to be \$0.7 billion, \$1.3 billion and \$1.2 billion at December 31, 2001, 2000 and 1999, respectively. SFAS No. 69 requires us to further reduce these estimates by an amount equal to the present value of estimated income taxes which might be payable by us in future years to arrive at the Standardized Measure. Future income taxes were calculated by applying the statutory federal and state income tax rate to pre-tax future net cash flows, net of the tax basis of the properties involved and utilization of available tax carryforwards related to oil and gas operations.

The principal sources of changes in the Standardized Measure of the future net cash flows for the three years ended December 31, 2001, are as follows (in thousands):

| | Year Ended December 31, | | |
|---|-------------------------|------------|------------|
| | 2001 | 2000 | 1999 |
| Balance, beginning of year..... | \$ 919,661 | \$ 927,800 | \$ 226,943 |
| Sales, net of production expenses..... | (144,055) | (166,571) | (60,578) |
| Net change in sales and transfer prices, net of production expenses..... | (674,439) | 96,104 | 516,097 |
| Changes in estimated future development costs..... | (18,134) | (14,593) | (52,951) |
| Extensions, discoveries and improved | | | |

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| | | | |
|---|------------|------------|------------|
| recovery, net of costs..... | 94,775 | 141,638 | 112,573 |
| Previously estimated development costs incurred during the year..... | 87,721 | 31,363 | 22,842 |
| Purchase of reserves in-place..... | -- | -- | 53,724 |
| Revision of quantity estimates..... | (166,869) | (104,200) | 404,705 |
| Accretion of discount..... | 145,375 | 115,605 | 22,694 |
| Net change in income taxes..... | 179,373 | (107,485) | (318,249) |
| | ----- | ----- | ----- |
| Balance, end of year..... | \$ 423,408 | \$ 919,661 | \$ 927,800 |
| | ===== | ===== | ===== |

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Results of Operations for Oil and Gas Producing Activities

The results of operations from oil and gas producing activities below exclude non-oil and gas revenues, general and administrative expenses, interest charges, interest income and interest capitalized. Income tax (expense) or benefit was determined by applying the statutory rates to pretax operating results (in thousands).

| | Year Ended December 31, | | |
|--|-------------------------|-----------|-----------|
| | 2001 | 2000 | 1999 |
| | ----- | ----- | ----- |
| Revenues from oil and gas producing activities... | \$215,247 | \$149,342 | \$116,223 |
| Production costs..... | (71,192) | (62,140) | (55,645) |
| Depreciation, depletion and amortization..... | (27,009) | (19,953) | (18,177) |
| Income tax expense..... | (45,987) | (26,227) | (16,536) |
| | ----- | ----- | ----- |
| Results of operations from producing activities (excluding corporate overhead and interest costs)..... | \$ 71,059 | \$ 41,022 | \$ 25,865 |
| | ===== | ===== | ===== |

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Note 20--Quarterly Financial Data (Unaudited)

The following table shows summary financial data for 2001 and 2000 (in thousands, except per share data):

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| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter(1) | Total |
|---|------------------|-------------------|------------------|----------------------|-------------|
| 2001 | | | | | |
| Revenues..... | \$ 58,232 | \$ 58,424 | \$ 54,168 | \$ 44,896 | \$ 215,720 |
| Operating profit..... | 31,172 | 22,510 | 25,217 | 15,415 | 94,314 |
| Income before cumulative effect of accounting change..... | 20,952 | 100,102 | 15,154 | 19,109 | 155,317 |
| Cumulative effect of accounting change..... | (1,986) | -- | -- | -- | (1,986) |
| Net income..... | 18,966 | 100,102 | 15,154 | 19,109 | 153,331 |
| Basic EPS | | | | | |
| Income before cumulative effect of accounting change..... | 1.11 | 3.83 | 0.63 | 0.79 | 6.07 |
| Cumulative effect of accounting change..... | (0.11) | -- | -- | -- | (0.09) |
| Net income..... | 1.00 | 3.83 | 0.63 | 0.79 | 5.98 |
| Diluted EPS | | | | | |
| Income before cumulative effect of accounting change..... | 0.72 | 2.68 | 0.58 | 0.75 | 4.82 |
| Cumulative effect of accounting change..... | (0.06) | -- | -- | -- | (0.07) |
| Net income..... | 0.66 | 2.68 | 0.58 | 0.75 | 4.75 |
| 2000 | | | | | |
| Revenues..... | \$2,087,685 | \$1,427,044 | \$1,542,463 | \$1,573,393 | \$6,630,585 |
| Operating profit..... | 53,502 | 54,400 | 48,706 | 55,660 | 212,268 |
| Income before extraordinary item and cumulative effect of accounting change..... | 21,268 | 8,992 | 7,026 | 8,638 | 45,924 |
| Extraordinary item..... | (1,365) | (3,623) | -- | -- | (4,988) |
| Cumulative effect of accounting change..... | (121) | -- | -- | -- | (121) |
| Net income..... | 19,782 | 5,369 | 7,026 | 8,638 | 40,815 |
| Basic EPS | | | | | |
| Income before extraordinary item and cumulative effect of accounting change..... | 0.98 | 0.29 | 0.19 | 0.29 | 1.75 |
| Extraordinary item..... | (0.08) | (0.20) | -- | -- | (0.28) |
| Cumulative effect of accounting change..... | -- | -- | -- | -- | (0.01) |
| Net income..... | 0.90 | 0.09 | 0.19 | 0.29 | 1.46 |
| Diluted EPS | | | | | |
| Income before extraordinary item and cumulative effect of accounting change..... | 0.72 | 0.28 | 0.18 | 0.27 | 1.56 |
| Extraordinary item..... | (0.05) | (0.19) | -- | -- | (0.17) |
| Cumulative effect of accounting change..... | -- | -- | -- | -- | -- |
| Net income..... | 0.67 | 0.09 | 0.18 | 0.27 | 1.39 |

(1) For 2000, includes a \$5.0 million charge to reserve for potentially uncollectible accounts receivable.

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Note 21--Operating Segments

Prior to completion of the Transactions , our operations consisted of two operating segments: (1) Upstream Operations--engages in the acquisition, exploitation, development, exploration and production of crude oil and natural gas and (2) Midstream Operations--engages in pipeline transportation, purchases and resales of crude oil at various points along the distribution chain and the leasing of certain terminalling and storage assets. As a result of the Transactions we no longer have a Midstream segment.

| | Upstream | Midstream | Total |
|---|----------------|--------------|--------------|
| | ----- | ----- | ----- |
| | (In thousands) | | |
| 2000 | | | |
| Revenues: | | | |
| External customers..... | \$149,342 | \$ 6,425,644 | \$ 6,574,986 |
| Intersegment (a)..... | -- | 215,543 | 215,543 |
| Gain on sale of assets..... | -- | 48,188 | 48,188 |
| Interest and other income (expense)..... | (3,468) | 10,879 | 7,411 |
| | ----- | ----- | ----- |
| Total revenues of reportable segments.. | \$145,874 | \$ 6,700,254 | \$ 6,846,128 |
| | ===== | ===== | ===== |
| Segment gross margin (b)..... | \$ 86,202 | \$ 126,066 | \$ 212,268 |
| Segment gross profit (c)..... | 76,297 | 85,195 | 161,492 |
| Segment income (loss) before income taxes, extraordinary item and cumulative effect of accounting change..... | 23,009 | 91,033 | 114,042 |
| Interest expense..... | 27,346 | 28,482 | 55,828 |
| Depreciation, depletion and amortization... | 22,474 | 24,747 | 47,221 |
| Income tax expense..... | 6,503 | 19,080 | 25,583 |
| Extraordinary item, net of tax and minority interest..... | -- | (4,988) | (4,988) |
| Capital expenditures..... | 81,475 | 12,603 | 94,078 |
| Assets..... | 458,678 | 935,651 | 1,394,329 |
| 1999 | | | |
| Revenues: | | | |
| External customers..... | \$116,223 | \$10,796,998 | \$10,913,221 |
| Intersegment (a)..... | -- | 75,454 | 75,454 |
| Gain on sale of assets..... | -- | 16,457 | 16,457 |
| Interest and other income..... | 241 | 10,783 | 11,024 |
| | ----- | ----- | ----- |
| Total revenues of reportable segments.. | \$116,464 | \$10,899,692 | \$11,016,156 |
| | ===== | ===== | ===== |
| Segment gross margin (b)..... | \$ 60,578 | \$ (58,750) | \$ 1,828 |
| Segment gross profit (c)..... | 52,775 | (82,349) | (29,574) |
| Segment income (loss) before income taxes and extraordinary item..... | 8,132 | (93,601) | (85,469) |
| Interest expense..... | 25,298 | 21,080 | 46,378 |

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| | | | |
|---|---------|-----------|-----------|
| Depreciation, depletion and amortization... | 19,586 | 17,412 | 36,998 |
| Income tax benefit..... | 1,635 | 18,844 | 20,479 |
| Extraordinary item, net of tax and minority interest..... | -- | (544) | (544) |
| Capital expenditures..... | 77,899 | 189,286 | 267,185 |
| Assets..... | 445,921 | 1,243,639 | 1,689,560 |

-
- (a) Intersegment revenues and transfers were conducted on an arm's-length basis.
 - (b) Gross margin is calculated as operating revenues less operating expenses.
 - (c) Gross profit is calculated as operating revenues less operating expenses and general and administrative expenses.

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PLAINS RESOURCES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

The following table reconciles segment revenues to amounts reported in our financial statements:

| | For the Year Ended December 31, | |
|---|------------------------------------|--------------|
| | 2000 | 1999 |
| Revenues of reportable segments..... | \$6,846,128 | \$11,016,156 |
| Intersegment..... | (215,543) | (75,454) |
| Net gain recorded upon the formation of PAA not allocated to reportable segments..... | -- | -- |
| Total company revenues..... | \$6,630,585 | \$10,940,702 |

PAA is the exclusive purchaser of all of our equity oil production. The following table reflects for the years ended December 31, 2000 and 1999, during which periods PAA was included in our consolidated financial statements, customers accounting for more than 10% of consolidated sales (excluding hedging effects):

| Customer | Percentage of Consolidated Sales | |
|-------------------------------------|-------------------------------------|------|
| | Year Ended December 31, | |
| | 2000 | 1999 |
| Marathon Ashland Petroleum (1)..... | 12% | -- |

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| | | |
|--|----|-----|
| Sempra Energy Trading Corporation (1)..... | -- | 22% |
| Koch Oil Company (1)..... | -- | 18% |

| | Percentage of Oil and Gas Sales(2) | |
|---------------------------------|---------------------------------------|-----|
| | ----- | |
| Chevron..... | 43% | 39% |
| Equiva Trading Company..... | 23% | -- |
| Tosco Refining Company..... | -- | 19% |
| Conoco Inc..... | -- | 11% |
| Marathon Ashland Petroleum..... | 13% | 16% |

-
- (1) These customers pertain to our midstream segment Represents percentage of oil and gas sales revenues plus marketing, transportation, storage and terminalling revenues.
- (2) These percentages represent the entities that purchased our equity crude production from PAA.

We do not believe the loss of PAA as the exclusive purchaser of our equity production would have a material adverse effect on our results of operations. We believe PAA could be replaced by other purchasers under contracts with similar terms and conditions.

Note 22--Consolidating Financial Statements

The following financial information presents consolidating financial statements, which include:

- . the parent company only ("Parent");
- . the guarantor subsidiaries on a combined basis ("Guarantor Subsidiaries");
- . the nonguarantor subsidiaries on a combined basis ("Nonguarantor Subsidiaries");
- . elimination entries necessary to consolidate the Parent, the Guarantor Subsidiaries and the Nonguarantor Subsidiaries; and
- . Plains Resources Inc. on a consolidated basis.

These statements are presented because the 10.25% Notes discussed in Note 4 are not guaranteed by all of our subsidiaries.

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PLAINS RESOURCES INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING BALANCE SHEET (in thousands)

DECEMBER 31, 2001

| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries | Intercompany Eliminations | Consolidated |
|--------|--------|---------------------------|------------------------------|------------------------------|--------------|
| | ----- | ----- | ----- | ----- | ----- |
| ASSETS | | | | | |

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| | | | | | |
|--|------------|-----------|-----------|--------------|------------|
| Current Assets | | | | | |
| Cash and cash equivalents..... | \$ 1,013 | \$ 13 | \$ 153 | \$ -- | \$ 1,179 |
| Accounts receivable and other..... | 26,773 | 18,050 | -- | -- | 44,823 |
| Current intercompany advances..... | -- | 13,662 | (13,662) | -- | -- |
| Inventory..... | -- | 6,721 | -- | -- | 6,721 |
| | ----- | ----- | ----- | ----- | ----- |
| | 27,786 | 38,446 | (13,509) | -- | 52,723 |
| | ----- | ----- | ----- | ----- | ----- |
| Property and Equipment, | | | | | |
| at cost..... | 243,969 | 701,587 | -- | (149) | 945,407 |
| Less allowance for depreciation, depletion and amortization..... | (217,801) | 164,795) | -- | (55,386) | (437,982) |
| | ----- | ----- | ----- | ----- | ----- |
| | 26,168 | 536,792 | -- | (55,535) | 507,425 |
| | ----- | ----- | ----- | ----- | ----- |
| Investment in | | | | | |
| Subsidiaries and Intercompany Advances..... | 467,837 | (279,496) | 178,202 | (301,917) | 64,626 |
| | ----- | ----- | ----- | ----- | ----- |
| Other Assets..... | 10,313 | 13,769 | 383 | (451) | 24,014 |
| | ----- | ----- | ----- | ----- | ----- |
| | \$ 532,104 | \$309,511 | \$165,076 | \$ (357,903) | \$ 648,788 |
| | ===== | ===== | ===== | ===== | ===== |

LIABILITIES AND STOCKHOLDERS' EQUITY

| | | | | | |
|---|-------------|-----------|-----------|-------|-----------|
| Current Liabilities | | | | | |
| Accounts payable and other current liabilities..... | \$ (68,896) | \$ 42,581 | \$ 80,210 | \$ -- | \$ 53,895 |
| Interest payable..... | 8,286 | -- | -- | -- | 8,286 |
| Notes payable..... | -- | 511 | -- | -- | 511 |
| | ----- | ----- | ----- | ----- | ----- |
| | (60,610) | 43,092 | 80,210 | -- | 62,692 |
| | ----- | ----- | ----- | ----- | ----- |
| Long-Term Debt | | | | | |
| Bank debt..... | 11,500 | -- | -- | -- | 11,500 |
| Subordinated debt.... | 269,539 | -- | -- | -- | 269,539 |
| Other..... | -- | 1,022 | -- | -- | 1,022 |
| | ----- | ----- | ----- | ----- | ----- |
| | 281,039 | 1,022 | -- | -- | 282,061 |
| | ----- | ----- | ----- | ----- | ----- |
| Other Long-Term | | | | | |
| Liabilities..... | 3,013 | 1,413 | 463 | -- | 4,889 |
| | ----- | ----- | ----- | ----- | ----- |
| Deferred Income Taxes.. | 53,810 | 8,415 | (17,931) | -- | 44,294 |
| | ----- | ----- | ----- | ----- | ----- |
| Non-redeemable | | | | | |
| Preferred Stock, | | | | | |
| Common Stock and Other | | | | | |
| Stockholders' Equity | | | | | |
| Series D Cumulative | | | | | |
| Convertible | | | | | |

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| | | | | | |
|--|------------|-----------|-----------|--------------|------------|
| Preferred Stock..... | 23,300 | -- | -- | -- | 23,300 |
| Common Stock..... | 2,768 | 837 | -- | (837) | 2,768 |
| Additional paid-in capital..... | 268,520 | 3,805 | 43,390 | (47,195) | 268,520 |
| Retained earnings (accumulated deficit)..... | 37,676 | 250,927 | 61,263 | (312,190) | 37,676 |
| Accumulated other comprehensive income..... | 13,930 | -- | (2,319) | 2,319 | 13,930 |
| Treasury stock, at cost..... | (91,342) | -- | -- | -- | (91,342) |
| | ----- | ----- | ----- | ----- | ----- |
| | 254,852 | 255,569 | 102,334 | (357,903) | 254,852 |
| | ----- | ----- | ----- | ----- | ----- |
| | \$ 532,104 | \$309,511 | \$165,076 | \$ (357,903) | \$ 648,788 |
| | ===== | ===== | ===== | ===== | ===== |

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PLAINS RESOURCES INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING BALANCE SHEET (in thousands)

DECEMBER 31, 2000

| ASSETS | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries | Intercompany Eliminations | Consolidated |
|---|------------|---------------------------|------------------------------|------------------------------|--------------|
| | ----- | ----- | ----- | ----- | ----- |
| Current Assets | | | | | |
| Cash and cash equivalents..... | \$ 4 | \$ 597 | \$ 4,479 | \$ -- | \$ 5,080 |
| Accounts receivable and other..... | 12,193 | 15,596 | 347,696 | -- | 375,485 |
| Current intercompany advances..... | -- | 17,605 | (17,605) | -- | -- |
| Inventory..... | -- | 8,063 | 46,781 | -- | 54,844 |
| | ----- | ----- | ----- | ----- | ----- |
| | 12,197 | 41,861 | 381,351 | -- | 435,409 |
| | ----- | ----- | ----- | ----- | ----- |
| Property and Equipment, at cost..... | 237,591 | 570,677 | 473,471 | -- | 1,281,739 |
| Less allowance for depreciation, depletion and amortization..... | (215,942) | (138,871) | (27,266) | (55,386) | (437,465) |
| | ----- | ----- | ----- | ----- | ----- |
| | 21,649 | 431,806 | 446,205 | (55,386) | 844,274 |
| | ----- | ----- | ----- | ----- | ----- |
| Investment in Subsidiaries and Intercompany Advances..... | 389,467 | (254,891) | (6,372) | (128,204) | -- |
| Other Assets..... | 8,151 | 16,005 | 90,490 | -- | 114,646 |
| | ----- | ----- | ----- | ----- | ----- |
| | \$ 431,464 | \$ 234,781 | \$911,674 | \$ (183,590) | \$1,394,329 |

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| | ===== | ===== | ===== | ===== | ===== |
|---|------------|------------|-----------|--------------|-------------|
| LIABILITIES AND STOCKHOLDERS' | | | | | |
| EQUITY | | | | | |
| Current Liabilities | | | | | |
| Accounts payable and other current liabilities..... | \$ 7,105 | \$ 46,368 | \$359,823 | \$ 13 | \$ 413,309 |
| Notes payable and other current obligations..... | -- | 511 | 1,300 | -- | 1,811 |
| | ----- | ----- | ----- | ----- | ----- |
| | 7,105 | 46,879 | 361,123 | 13 | 415,120 |
| | ----- | ----- | ----- | ----- | ----- |
| Long-Term Debt | | | | | |
| Bank debt..... | 27,300 | -- | -- | -- | 27,300 |
| Bank debt of a subsidiary..... | -- | -- | 320,000 | -- | 320,000 |
| Subordinated debt.... | 277,543 | -- | -- | -- | 277,543 |
| Other..... | -- | 1,533 | -- | -- | 1,533 |
| | ----- | ----- | ----- | ----- | ----- |
| | 304,843 | 1,533 | 320,000 | -- | 626,376 |
| | ----- | ----- | ----- | ----- | ----- |
| Other Long-Term Liabilities..... | | | | | |
| | 2,413 | -- | 1,009 | -- | 3,422 |
| | ----- | ----- | ----- | ----- | ----- |
| Minority Interest in PAA..... | | | | | |
| | (70,037) | -- | 232,216 | 92 | 162,271 |
| | ----- | ----- | ----- | ----- | ----- |
| Cumulative Convertible Preferred Stock, Stated at Liquidation Preference..... | | | | | |
| | 50,000 | -- | -- | -- | 50,000 |
| | ----- | ----- | ----- | ----- | ----- |
| Non-redeemable Preferred Stock, Common Stock and Other Stockholders' Equity | | | | | |
| Series D Cumulative Convertible Preferred Stock..... | | | | | |
| | 23,300 | -- | -- | -- | 23,300 |
| Series H Cumulative Convertible Preferred Stock..... | | | | | |
| | 84,785 | -- | -- | -- | 84,785 |
| Common Stock..... | 1,875 | 78 | -- | (78) | 1,875 |
| Additional paid-in capital..... | 139,203 | 3,951 | 43,393 | (47,344) | 139,203 |
| Retained earnings (accumulated deficit)..... | (88,410) | 182,340 | (46,067) | (136,273) | (88,410) |
| Treasury stock, at cost..... | (23,613) | -- | -- | -- | (23,613) |
| | ----- | ----- | ----- | ----- | ----- |
| | 137,140 | 186,369 | (2,674) | (183,695) | 137,140 |
| | ----- | ----- | ----- | ----- | ----- |
| | \$ 431,464 | \$ 234,781 | \$911,674 | \$ (183,590) | \$1,394,329 |
| | ===== | ===== | ===== | ===== | ===== |

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PLAINS RESOURCES INC. AND SUBSIDIARIES

CONSOLIDATING STATEMENT OF OPERATIONS (in thousands)

YEAR ENDED DECEMBER 31, 2001

| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries | Intercompany Eliminations | Consolidated |
|---|----------|---------------------------|------------------------------|------------------------------|--------------|
| Revenues | | | | | |
| Crude oil and liquids..... | \$ -- | \$186,476 | \$ -- | \$ -- | \$186,476 |
| Natural gas..... | -- | 28,771 | -- | -- | 28,771 |
| Other operating revenues..... | -- | 473 | -- | -- | 473 |
| | ----- | ----- | ----- | ----- | ----- |
| | -- | 215,720 | -- | -- | 215,720 |
| | ----- | ----- | ----- | ----- | ----- |
| Expenses | | | | | |
| Production expenses... | -- | 71,192 | -- | -- | 71,192 |
| General and administrative..... | 10,023 | 11,260 | 10 | -- | 21,293 |
| Depreciation, depletion and amortization..... | 1,502 | 27,419 | -- | -- | 28,921 |
| | ----- | ----- | ----- | ----- | ----- |
| | 11,525 | 109,871 | 10 | -- | 121,406 |
| | ----- | ----- | ----- | ----- | ----- |
| Income (Loss) from Operations..... | (11,525) | 105,849 | (10) | -- | 94,314 |
| Other Income (Expense) | | | | | |
| Equity in earnings of subsidiary..... | 176,527 | -- | 18,540 | (176,527) | 18,540 |
| Gain on PAA unit transactions and public offerings..... | -- | -- | 170,157 | -- | 170,157 |
| Interest expense..... | (2,805) | (23,580) | -- | -- | (26,385) |
| Interest and other income..... | (312) | 463 | -- | -- | 151 |
| | ----- | ----- | ----- | ----- | ----- |
| Income (Loss) Before Income Taxes and Cumulative Effect of Accounting Change..... | 161,885 | 82,732 | 188,687 | (176,527) | 256,777 |
| Income tax (expense) benefit: | | | | | |
| Current..... | 44,749 | -- | (54,696) | -- | (9,947) |
| Deferred..... | (51,175) | (13,532) | (26,806) | -- | (91,513) |
| | ----- | ----- | ----- | ----- | ----- |
| Income (Loss) Before Cumulative Effect of Accounting Change..... | 155,459 | 69,200 | 107,185 | (176,527) | 155,317 |
| Cumulative effect of accounting change, net of tax benefit... | (2,128) | -- | 142 | -- | (1,986) |
| | ----- | ----- | ----- | ----- | ----- |

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| | | | | | |
|---|-----------|-----------|-----------|--------------|-----------|
| Net Income (Loss)..... | 153,331 | 69,200 | 107,327 | (176,527) | 153,331 |
| Cumulative preferred dividends..... | (27,245) | -- | -- | -- | (27,245) |
| Income (Loss) Available to Common Stockholders..... | \$126,086 | \$ 69,200 | \$107,327 | \$ (176,527) | \$126,086 |

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PLAINS RESOURCES INC. AND SUBSIDIARIES

CONSOLIDATING STATEMENT OF OPERATIONS (in thousands)

YEAR ENDED DECEMBER 31, 2000

| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries | Intercompany Eliminations | Consolidated |
|--|---------|------------------------|---------------------------|---------------------------|--------------|
| Revenues | | | | | |
| Crude oil and liquids..... | \$ 4 | \$131,667 | \$ -- | \$ 1,654 | \$ 133,325 |
| Natural gas..... | -- | 16,017 | -- | -- | 16,017 |
| Marketing, transportation, storage and terminalling..... | -- | -- | 6,641,187 | (215,543) | 6,425,644 |
| Gain on sale of assets..... | -- | -- | 48,188 | -- | 48,188 |
| | 4 | 147,684 | 6,689,375 | (213,889) | 6,623,174 |
| Expenses | | | | | |
| Production expenses... | -- | 62,140 | -- | -- | 62,140 |
| General and administrative..... | 2,054 | 7,851 | 40,871 | -- | 50,776 |
| Marketing, transportation, storage and terminalling..... | -- | -- | 6,506,504 | (213,889) | 6,292,615 |
| Unauthorized trading losses and related expenses..... | 1,000 | -- | 6,963 | -- | 7,963 |
| Depreciation, depletion and amortization..... | 3,068 | 19,406 | 24,747 | -- | 47,221 |
| | 6,122 | 89,397 | 6,579,085 | (213,889) | 6,460,715 |
| Income from Operations.. | (6,118) | 58,287 | 110,290 | -- | 162,459 |
| Other Income (Expense) | | | | | |
| Equity in earnings of subsidiary..... | 64,115 | -- | -- | (64,115) | -- |
| Interest expense..... | (9,581) | (20,827) | (28,482) | 3,062 | (55,828) |
| Interest and other | | | | | |

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| | | | | | |
|---|----------|-----------|-----------|-------------|-----------|
| income..... | (737) | 331 | 10,879 | (3,062) | 7,411 |
| | ----- | ----- | ----- | ----- | ----- |
| Income (Loss) Before Income Taxes, Minority Interest, Extraordinary Item and Cumulative Effect of Accounting Change..... | 47,679 | 37,791 | 92,687 | (64,115) | 114,042 |
| Minority interest..... | -- | -- | (42,535) | -- | (42,535) |
| Income tax (expense) benefit: | | | | | |
| Current..... | 24,094 | -- | (25,114) | -- | (1,020) |
| Deferred..... | (30,958) | 361 | 6,034 | -- | (24,563) |
| | ----- | ----- | ----- | ----- | ----- |
| Income (Loss) Before Extraordinary Item and Cumulative Effect of Accounting Change..... | 40,815 | 38,152 | 31,072 | (64,115) | 45,924 |
| Extraordinary item, net of tax benefit and minority interest..... | -- | -- | (4,988) | -- | (4,988) |
| Cumulative effect of accounting change, net of tax benefit... | -- | (121) | -- | -- | (121) |
| | ----- | ----- | ----- | ----- | ----- |
| Net Income (Loss)..... | 40,815 | 38,031 | 26,084 | (64,115) | 40,815 |
| Cumulative preferred dividends..... | (14,725) | -- | -- | -- | (14,725) |
| | ----- | ----- | ----- | ----- | ----- |
| Income (Loss) Available to Common Stockholders..... | \$26,090 | \$ 38,031 | \$ 26,084 | \$ (64,115) | \$ 26,090 |
| | ===== | ===== | ===== | ===== | ===== |

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PLAINS RESOURCES INC. AND SUBSIDIARIES

CONSOLIDATING STATEMENT OF OPERATIONS (in thousands)

YEAR ENDED DECEMBER 31, 1999

| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries | Intercompany Eliminations | Consolidated |
|---|--------|---------------------------|------------------------------|------------------------------|--------------|
| | ----- | ----- | ----- | ----- | ----- |
| Revenues | | | | | |
| Crude oil and liquids..... | \$ -- | \$109,641 | \$ -- | \$ 1,487 | \$ 111,128 |
| Natural gas..... | -- | 5,095 | -- | -- | 5,095 |
| Marketing, transportation, storage and terminalling..... | -- | -- | 10,872,452 | (75,454) | 10,796,998 |
| Gain on sale of assets..... | -- | -- | 16,457 | -- | 16,457 |

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| | | | | | |
|--|-------------|-----------|-------------|-----------|-------------|
| | ----- | ----- | ----- | ----- | ----- |
| | -- | 114,736 | 10,888,909 | (73,967) | 10,929,678 |
| | ----- | ----- | ----- | ----- | ----- |
| Expenses | | | | | |
| Production expenses... | -- | 55,645 | -- | -- | 55,645 |
| General and administrative..... | 2,311 | 5,492 | 23,599 | -- | 31,402 |
| Depreciation, depletion and amortization..... | 2,096 | 17,490 | 17,412 | -- | 36,998 |
| Marketing, transportation, storage and terminalling..... | -- | -- | 10,763,275 | (73,967) | 10,689,308 |
| Unauthorized trading losses and related expenses..... | -- | -- | 166,440 | -- | 166,440 |
| | ----- | ----- | ----- | ----- | ----- |
| | 4,407 | 78,627 | 10,970,726 | (73,967) | 10,979,793 |
| | ----- | ----- | ----- | ----- | ----- |
| Income (Loss) from Operations..... | (4,407) | 36,109 | (81,817) | -- | (50,115) |
| Other Income (Expense) | | | | | |
| Equity in earnings (loss) of subsidiary..... | (11,510) | -- | -- | 11,510 | -- |
| Gain on PAA unit offering..... | -- | -- | 9,787 | -- | 9,787 |
| Interest expense..... | (6,994) | (18,851) | (21,080) | 547 | (46,378) |
| Interest and other income..... | 699 | 89 | 996 | (547) | 1,237 |
| | ----- | ----- | ----- | ----- | ----- |
| Income (Loss) Before Income Taxes, Minority Interest and Extraordinary Item..... | (22,212) | 17,347 | (92,114) | 11,510 | (85,469) |
| Minority interest in PAA..... | -- | -- | 40,203 | -- | 40,203 |
| Income tax (expense) benefit: | | | | | |
| Current..... | 338 | -- | (331) | -- | 7 |
| Deferred..... | (3,457) | 4,754 | 19,175 | -- | 20,472 |
| | ----- | ----- | ----- | ----- | ----- |
| Income (Loss) Before Extraordinary Item..... | (25,331) | 22,101 | (33,067) | 11,510 | (24,787) |
| Extraordinary item, net of tax benefit and minority interest..... | -- | -- | (544) | -- | (544) |
| | ----- | ----- | ----- | ----- | ----- |
| Net Income (Loss)..... | (25,331) | 22,101 | (33,611) | 11,510 | (25,331) |
| Cumulative preferred dividends..... | (10,026) | -- | -- | -- | (10,026) |
| | ----- | ----- | ----- | ----- | ----- |
| Income (Loss) Available to Common Stockholders..... | \$ (35,357) | \$ 22,101 | \$ (33,611) | \$ 11,510 | \$ (35,357) |
| | ===== | ===== | ===== | ===== | ===== |

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PLAINS RESOURCES INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS (in thousands)

YEAR ENDED DECEMBER 31, 2001

| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries | Intercompany Eliminations | Consolidated |
|--|------------|---------------------------|------------------------------|------------------------------|--------------|
| | ----- | ----- | ----- | ----- | ----- |
| CASH FLOWS FROM | | | | | |
| OPERATING ACTIVITIES | | | | | |
| Net income (loss)..... | \$ 153,331 | \$ 69,200 | \$107,327 | \$ (176,527) | \$ 153,331 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | | | |
| Depreciation, depletion, and amortization..... | 1,502 | 27,419 | -- | -- | 28,921 |
| Equity earnings in subsidiary..... | (176,527) | -- | (18,540) | 176,527 | (18,540) |
| Distributions from subsidiary..... | -- | -- | 31,553 | -- | 31,553 |
| Noncash gains..... | -- | -- | (170,157) | -- | (170,157) |
| Deferred income tax... | 51,175 | 13,532 | 26,806 | -- | 91,513 |
| Cumulative effect of adoption of SFAS 123..... | 2,128 | -- | (142) | -- | 1,986 |
| Change in derivative fair value..... | 1,227 | -- | -- | -- | 1,227 |
| Noncash compensation expense..... | 4,514 | -- | -- | -- | 4,514 |
| Other noncash items... | 1,626 | -- | -- | -- | 1,626 |
| Change in assets and liabilities resulting from operating activities:..... | | | | | |
| Accounts receivable and other..... | (14,580) | (7,461) | 43,064 | -- | 21,023 |
| Inventory..... | -- | 1,342 | 1,133 | -- | 2,475 |
| Accounts payable and other current liabilities..... | (76,001) | (3,787) | (1,486) | -- | (81,274) |
| Other long-term liabilities..... | 600 | 1,413 | (546) | -- | 1,467 |
| Advances from (payments to) affiliates..... | 143,285 | 30,054 | (122,876) | -- | 50,463 |
| Net cash provided by (used in) operating activities..... | 92,280 | 131,712 | (103,864) | -- | 120,128 |
| CASH FLOWS FROM | | | | | |
| INVESTING ACTIVITIES | | | | | |

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| | | | | | |
|--|-----------|-----------|----------|-------|-----------|
| Acquisition, exploration and development costs.. | -- | (131,785) | -- | -- | (131,785) |
| Additions to other property and assets.... | (561) | -- | -- | -- | (561) |
| Proceeds from the sale of PAA units..... | -- | -- | 106,941 | -- | 106,941 |
| Investment in PAA..... | -- | -- | (3,978) | -- | (3,978) |
| | ----- | ----- | ----- | ----- | ----- |
| Net cash provided by (used in) investing activities..... | (561) | (131,785) | 102,963 | -- | (29,383) |
| | ----- | ----- | ----- | ----- | ----- |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | | | |
| Proceeds from long-term debt..... | 204,900 | -- | -- | -- | 204,900 |
| Proceeds from sale of capital stock, options and warrants..... | 9,169 | -- | -- | -- | 9,169 |
| Proceeds from issuance of preferred stock..... | -- | -- | -- | -- | -- |
| Purchase of senior subordinated notes..... | (7,550) | -- | -- | -- | (7,550) |
| Principal payments of long-term debt..... | (220,700) | (511) | -- | -- | (221,211) |
| Purchase of treasury stock..... | (67,729) | -- | -- | -- | (67,729) |
| Preferred stock dividends..... | (8,698) | -- | -- | -- | (8,698) |
| Other..... | (102) | -- | -- | -- | (102) |
| | ----- | ----- | ----- | ----- | ----- |
| Net cash used in financing activities... | (90,710) | (511) | -- | -- | (91,221) |
| | ----- | ----- | ----- | ----- | ----- |
| Net decrease in cash and cash equivalents..... | 1,009 | (584) | (901) | -- | (476) |
| Decrease in cash due to deconsolidation of PAA..... | -- | -- | (3,425) | -- | (3,425) |
| Cash and cash equivalents, beginning of period..... | \$ 4 | \$ 597 | \$ 4,479 | \$ -- | 5,080 |
| | ----- | ----- | ----- | ----- | ----- |
| Cash and cash equivalents, end of period..... | \$ 1,013 | \$ 13 | \$ 153 | \$ -- | \$ 1,179 |
| | ===== | ===== | ===== | ===== | ===== |

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PLAINS RESOURCES INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS (in thousands)

YEAR ENDED DECEMBER 31, 2000

Guarantor Nonguarantor Intercompany

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| | Parent | Subsidiaries | Subsidiaries | Eliminations | Consolidated |
|---|-----------|--------------|--------------|--------------|--------------|
| | ----- | ----- | ----- | ----- | ----- |
| CASH FLOWS FROM | | | | | |
| OPERATING ACTIVITIES | | | | | |
| Net income (loss)..... | \$ 40,815 | \$38,031 | \$ 26,084 | \$ (64,115) | \$ 40,815 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | | | |
| Depreciation, depletion, and amortization..... | 3,068 | 19,406 | 24,747 | -- | 47,221 |
| Gain on sale of assets (Note 6)..... | -- | -- | (48,188) | -- | (48,188) |
| Minority interest in income of a subsidiary..... | -- | -- | 35,566 | -- | 35,566 |
| Equity earnings in subsidiary..... | (64,115) | -- | -- | 64,115 | -- |
| Deferred income tax... | 30,958 | (362) | (9,299) | -- | 21,297 |
| Noncash compensation expense..... | (407) | -- | 3,089 | -- | 2,682 |
| Allowance for doubtful accounts..... | -- | -- | 5,000 | -- | 5,000 |
| Other noncash items... | 6,351 | -- | 4,574 | -- | 10,925 |
| Change in assets and liabilities resulting from operating activities: | | | | | |
| Accounts receivable and other..... | (10,385) | (7,461) | 120,497 | -- | 102,651 |
| Inventory..... | -- | (2,023) | (11,954) | -- | (13,977) |
| Pipeline linefill..... | -- | -- | (16,679) | -- | (16,679) |
| Accounts payable and other current liabilities..... | (16,595) | 34,685 | (161,543) | -- | (143,453) |
| Other long-term liabilities..... | 591 | -- | (8,591) | -- | (8,000) |
| Advances from affiliates..... | 119,735 | (9,889) | (109,846) | -- | -- |
| Net cash provided by (used in) operating activities..... | 110,016 | 72,387 | (146,543) | -- | 35,860 |
| CASH FLOWS FROM | | | | | |
| INVESTING ACTIVITIES | | | | | |
| Payments for crude oil pipeline, gathering and terminal assets..... | -- | -- | (12,219) | -- | (12,219) |
| Payments for acquisition, exploration, and development costs..... | (3,894) | (74,448) | (384) | -- | (78,726) |
| Payments for additions to other property and assets..... | -- | (2,476) | (657) | -- | (3,133) |
| Proceeds from asset sales (Note 6)..... | -- | -- | 224,261 | -- | 224,261 |

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| | | | | | |
|--|-----------|----------|-------------|-------|-------------|
| Net cash provided by (used in) investing activities..... | (3,894) | (76,924) | 211,001 | -- | 130,183 |
| | ----- | ----- | ----- | ----- | ----- |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | | | |
| Proceeds from long-term debt..... | 264,825 | -- | 1,433,750 | -- | 1,698,575 |
| Proceeds from short-term debt..... | -- | -- | 51,300 | -- | 51,300 |
| Proceeds from sale of capital stock, options and warrants..... | 2,301 | -- | -- | -- | 2,301 |
| Principal payments of long-term debt..... | (375,336) | -- | (1,423,850) | -- | (1,799,186) |
| Principal payments of short-term debt..... | -- | -- | (108,719) | -- | (108,719) |
| Purchase of treasury stock..... | (23,613) | -- | -- | -- | (23,613) |
| Costs incurred in connection with financing arrangements..... | -- | -- | (6,748) | -- | (6,748) |
| Preferred stock dividends..... | (13,409) | -- | -- | -- | (13,409) |
| Distribution to unitholders..... | 30,133 | -- | (59,565) | -- | (29,432) |
| Other..... | (260) | -- | -- | -- | (260) |
| | ----- | ----- | ----- | ----- | ----- |
| Net cash used in financing activities... | (115,359) | -- | (113,832) | -- | (229,191) |
| | ----- | ----- | ----- | ----- | ----- |
| Net decrease in cash and cash equivalents..... | (9,237) | (4,537) | (49,374) | -- | (63,148) |
| Cash and cash equivalents, beginning of period..... | \$ 9,241 | \$ 5,134 | \$ 53,853 | \$ -- | 68,228 |
| | ----- | ----- | ----- | ----- | ----- |
| Cash and cash equivalents, end of period..... | \$ 4 | \$ 597 | \$ 4,479 | \$ -- | \$ 5,080 |
| | ===== | ===== | ===== | ===== | ===== |

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PLAINS RESOURCES INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS (in thousands)

YEAR ENDED DECEMBER 31, 1999

| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries | Intercompany Eliminations | Consolidated |
|---|--------|---------------------------|------------------------------|------------------------------|--------------|
| | ----- | ----- | ----- | ----- | ----- |
| CASH FLOWS FROM OPERATING ACTIVITIES | | | | | |

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| | | | | | |
|---|-------------|-----------|-------------|-----------|-------------|
| Net income (loss)..... | \$ (25,331) | \$ 22,101 | \$ (33,611) | \$ 11,510 | \$ (25,331) |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | | | |
| Depreciation, depletion, and amortization..... | 2,096 | 17,490 | 17,412 | -- | 36,998 |
| Noncash gains (Note 4 and 6)..... | -- | -- | (26,244) | -- | (26,244) |
| Minority interest in income of a subsidiary..... | -- | -- | (40,203) | -- | (40,203) |
| Equity in earnings of subsidiary..... | 11,510 | -- | -- | (11,510) | -- |
| Deferred income tax... Noncash compensation expense..... | 3,457 | (4,754) | (19,175) | -- | (20,472) |
| Other noncash items... | (1,108) | -- | 1,013 | -- | 1,013 |
| Change in assets and liabilities resulting from operating activities: | | | 1,047 | -- | (61) |
| Accounts receivable and other..... | (970) | (1,287) | (224,181) | -- | (226,438) |
| Inventory..... | -- | (842) | 34,772 | -- | 33,930 |
| Pipeline linefill..... | -- | -- | (3) | -- | (3) |
| Accounts payable and other current liabilities..... | 5,275 | 2,169 | 164,530 | -- | 171,974 |
| Other long-term liabilities..... | -- | -- | 18,873 | -- | 18,873 |
| Net cash provided by (used in) operating activities..... | (5,071) | 34,877 | (105,770) | -- | (75,964) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | | | |
| Payments for midstream acquisitions (See Note 6)..... | -- | -- | (176,918) | -- | (176,918) |
| Payments for crude oil pipeline, gathering and terminal assets..... | -- | -- | (12,507) | -- | (12,507) |
| Payments for acquisition, exploration, and development costs..... | (3,793) | (74,106) | -- | -- | (77,899) |
| Payments for additions to other property and assets..... | (267) | (2,137) | (68) | -- | (2,472) |
| Proceeds from sale of pipeline linefill..... | -- | -- | 3,400 | -- | 3,400 |
| Net cash provided by (used in) investing activities..... | (4,060) | (76,243) | (186,093) | -- | (266,396) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | | | |
| Advances/investments | | | | | |

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| | | | | | |
|--|-----------|----------|-----------|-------|-----------|
| with affiliates..... | (194,902) | 46,306 | 148,396 | 200 | -- |
| Proceeds from long-term debt..... | 341,250 | -- | 403,721 | -- | 744,971 |
| Proceeds from short-term debt..... | -- | -- | 131,119 | -- | 131,119 |
| Proceeds from sale of capital stock, options and warrants..... | 5,542 | -- | -- | -- | 5,542 |
| Proceeds from issuance of preferred stock..... | 50,000 | -- | -- | -- | 50,000 |
| Proceeds from issuance of common units (Note 4)..... | (25,000) | -- | 75,759 | -- | 50,759 |
| Principal payments of long-term debt..... | (180,711) | -- | (268,621) | -- | (449,332) |
| Principal payments of short-term debt..... | -- | -- | (82,150) | -- | (82,150) |
| Costs incurred in connection with financing arrangements..... | (2,205) | -- | (17,243) | -- | (19,448) |
| Preferred stock dividends..... | (4,245) | -- | -- | -- | (4,245) |
| Distribution to unitholders..... | 29,472 | -- | (51,673) | -- | (22,201) |
| Other..... | (971) | -- | -- | -- | (971) |
| | ----- | ----- | ----- | ----- | ----- |
| Net cash provided by financing activities... | 18,230 | 46,306 | 339,308 | 200 | 404,044 |
| | ----- | ----- | ----- | ----- | ----- |
| Net increase in cash and cash equivalents..... | 9,099 | 4,940 | 47,445 | 200 | 61,684 |
| Cash and cash equivalents, beginning of period..... | 142 | 194 | 6,408 | (200) | 6,544 |
| | ----- | ----- | ----- | ----- | ----- |
| Cash and cash equivalents, end of period..... | \$ 9,241 | \$ 5,134 | \$ 53,853 | \$ -- | \$ 68,228 |
| | ===== | ===== | ===== | ===== | ===== |

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

PLAINS RESOURCES INC.

By: /s/ CYNTHIA A. FEEBACK

Cynthia A. Feedback, Senior
Vice President--Accounting
and Treasurer (Principal
Accounting Officer)

Date: March 28, 2002