

Approved: April 29, 1999
Date

MINUTES OF THE HOUSE COMMITTEE ON TAXATION.

The meeting was called to order by Chairperson David Adkins at 9:00 a.m. on March 9, 1999, in Room 519-S of the Capitol.

All members were present except: Rep. Howell - excused

Committee staff present: Chris Courtwright, Legislative Research Department
April Holman, Legislative Research Department
Don Hayward, Revisor of Statutes
Shirley Sicilian, Department of Revenue
Mary Shaw, Committee Secretary

Conferees appearing before the committee:

Dr. W. F. Lawson, Director National Petroleum Technology Office, U. S. Dept. of Energy
Dr. Timothy R. Carr, Chief, Petroleum Research Sect., Univ. of Kansas Energy Research Ctr.
David P. Williams, Environmental Geologist, KCC, Conservation Division
Charles Ranson, President, Kansas. Inc.
Richard Koll, Finance Manager, Vess Oil Corporation
Tom Casey, Manager, Express Well Service
Danny Biggs, Superintendent, Pickrell Drilling Company
Lester Town, Producer, Driller and Purchaser, Eastern Kansas Oil & Gas Assn. (EKOGA)
Robert Krehbiel, Executive Vice President, Kansas Independent Oil & Gas Assn (KIOGA)
Jim Ploger, Energy Program Manager, Kansas Corporation Commission (written)

Others attending: See attached list.

The Chairman mentioned that at his invitation, and consultation and urging of some of the committee members whose districts are directly impacted by the crisis in the oil industry, a briefing was scheduled for the meeting. He mentioned that the committee is interested in focusing not one piece of legislation, but more of a global sense as to how Kansas can respond and react in its economic planning in what is a real and sustained price crisis in the oil industry at this time. The Chairman further explained that it is clear that much of the stress of consumer price cuts has been borne by an industry that is very critical to Kansas. He noted that one of the cornerstones of the Kansas economy, including agriculture and aviation, is oil. The Chairman mentioned that the purpose for today's hearing is not only to hear from people that work in the Kansas oil industry, but to hear from experts that can provide the committee with more of a global perspective on the issues. The Chair thanked the conferees for their willingness to appear before the committee.

The Chairman recognized Representative Aurand who made a motion, and seconded by Representative Minor, to introduce a committee bill dealing with the application of sales tax and where it is applied for automobiles. Motion carried.

The Chairman introduced Dr. W. F. Lawson, Director of the National Petroleum Technology Office, U. S. Department of Energy who spoke regarding U.S. Oil and Gas Trends. Dr. Lawson provided background on the domestic energy picture, and in particular, how it relates to oil and gave a few insights into domestic oil independents in the country. (Attachment 1)

The Chairman introduced Dr. Timothy R. Carr, Chief of Petroleum Research Section, University of Kansas Energy Research Center, who spoke regarding the importance of the Kansas petroleum industry on the economy of Kansas and his analysis of the industry's present state. (Attachment 2)

The Chairman introduced David P. Williams, Oil and Gas Production Supervisor - Environmental Geologist, Kansas Corporation Commission - Conservation Division, who spoke regarding an overview of Kansas oil and gas production for 1998. (Attachment 3)

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON TAXATION, Room 519-S Statehouse, at 9:00 a.m. on March 9, 1999.

The Chairman introduced Charles Ranson, President, Kansas, Inc., who spoke regarding the severance tax on the oil and gas industry. (Attachment 4)

The Chairman introduced Richard Koll, Finance Manager, Vess Oil Corporation, who spoke regarding the economic crisis facing the Kansas oil industry. (Attachment 5)

The Chairman introduced Tom Casey, Manager, Express Well Service, who spoke regarding the current economic condition of the Kansas oilfield supply and service companies. (Attachment 6)

The Chairman introduced Danny Biggs, Vice-President-Superintendent, Pickrell Drilling Company, who spoke regarding how the oil industry has been devastated by the historically low oil prices and their only source of income is at the well head and they have no control of the price they receive for their product. (Attachment 7)

The Chairman introduced Lester Town, Producer, Driller and Purchaser, Eastern Kansas Oil and Gas Association (EKOGA), who spoke regarding his perspective on the devastating effect oil prices are having on the oil and gas industry in Eastern Kansas. (Attachment 8)

The Chairman introduced Robert Krehbiel, Executive Vice President, Kansas Independent Oil and Gas Association (KIOGA), who spoke regarding the economic crisis facing the domestic oil producer. (Attachment 9)

Written information was distributed regarding the following:

Remarks of Jim Ploger, Energy Program Manager, Kansas Corporation Commission, Topeka, titled, "State Assistance Efforts for Oil Producers". (Attachment 10).

Remarks by Philip M. Knighton, M.S., Geology, JD, December 14, 1998, "Suggestions for the Prevention of Waste of a National Resource". (Attachment 11)

The Chairman thanked the conferees for appearing before the committee.

The meeting was adjourned at 11:04 a.m.

HOUSE TAXATION COMMITTEE
GUEST LIST

DATE: March 9, 1999

William F. Lawson	U.S. Dept. of Energy
RICHARD KOLL, KIOGA	
DAVID WILLIAMS	KCC - WICHITA
John O. Farmer III - KIOGA	
Tim Carr	Kansas Geol. Survey - Lawrence
Jonathan Small	Mobil Oil # KOCH INDUST.
Sharolyn Meyeres	KIOGA - WICHITA
Danny Biggs	Pickrell Drlg - Great Bend
Tom CASEY	EXPRESS WELL SERVICE
MIKE TRAYLOR	MALLASKEY OILFIELD SERV.
NICK POWELL	COLT ENERGY, INC.
Dick Schremmer	Bear Petroleum INC.
Jim Ploger	Ks Corp Commission
Wendy Deen	Russell Co. Leadership
Terri Walker	Russell Co. Leadership
Scott Trapp	New Generation Oil, Inc.
Daron Woelk	Russell Chamber of Com.
Chad Jerke	Russell Co. Leadership
Dana New Poth Padant	Russell Co. Leadership

HOUSE TAXATION COMMITTEE
GUEST LIST

DATE: March 9, 1999

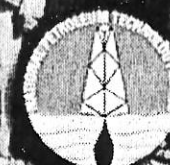
Kelly Boannum	City of Russell
Roger Krak	Russell County
Tom Bruno	EKO GA
Scott Schneider	MGA
Tom Palane	PMCA OF KS
Ken Peterson	KS Petroleum Council
Bill Bryan	OKY USA Inc
Jack Graves	Oil Well & K&E Energy
Charles Gorges	Pioneer Oil
Dick Guinotte	EOTT ENERGY CORP.
Bob Reusch	Reusch Well Service
Bob Ebertart	Bob Cat Oil (EKO GA)
Lester Scheneman	Oil Producer
MIKE Olson	CONTINENTAL EXPLORATION, Inc
Art Soom	mid - sm Lumberman Dist
Yard Hester	KDOR
Rim Komarek	KDOR
Christy Caldwell	Topeka Chamber of Commerce
Natalie Bright	KCCI

U.S. Oil and Gas Trends

Dr. W.F. Lawson

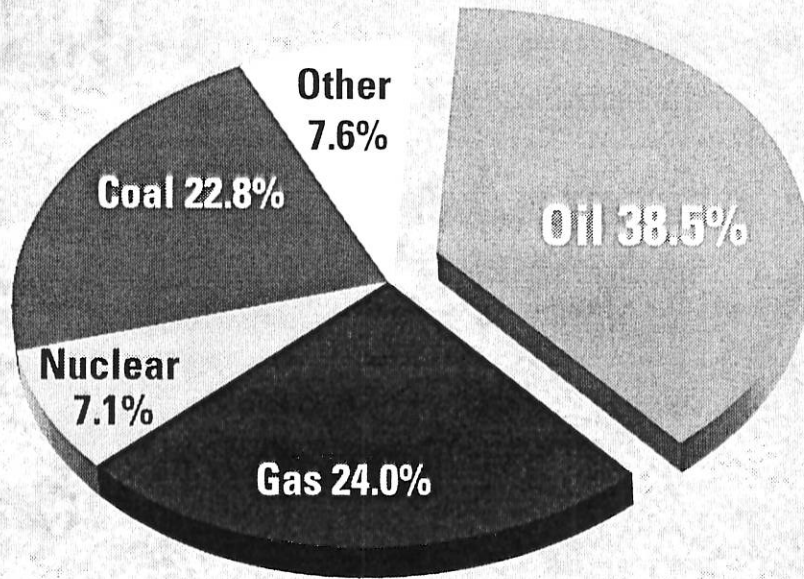
Director, National Petroleum Technology Office

U.S. Department of Energy

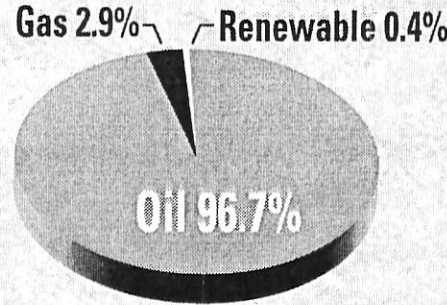
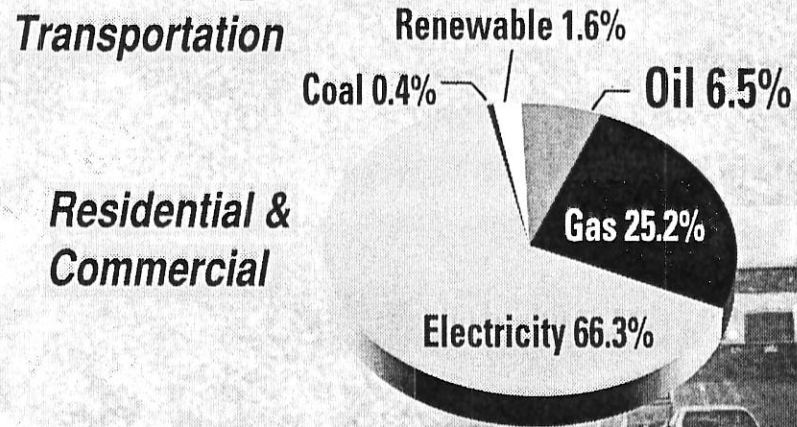
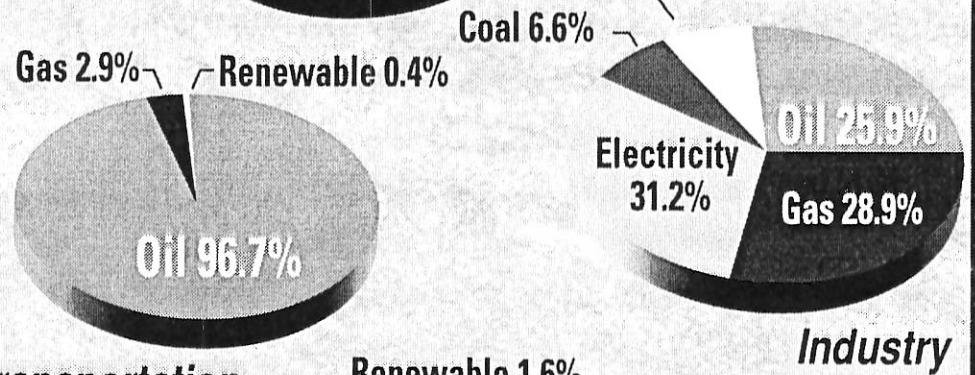
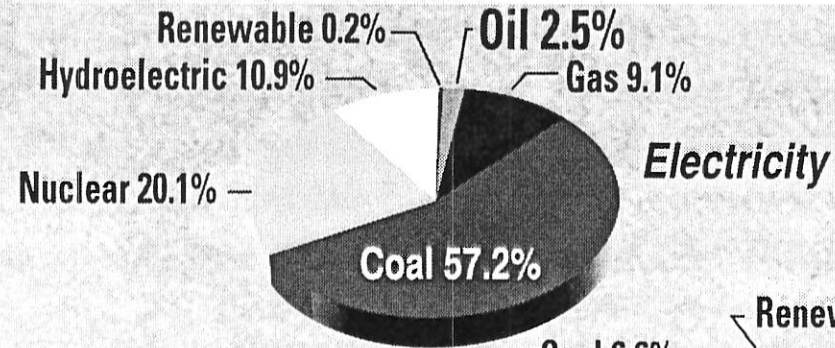


U.S. Oil Trends

Total U.S. Energy Consumption
94.2 Quadrillion Btu (1997)



Our Economy Runs on Oil



✓ Oil is the largest source of U.S. energy (38%).

Source: EIA/Annual Energy Review, 1997

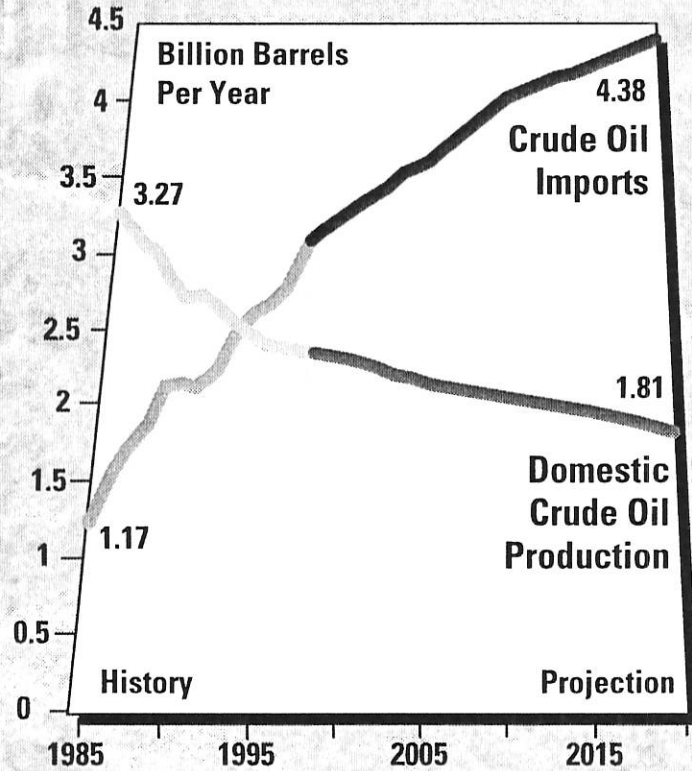
Finding cleaner, cheaper, smarter ways to fuel America's economy



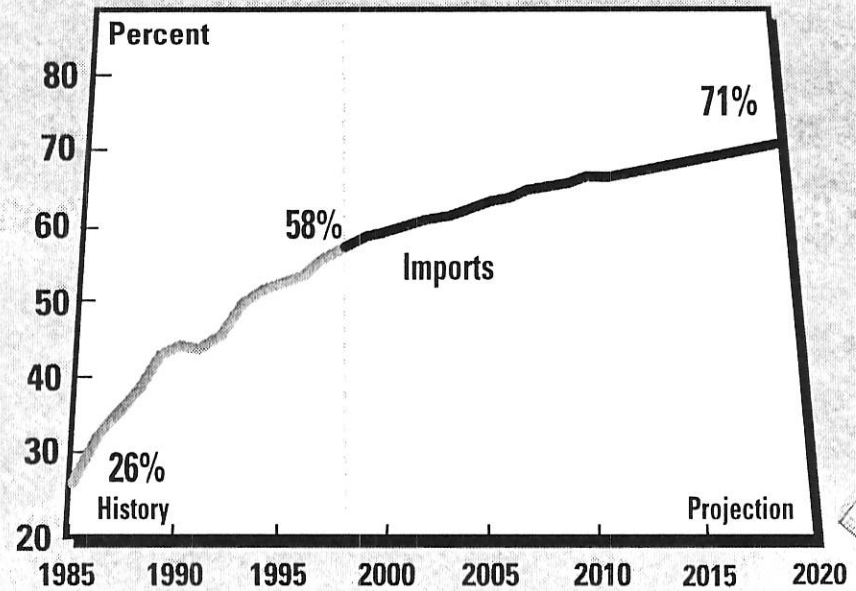
U.S. Oil Trends

Domestic Production Is Declining

Imports vs. Domestic Crude Production



Import Share of Crude Oil Supply



Source: EIA Monthly Review, Internet February, 1999

Sources: EIA Annual Energy Review, 1997
EIA Monthly Energy Review, Internet February, 1999
EIA Annual Energy Outlook, 1999

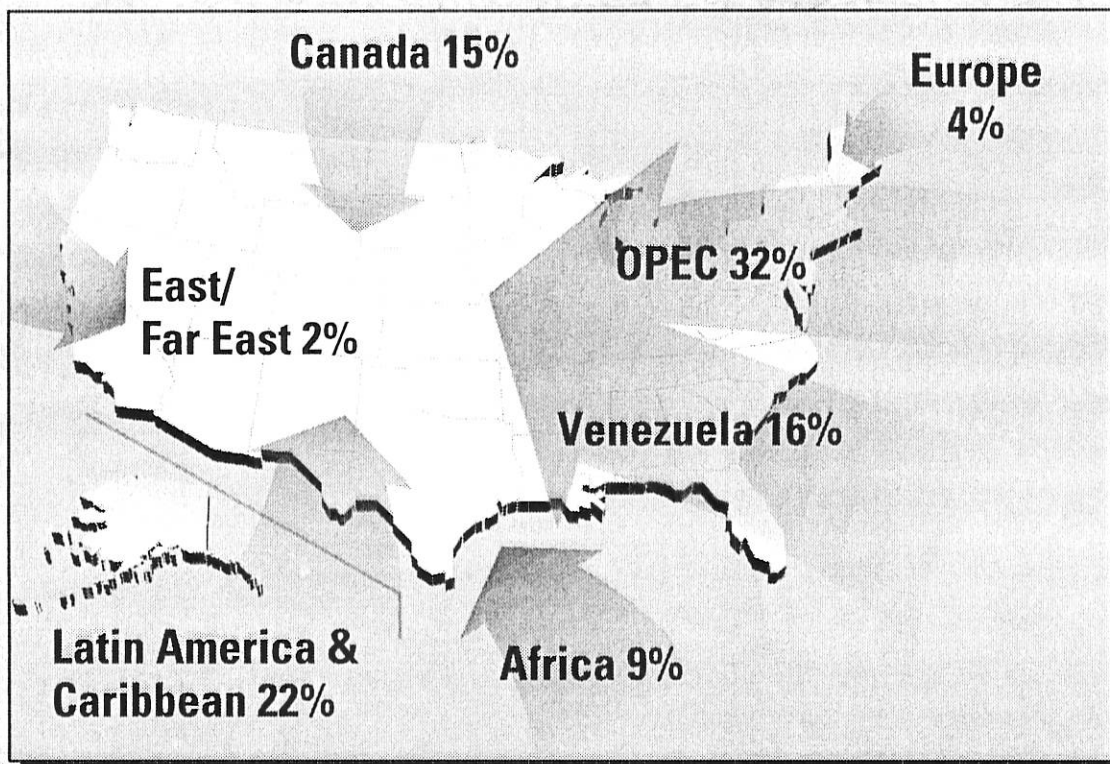
Finding cleaner, cheaper, smarter ways to fuel America's economy



U.S. Oil Trends

Crude Imports Are Rising

Crude Imports in 1998:
8.58 Million Barrels Per Day

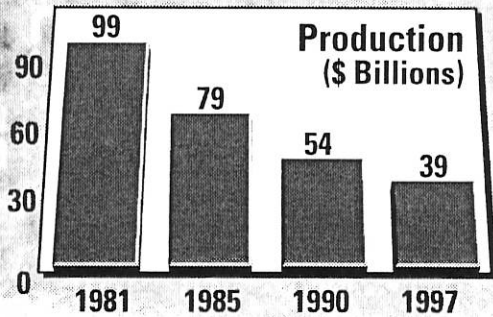


Source: EIA Monthly Review, Internet February, 1999

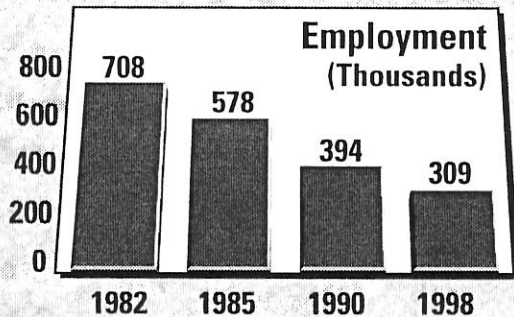
Finding cleaner, cheaper, smarter ways to fuel America's economy



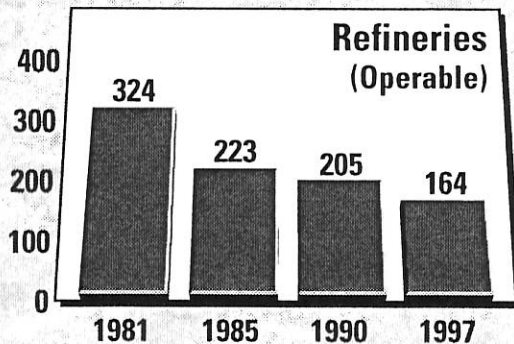
U.S. Oil Trends



• 60% decrease in value of domestic oil production



• 56% of petroleum production jobs lost

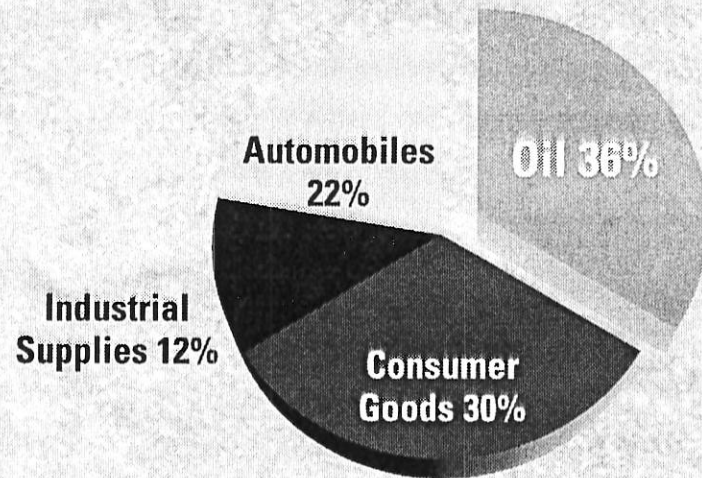


• 49% of domestic refineries closed

Source: Production – IPAA, 1998
 Employment – IPAA, Internet 1999
 Refineries – EIA Annual Energy Review, 1997

Crude Imports Increasingly Harmful to U.S. Economy

Petroleum Imports Account for One-Third of the U.S. Trade Deficit



1998 Merchandise Trade Deficit: \$181 Billion

Source: MER Internet February 1999

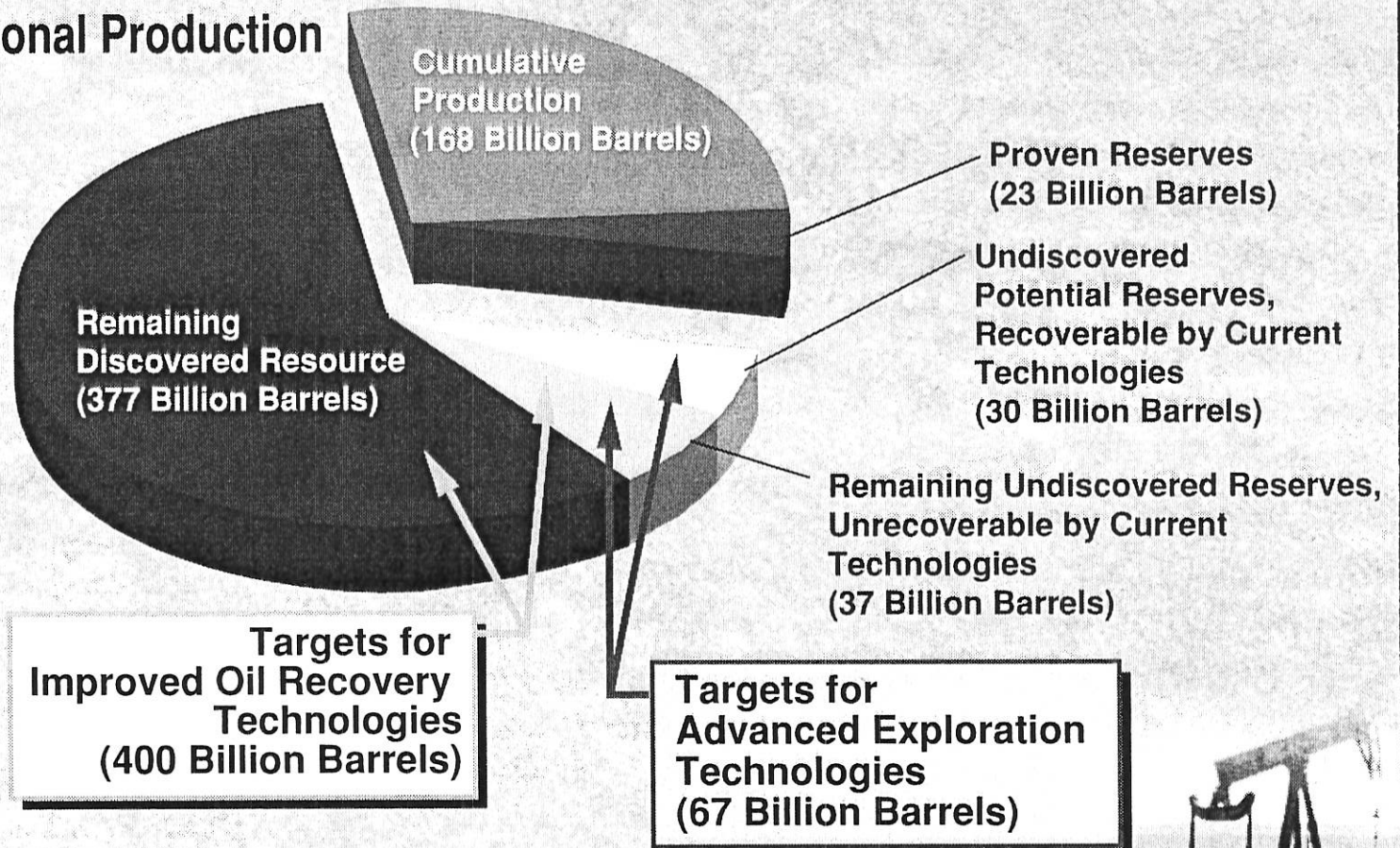
Finding cleaner, cheaper, smarter ways to fuel America's economy



U.S. Oil Trends

Advanced Technology Has a Significant Target

Two-Thirds of U.S. Oil Resource Remains after Conventional Production

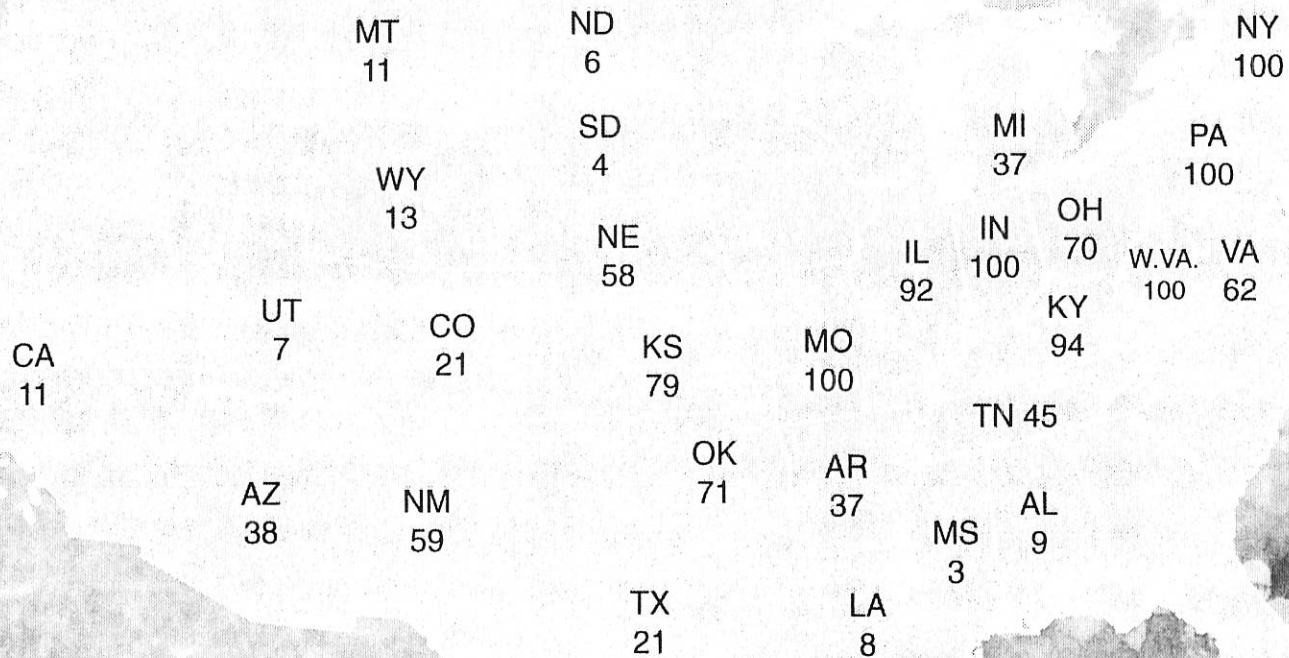


Source: EIA, 1997; USGS, 1995; IPAA, 1998; Intek Inc., 1998

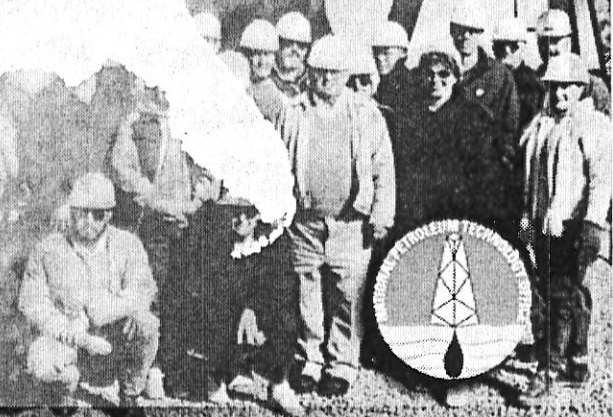
Finding cleaner, cheaper, smarter ways to fuel America's economy



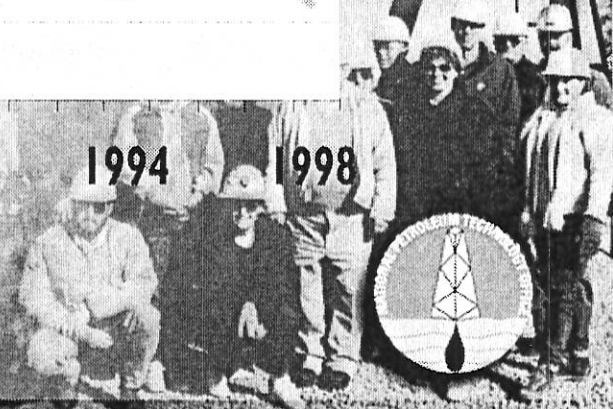
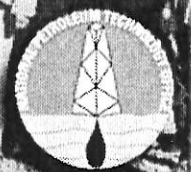
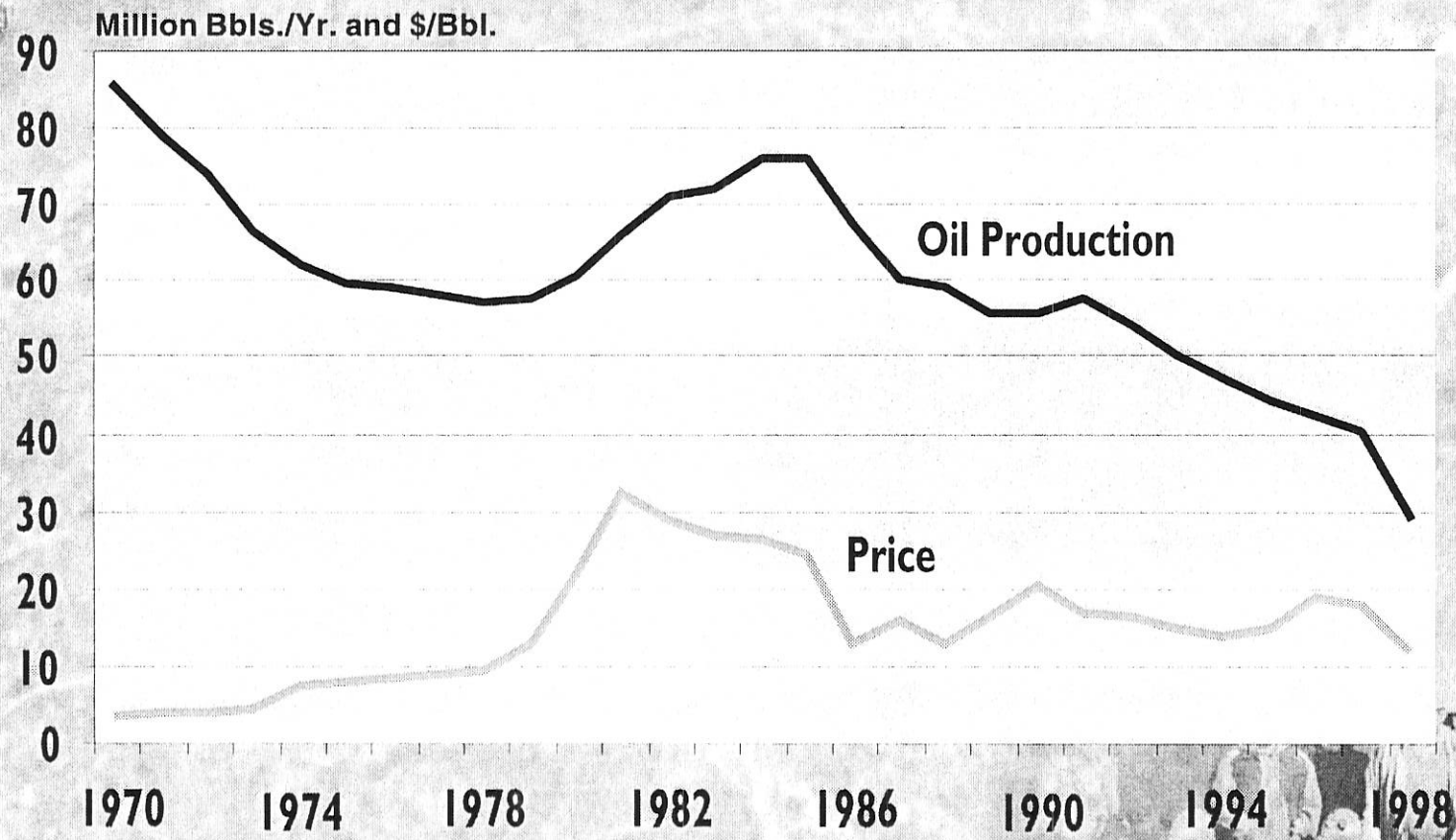
Stripper Well % Production 1997



Source: EIA, 1998



Kansas Production & U.S. Average Well Head Price



Characterization of Domestic Oil and Gas Industry

Majors

- Top 23 produce 35% Gas and 60% Oil
- Most have in-house research facilities
- Trend is to explore and produce overseas

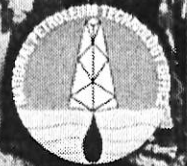
Independents

- >24,000 Independents
- Drill 85% domestic wells
- Typical # employees - 10 full, 3 part-time
- >60% projects are small (<\$2 million)



A Picture of the Independent

- Well educated with >50% holding degrees
- Biggest concerns:
 - Product Price (84%)
 - Produced Water and Environment Costs (12%)
- Drill 85% of all domestic wells
- Account for 43% of U.S. Lower 48 oil production and proved reserves and 60% of gas production
- 75% operate in fewer than 3 states and 40% in only one
- Annual oil field services and supplies expenditures:
 - 42% spend > \$1,000,000
 - 43% spend \$100,000-999,999
 - 15% spend <\$100,000



National Petroleum Technology Office Contacts

- Director, **Bill Lawson**, National Petroleum Technology Program, 918-699-2003, Fax 918-699-2005, E-mail address: blawson@npto.doe.gov
- Technology Transfer, **Herb Tiedemann**, 918-699-2017, Fax 918-699-2005, E-mail address: htiedema@npto.doe.gov



National Petroleum Technology Office

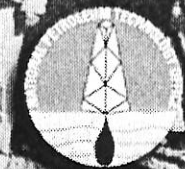
P.O. Box 3628

Tulsa, OK 74101-3628

Connect with us on the web



<http://www.npto.doe.gov>



1-12

Testimony before the Senate Tax Committee. 3/9/99

Chairman Adkins and Members of the Committee:

My name is Timothy R. Carr. I am Chief of the Petroleum Research Section of the Kansas Geological Survey and Co-Director of the University of Kansas Energy Research Center. I do not come as an advocate of any legislation before the committee, but to inform you of the importance of the Kansas petroleum industry on our state's economy, and my analysis of the industry's present state.

These are the major points that I would like to express to the committee:

- 1) The oil and gas industry is a major component of the Kansas economy. The average value of Kansas oil and gas at the wellhead is \$2.0+ billion. Over the last half of the twentieth century, the value of oil and gas is comparable to the cash receipts for all the crops grown in the state (See attached Figure 1). Kansas is one of the few states in the Union that remain, to the present day, a net exporter of energy. Oil and gas production contributes directly to the wealth generated in Kansas.
- 2) The Kansas oil and gas industry is price and cost sensitive. In the first half of 1998, over 98% of the 41,520 producing oil wells made less than 15 barrels of oil per day. These stripper wells produce over 73% of the oil in Kansas. As the average price for oil has dramatically decreased during 1998, so has Kansas production. Kansas monthly oil production has declined approximately a million barrels per month from February to October of 1998 (See attached Figure 2). This unprecedented decline is paralleled by a price decline from \$14.00 to \$10.00 per barrel. In December, average prices were in the \$8.00 per barrel range and monthly production was probably in the vicinity of 2 million barrels.
- 3) Kansas oil and gas is produced by 3,000 operating companies that employ 6,900 Kansas citizens and numerous people outside the state in towns such as Oklahoma City, Denver and Houston. Employment in Kansas is distributed throughout the 90 counties that have reported petroleum production with concentrations in locales such as Chanute, Liberal, Hays, Russell, and Wichita.
- 4) The Kansas petroleum industry is in crisis. In 1997 the value of oil and gas produced at the well head was \$2.25 billion. In 1998, I estimate the value of oil and gas at \$1.67 billion. The decreased value of \$580 million is concentrated in oil. In terms of barrels, oil production in 1998 will decrease by 20% and the value will decrease almost 50%. This is an unprecedented decrease in production that is related to the decrease in oil prices.
- 5) All Kansas citizens need to be concerned. Using input-output multipliers from the US Department of Commerce's Bureau of Economic Analysis, one can estimate the impact of decreased value of oil and gas on the output of the Kansas economy (a

House Taxation
3-9-99
Attachment 2

decrease of approximately \$865 million) and employment (in excess of 6,000 Kansas citizens). Note: that these would not just be people employed directly in the petroleum industry, but would be the mechanic in Bazine or the waitress in Iola.

- 6) The impact of decreased tax revenue at the state and especially local level will be significant. In western and south central Kansas many counties derive a very large portion of their ad valorem taxes from oil and gas production (in some cases in excess of 50%). Raising mill rates to compensate for the decreased valuations could result in a negative feedback loop. In addition, the salaries and royalty incomes of many Kansas citizens are undergoing a negative impact. The total negative impact on the state economy should be felt in terms of reduced state and local tax revenue.

These are the main points that I would like to stress. I would like to walk you through the attached figures that were extracted from Kansas Geological Survey Open-File reports. Additional information is available in two reports entitled:

1998 Kansas Oil and Gas Production: An Examination of the Importance of Stripper Production, and

1998 Kansas Oil and Gas Production and Value

The reports are available from the Kansas Geological Survey Web Site at:
<http://www.kgs.ukans.edu/PRS/Info/webPubs.html>

Attached Figure 1. Value of Kansas oil and gas production at the wellhead and cash receipts for all crops from 1953 to 1998. Dollar values are times 1,000.

Attached Figure 2. Kansas oil production for January through October of 1998 and average monthly-posted price per barrel for the best quality Kansas oil exclusive of transportation costs. Due to the dominance of stripper wells, monthly production is strongly influenced by price.

Attached Figure 3. Monthly and cumulative Kansas oil production for 1998. Cumulative annual production for 1998 is estimated to be just over 32 million barrels. Production in 1998 represents a significant decline from the nearly 40 million barrels produced in 1997. Similar analysis was carried out for gas.

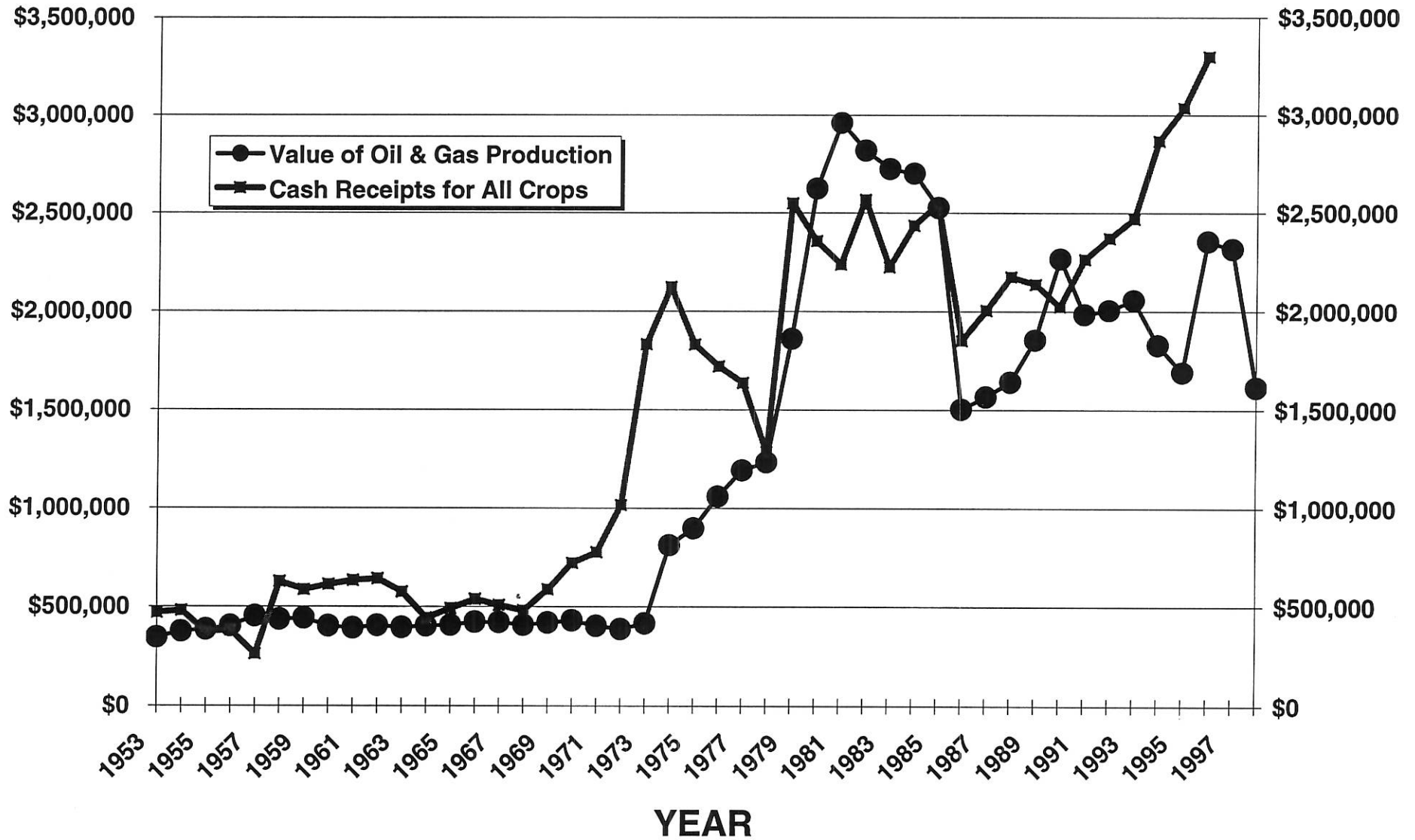
Attached Figure 4. Monthly and cumulative value of Kansas oil production during 1998. Cumulative value of Kansas oil production is estimated at approximately \$400 million. This is a decrease in value of approximately \$350 million from 1997.

Attached Figure 5. Map showing the distribution of Kansas counties that have produced oil and gas. Figure is from the web site of the Kansas Geological Survey (<http://www.kgs.ukans.edu/PRS/petro/interactive.html>)

I thank you for your time and consideration.

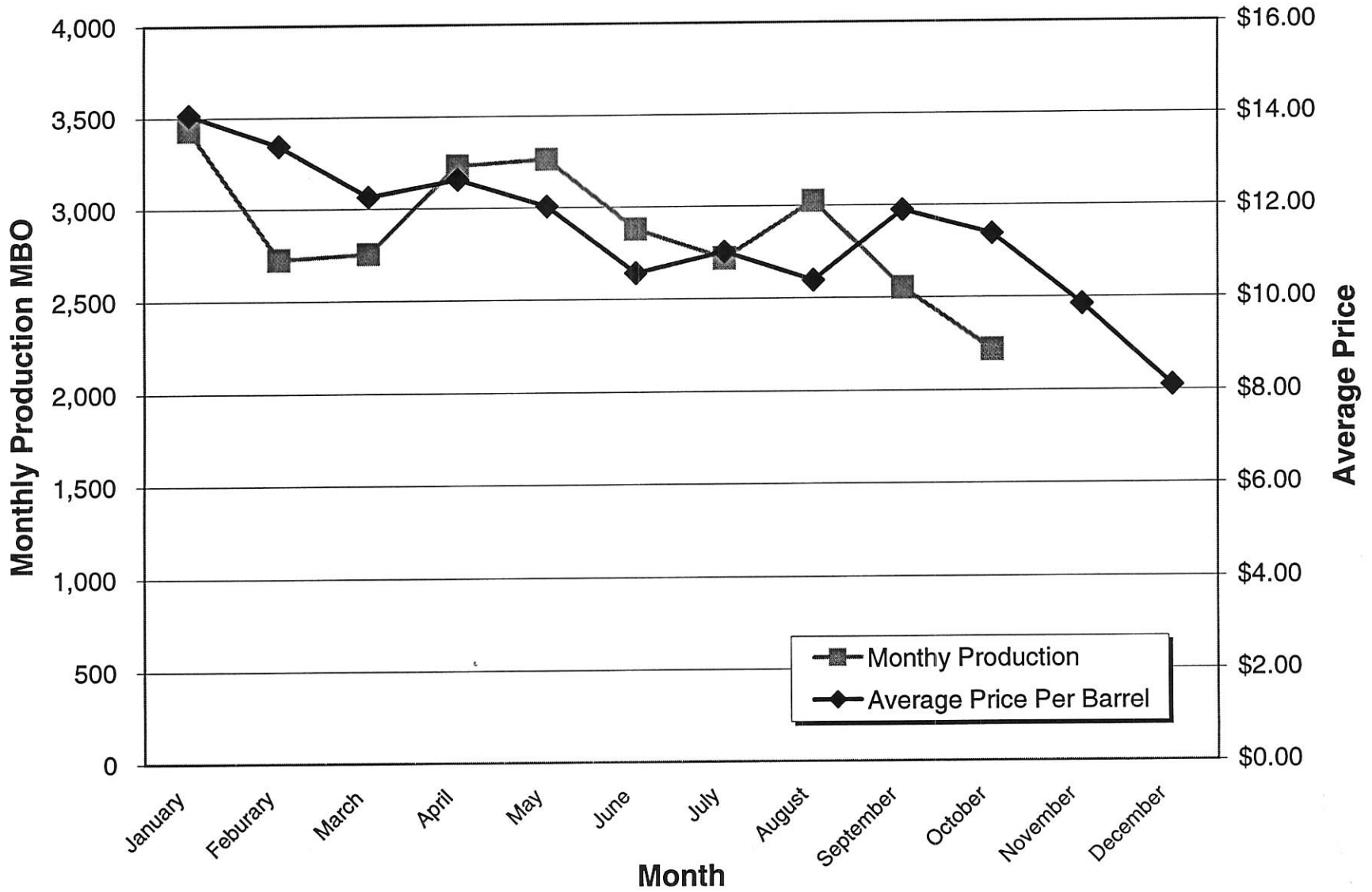
2-3
2-2

KANSAS PRODUCTION (\$1,000)



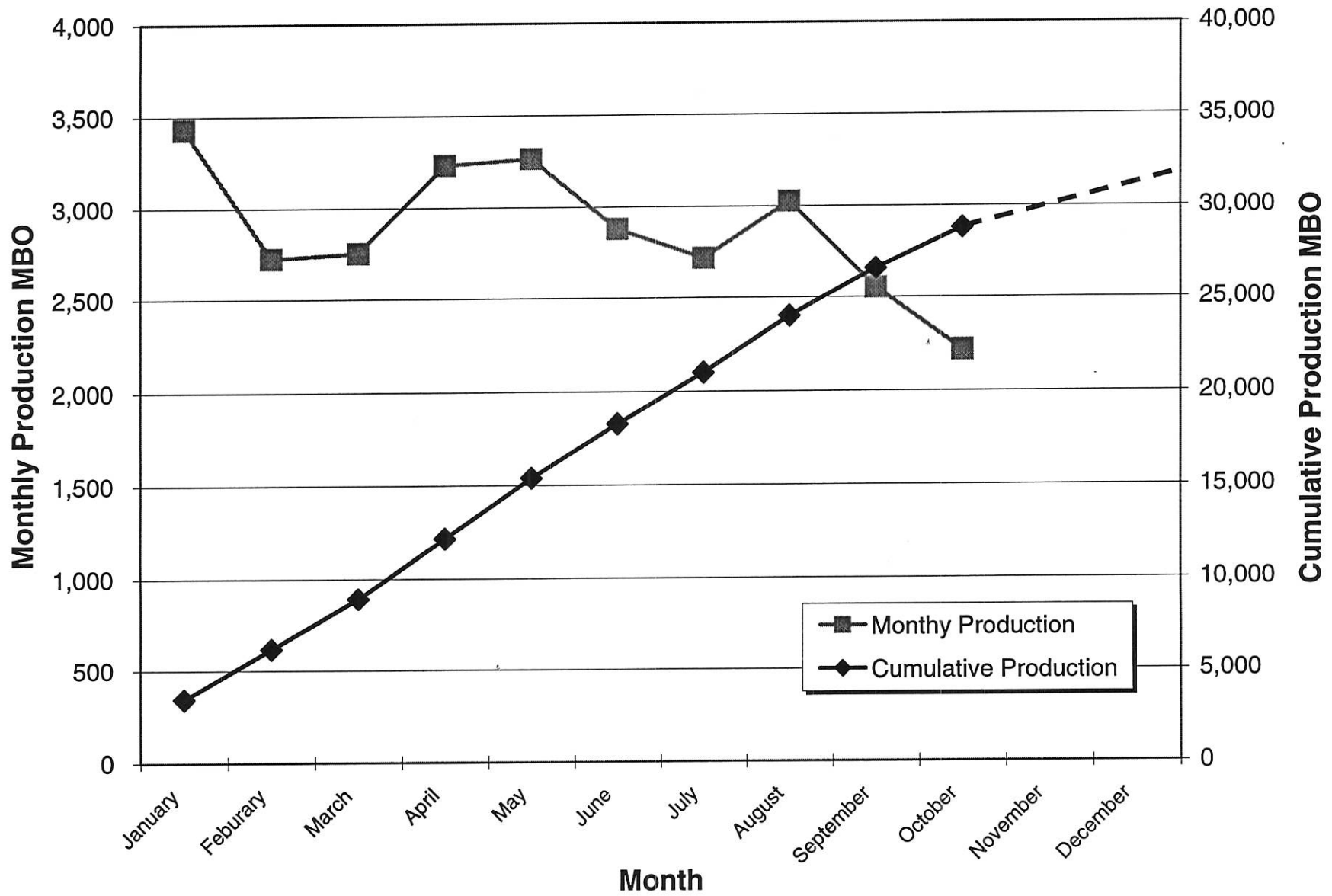
2-4
2-3

Kansas Oil Production 1998



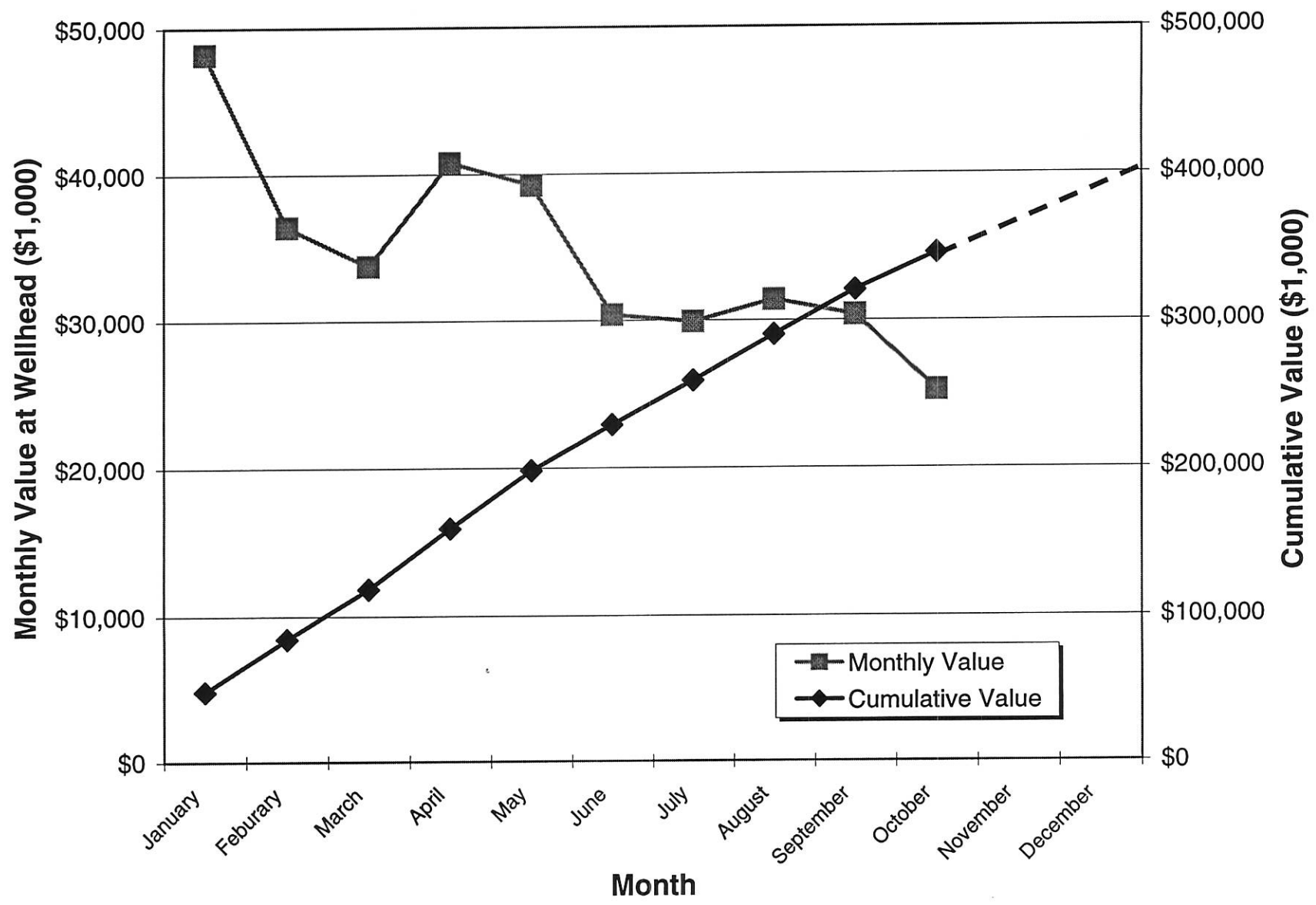
2-5
2-4

Kansas Oil Production 1998



2-6
2-5

Value of Kansas Oil Production



1-2-96

Oil and Gas Production in Kansas

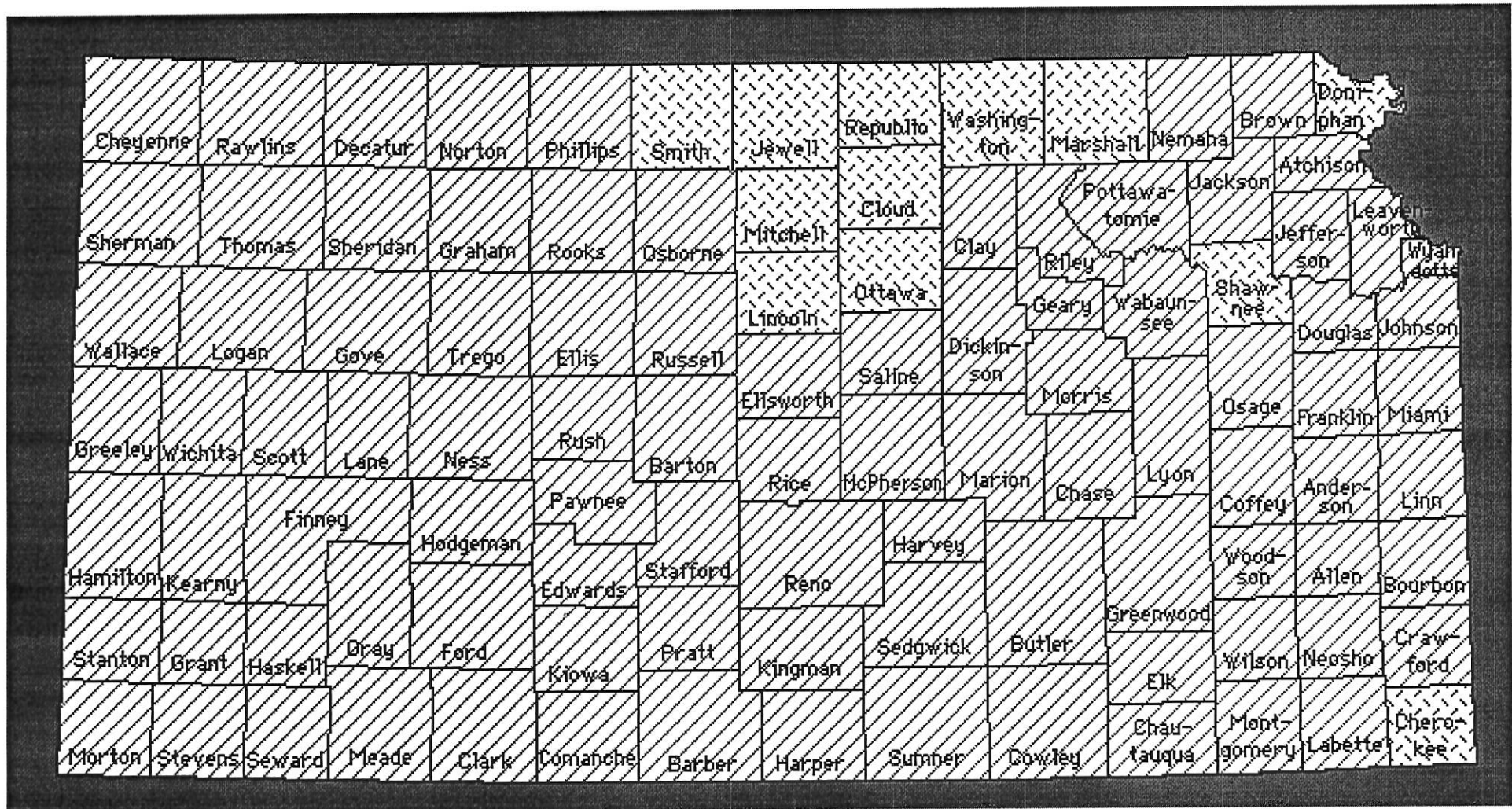


Figure 5

[Http://www.kgs.ukans.edu/PRS/petro/interactive.html](http://www.kgs.ukans.edu/PRS/petro/interactive.html)

OVERVIEW OF KANSAS OIL AND GAS PRODUCTION FOR 1998

David P. Williams
Kansas Corporation Commission - Conservation Division
Production Supervisor - Environmental Geologist
Wichita, Kansas
March 9, 1999

EXECUTIVE SUMMARY

Oil and gas production in Kansas has been established in 91 counties throughout the state. Southwestern Kansas remains the primary natural gas producing region of the state, with approximately 78% of the total yearly statewide gas production. This gas production is attributed to three major producing fields: Hugoton (60.8%); Panoma (15.0%); and Greenwood (1.8%). The remaining gas production (22.4%) is statewide from all other fields.

During 1998, Kansas has experienced an overall decline in oil and gas production, resulting in a reduction in exploratory drilling and well plugging. Natural gas production is estimated to decline approximately 8.3%, with the average wellhead gas price declining approximately 12.8%.¹ The decline in oil production is more dramatic and is estimated to decline approximately 19.1%, with the yearly average posted price for "Kansas common" crude oil declining by more than 37.4%.²

Drilling permits, as approved by the Kansas Corporation Commission (KCC) have decreased from the prior year total by approximately 51.6%. A comparison of the number of actual wells drilled with the number of permits issued shows a decrease of more than 48.5%. With the decrease in well permits, a decline in the number of active Kansas rotary drilling rigs of similar proportion is noted (-52.6%).³

The 1998 Kansas well plugging activity by licensed operators shows a statewide decrease in total well plugging of more than 18.5% from the prior year period (all well types). The percentage breakdown of this decrease by category of wells plugged (from the prior year period by well type) is as follows: dry and abandoned well plugging (~36.9%); oil well plugging (~16.1%); gas well plugging (~15.6%); salt water disposal plugging (~18.7%); enhanced recovery well plugging (~4.0%); and other well plugging (~34.6%).

EXHIBITS

Figure 1:	Oil & Gas Fields in Kansas;
Figure 1 A:	Anadarko Basin Province in Kansas;
Figure 1 B:	Major Producing Gas Fields in Kansas;
Figure 2:	Kansas Gas Product by Major Gas Field 1984-1998;
Figure 2 A:	Data source: Figure 2;
Figure 3:	Kansas Gas & Average Wellhead Price 1984 - 1998;
Figure 4:	Kansas Oil Product & Kansas Average Posted Crude Oil Price 1984-1998.
Figure 4A:	Data source: Figure 3 and 4; ¹
Figure 5:	KCC Total Intents to Drill Permitted for Kansas 1989-1998;
Figure 6:	KCC Drilling Intents Permitted Vs. Wells Actual Drilled in Kansas 1996-1998;
Figure 6 A:	Kansas Intent Permits and Monthly Crude Oil Posted Price 1996-1998;
Figure 7:	Kansas Active Rig Count 1995-1998;
Figure 7A:	Data source: Figure 7;
Figure 8:	Kansas Well Plugging Summary 1987-1998;
Figure 8A:	Data source: Figure 8.

¹ The Total Gas Production and Average Yearly Gas Price Is Estimated for 1998.

² The Total Oil Production Is Estimated for 1998. Data Source for the 1998 Average Posted Crude Oil Price Is from National Cooperative Refinery Association (NCRA).

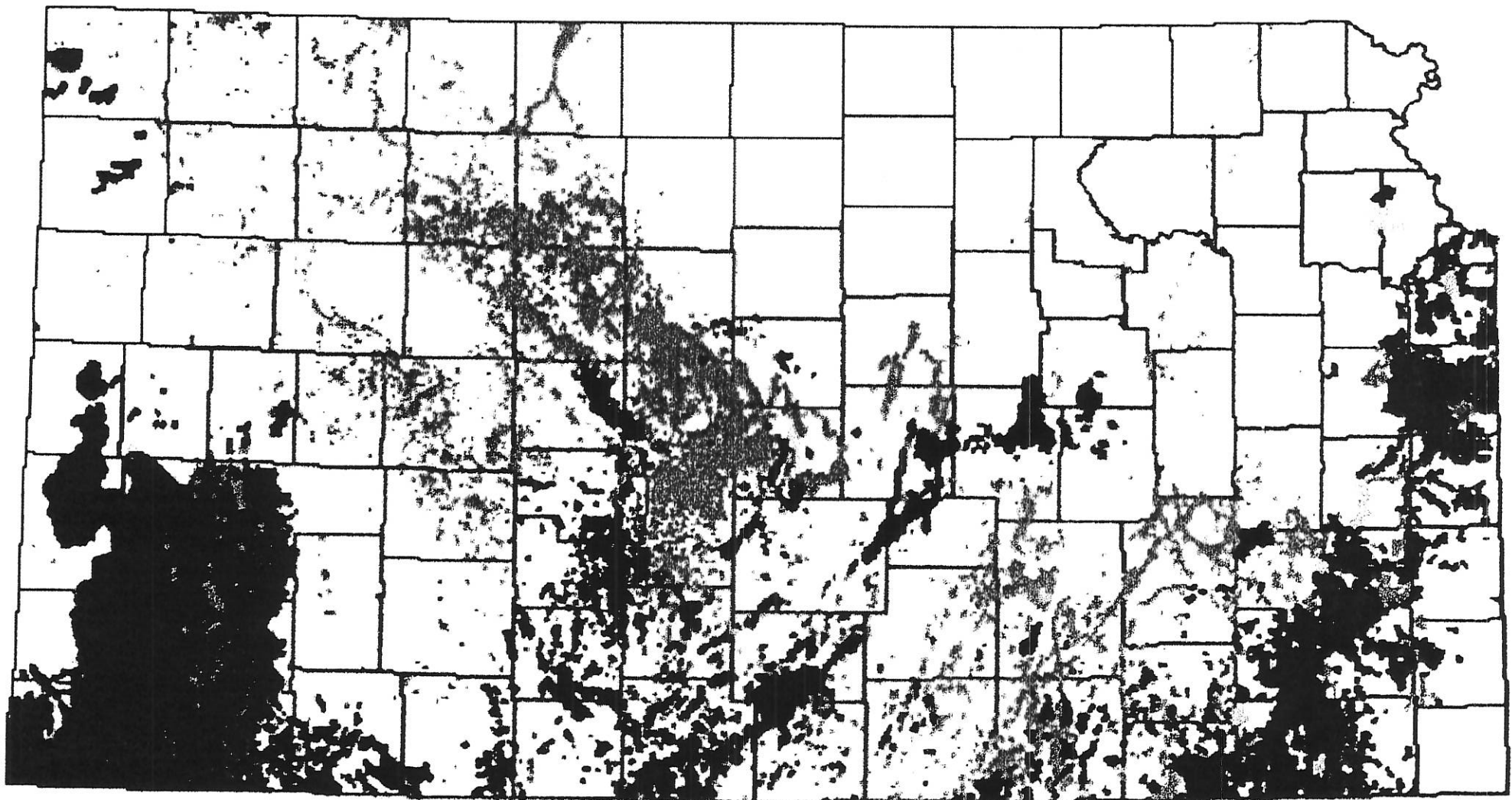
³ Kansas Active Rig Count is estimated for 1998 from source: Baker Hughes Rig Count as published in Oil & Gas Journal.

House Taxation.
3 9-99
Attachment 3

Oil and Gas Fields in Kansas



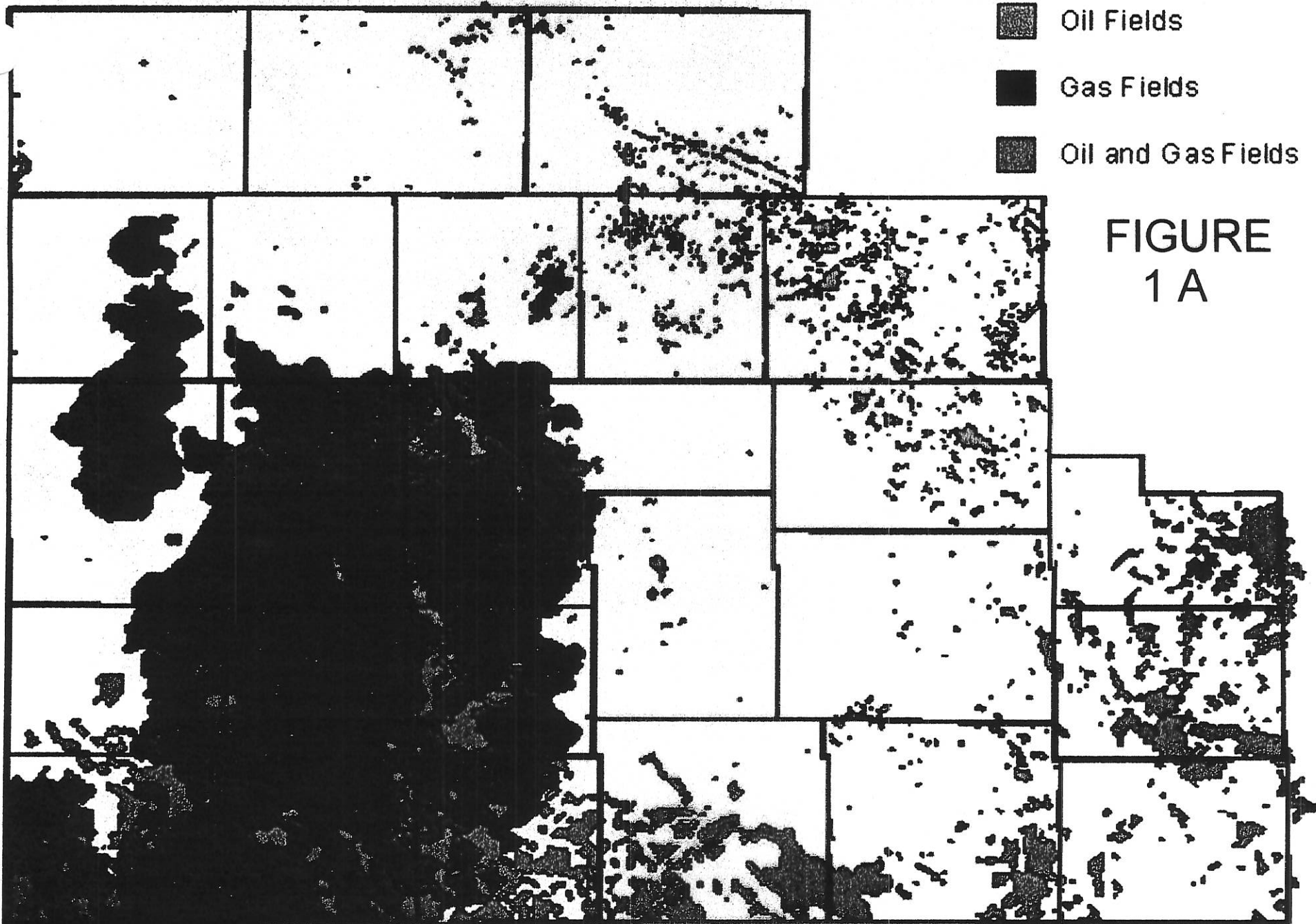
Figure 1






0 50 mi

A scale bar indicating a distance of 50 miles, starting from 0.

Oil and Gas Fields



-  Oil Fields
-  Gas Fields
-  Oil and Gas Fields

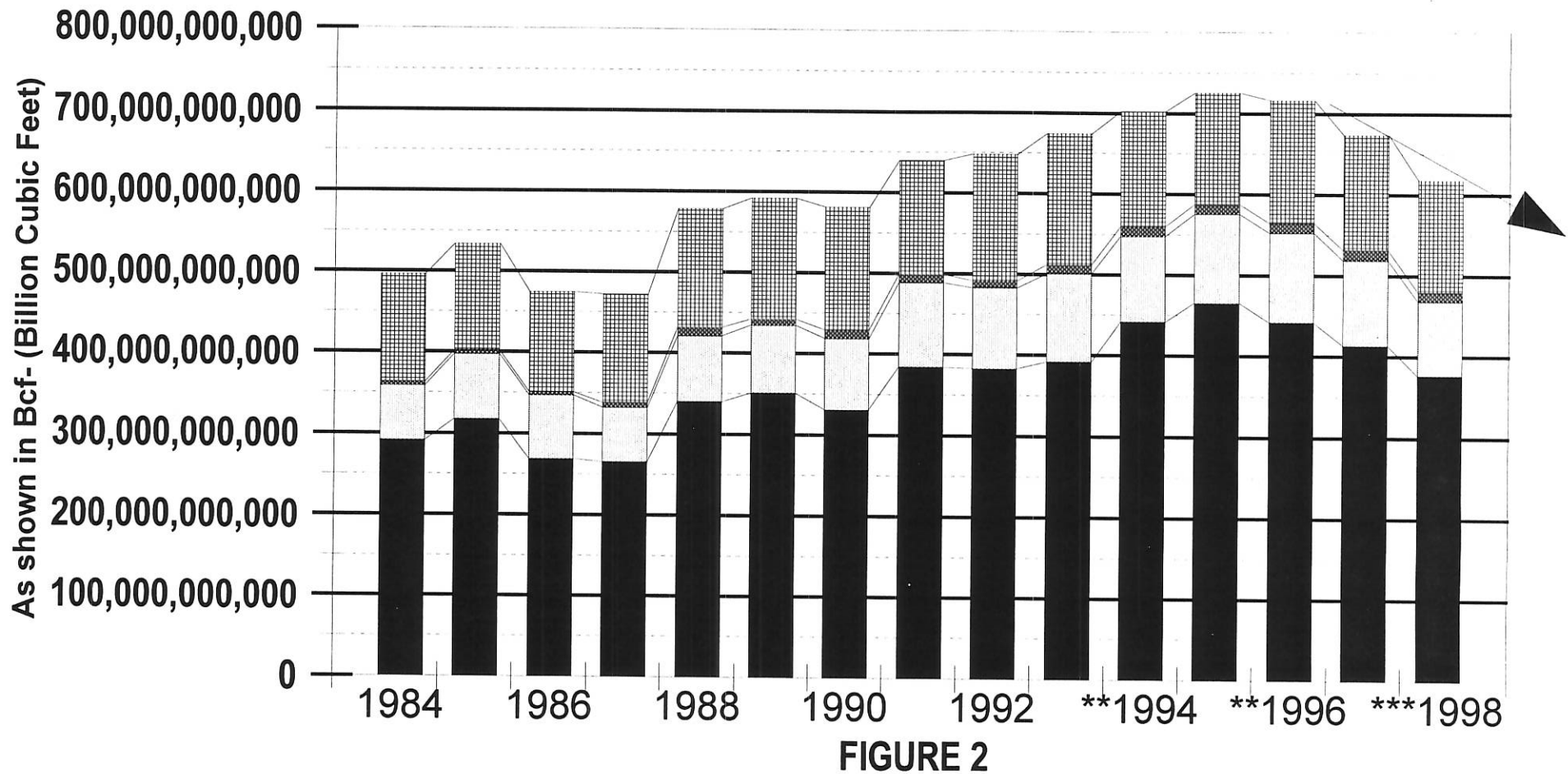
**FIGURE
1 A**

3-3

Anadarko Basin Province in Kansas

KANSAS GAS PRODUCT BY MAJOR GAS FIELDS 1984-1998

3-5



DPW/KCC/1/12/99 ***1998 TOTAL IS ESTIMATED USING 6 MONTHS ACTUAL GAS PRODUCTION. **ALL VOLUMES SUBJECT TO K.D.O.R. REVISIONS.

KANSAS GAS PRODUCTION BY FIELD WITH % 1984-1998 - FIGURE 2 A.

Year	Hugoton	Panoma	Greenwood	Other	*Kansas Total
1984	290995962000	66922616000	4293909000	133564513000	495777000000
1985	316548466000	80087990000	4643765000	132119779000	533400000000
1986	268555088000	78615361000	3363674000	123310877000	473845000000
1987	265182345000	66642440000	6298196000	133520019000	471643000000
1988	339118768000	81940915000	10689315000	146597002000	578346000000
1989	350524593000	83584922000	7959640000	149902845000	591972000000
1990	330848686000	87891593000	10573915000	152233806000	581548000000
1991	383873739000	104475235000	10744602000	140349424000	639443000000
1992	383052317000	99407711000	9066859000	156504113000	648031000000
1993	390785539000	109909545000	10756566000	162661350000	674113000000
**1994	441406290000	106396869000	11936901000	142317940000	702058000000
**1995	464821214000	110789570000	11328752000	138491464000	725431000000
**1996	440872140000	111027373000	12497639000	152015848000	716413000000
**1997	413145739000	104936180000	12655338000	142859743000	673597000000
***1998	375895290000	92530980000	11249319000	138324411000	618000000000
%	60.80%	15%	1.82%	22.38%	100%

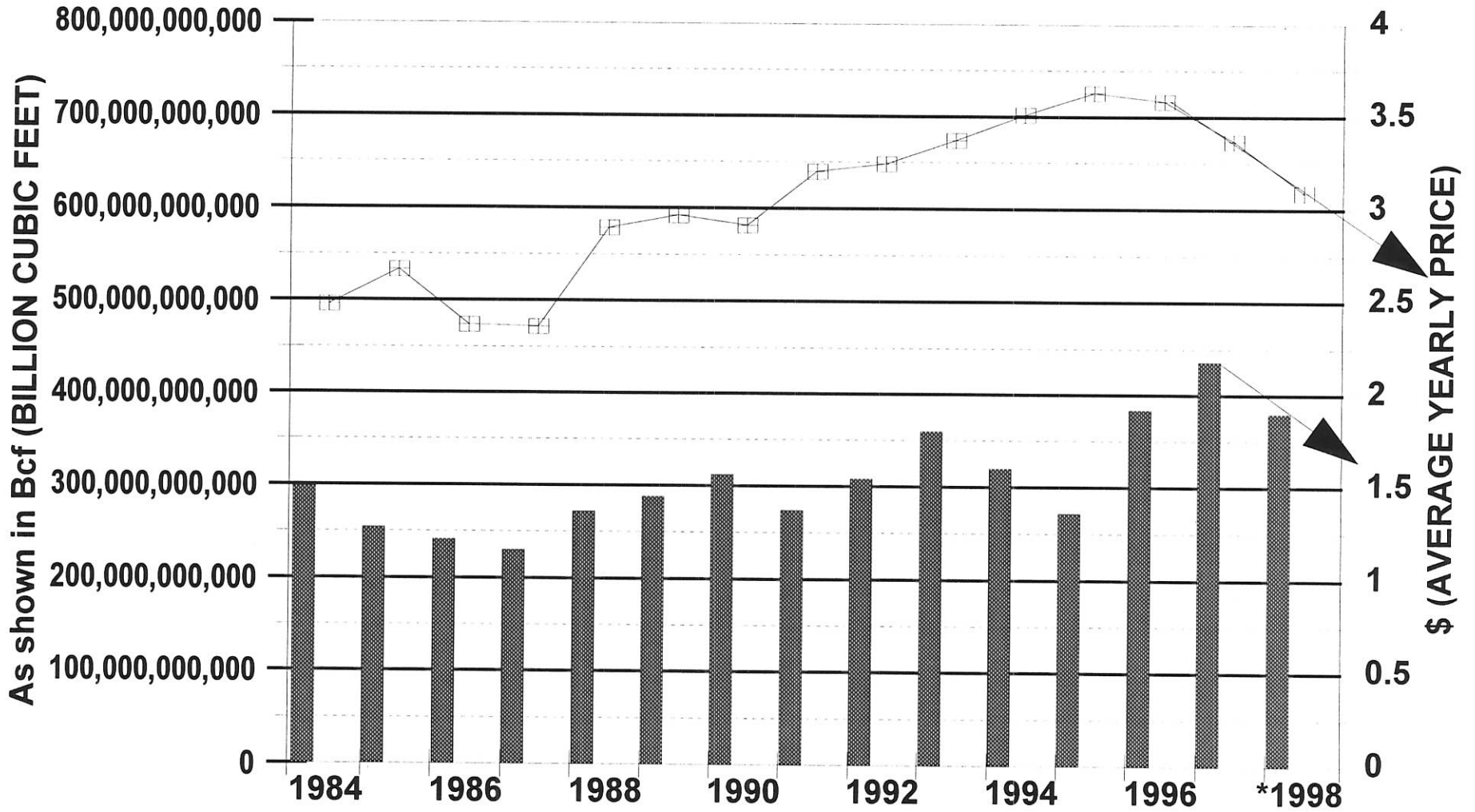
**** Original Hugoton, Panoma & Greenwood volumes as reported has been adjusted for post period corrections to reflect actual production/year.**

*****1998 Estimated total production volume is from actual reported production for 1998 from KCC Proration Reports then estimated for the remainder of the state by field percentage contributions.**

KANSAS GAS & AVERAGE WELLHEAD \$

1984 - 1998

3-7



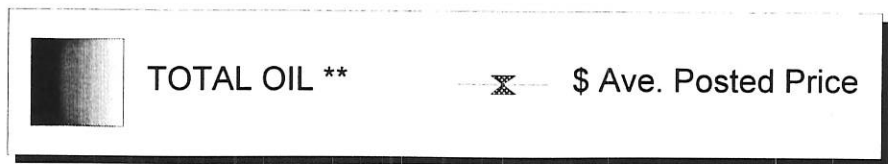
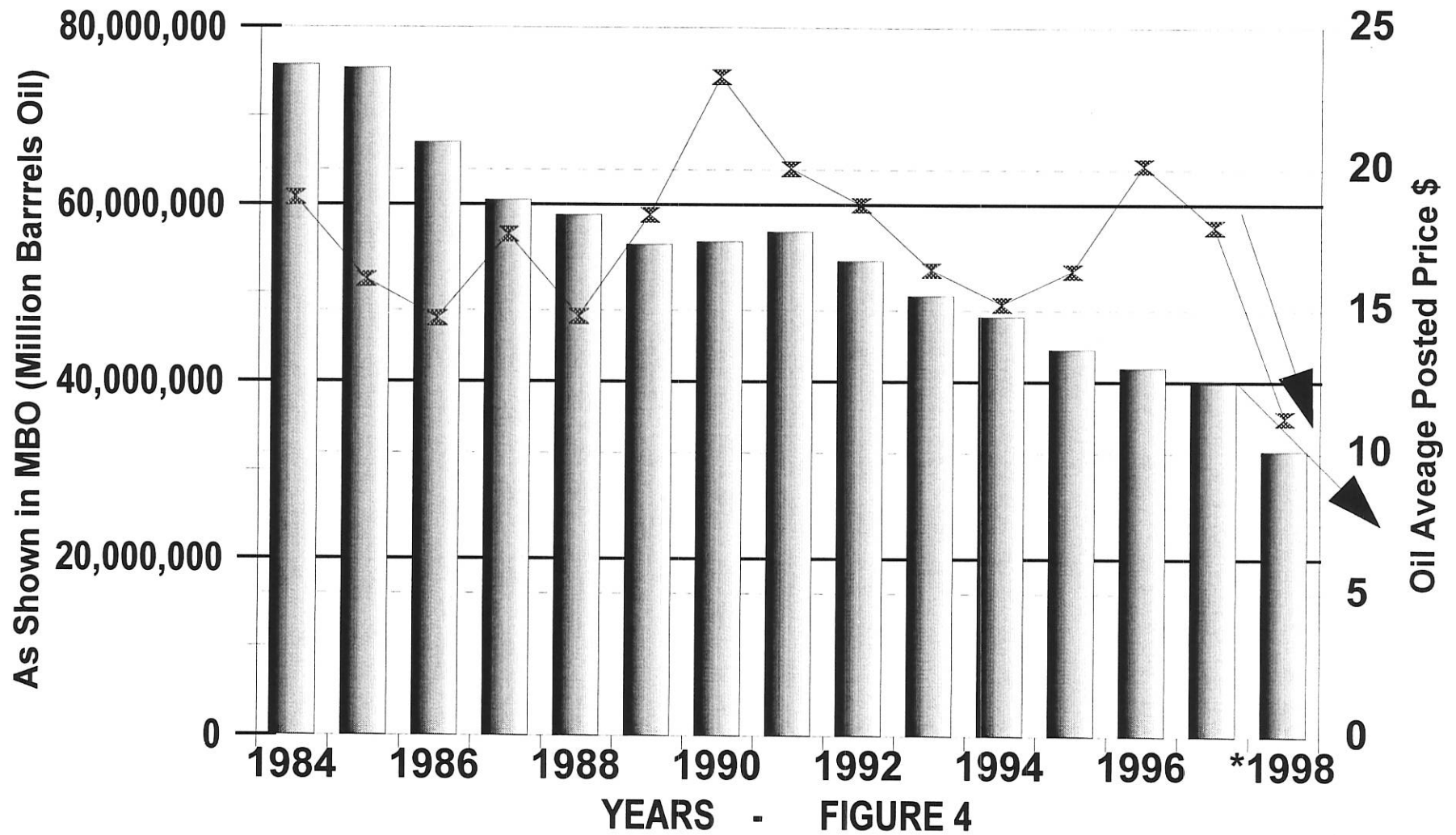
YEARS - FIGURE 3

TOTAL GAS
 \$ WH AVERAGE PRICE

KCC/DPW-3/5/1999. *1998 Estimated Gas Volume. Average Posted Price \$ Data: KDOR & NCRA Kansas Posted Price Reports.

Kansas Oil Product & Ave Posted \$ 1984 - 1998 & Trend

3-8



KCC/DPW-3/5/1999. *1998 Estimated Oil Volume. Average Posted Price \$ Data: E.I.A. & NCRA Kansas Posted Price Reports.

Kansas Total Oil & Gas 1984-1998 With Average \$ - Figure 4 A

3-9

YEAR	TOTAL GAS	TOTAL OIL **	WH GAS \$	KS OIL POSTED AVE.\$
1984	495,777,000,000	75,729,000	1.49	19
1985	533,400,000,000	75,407,000	1.27	16.1
1986	473,845,000,000	67,032,000	1.21	14.73
1987	471,643,000,000	60,544,000	1.15	17.7
1988	578,346,000,000	58,824,000	1.36	14.8
1989	591,972,000,000	55,485,000	1.44	18.39
1990	581,548,000,000	55,827,000	1.56	23.27
1991	639,443,000,000	56,927,000	1.37	20.04
1992	648,031,000,000	53,633,000	1.54	18.76
1993	674,113,000,000	49,691,000	1.8	16.43
1994	702,058,000,000	47,327,000	1.6	15.22
1995	725,431,000,000	43,616,000	1.36	16.39
1996	716,413,000,000	41,599,000	1.92	20.15
1997	673,597,000,000	39,836,000	2.18	17.95
*1998	618,000,000,000	32,246,000	1.9	11.23
* 1998 TOTAL OIL & GAS VOLUMES AND GAS WELLHEAD PRICE ARE ESTIMATED FOR TOTAL YEAR.				
* 1998 KANSAS AVERAGE POSTED OIL PRICE DATA SOURCE: 1998 N.C.R.A. POSTED PRICE REPORTS.				
**Data Source: Energy Information Agency as published in Twentieth Century Petroleum Statistics 1998 by DeGolyer and MacNaughton				

KANSAS TOTAL INTENTS PERMITTED

1989 - 1998

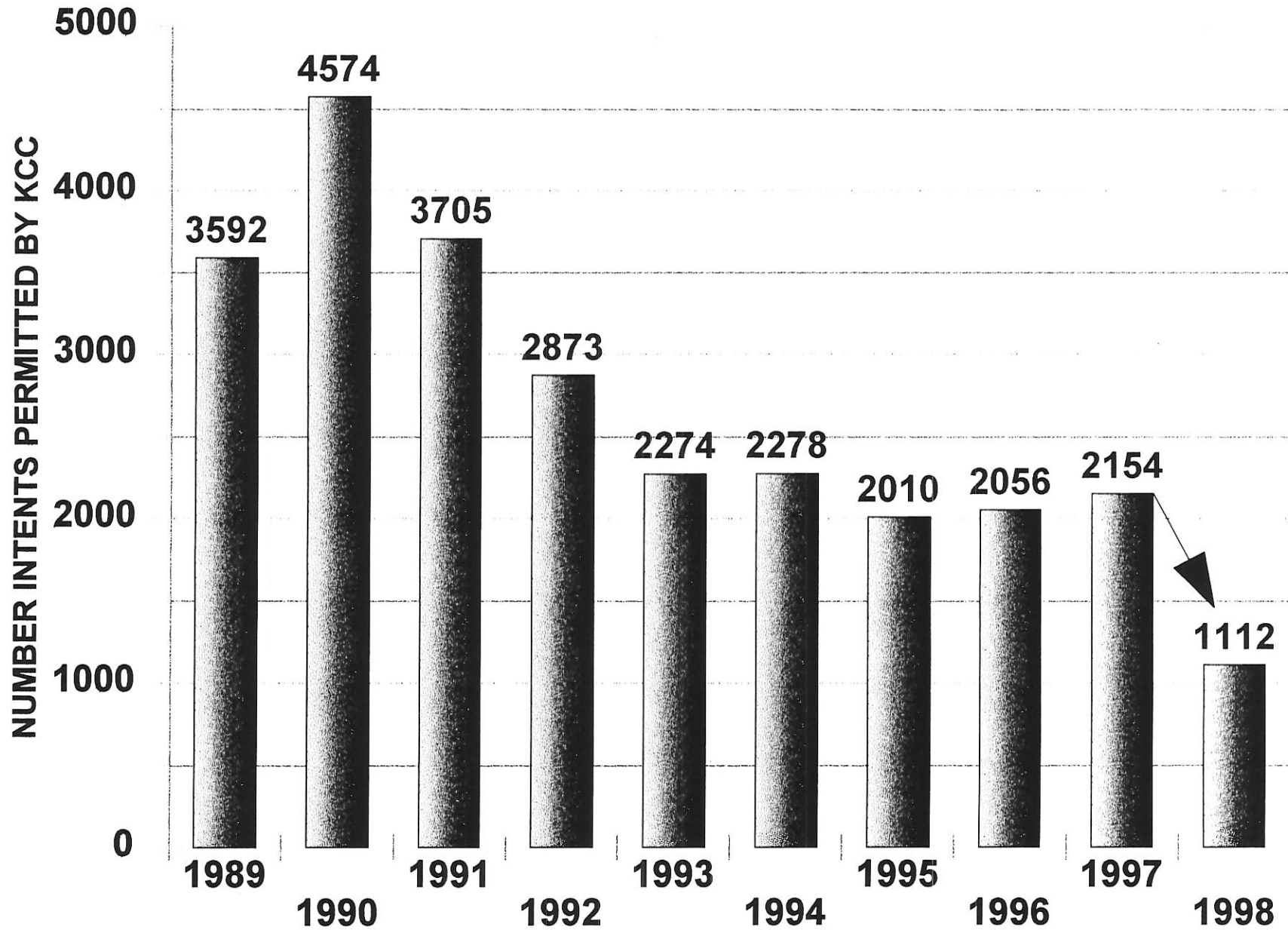


FIGURE 5

3-10

KS. DRILLING INTENTS & ACTUAL DRILLED 1996-1998

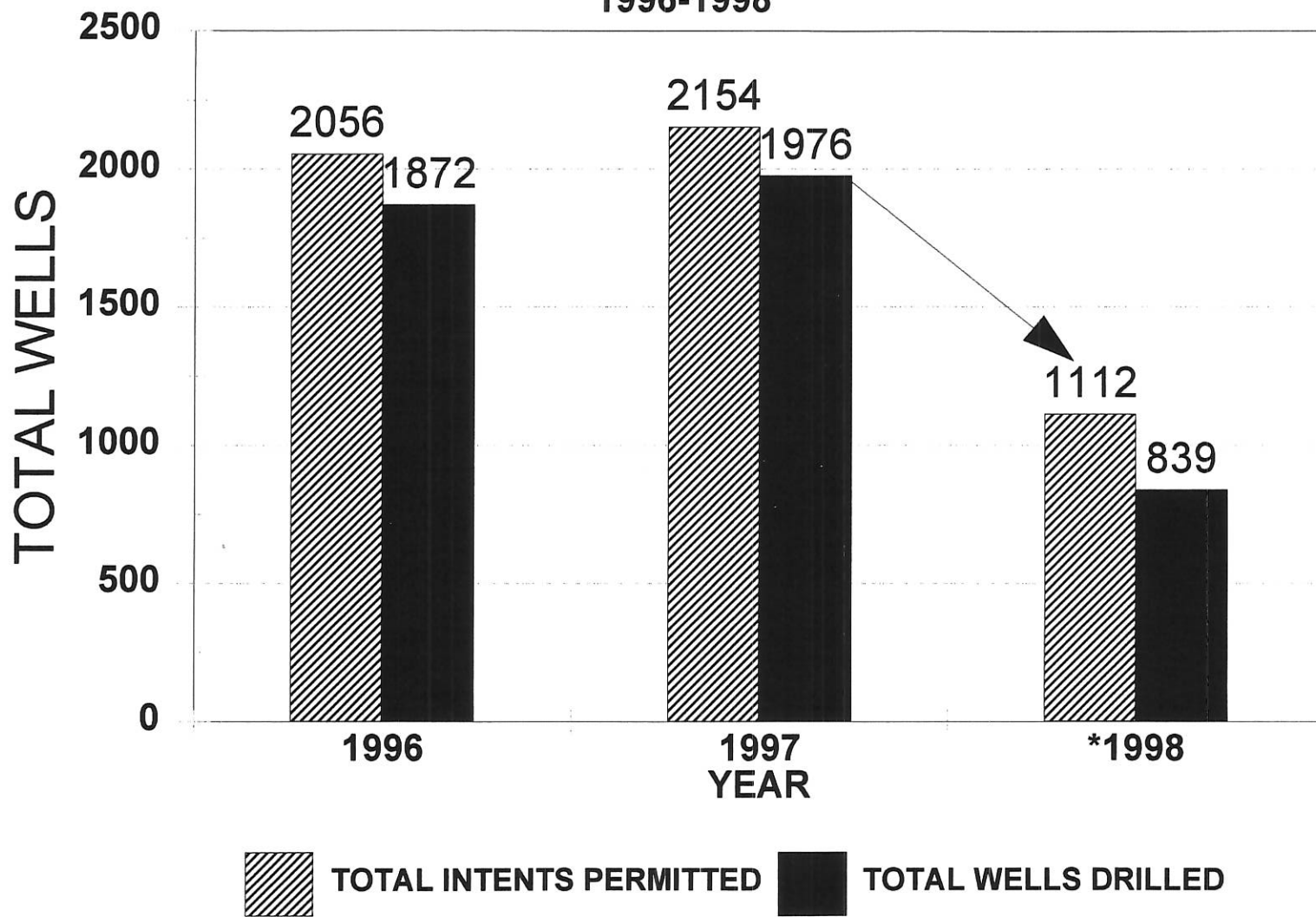


FIGURE 6

C/DPW 1/14/1999. *1998 DATA IS FROM ACTUAL PERMITS APPROVED AND ASSOCIATED SPUD CALLS RECEIVED FOR NEW WELLS DRILLED..

KS. INTENT COUNT OF APPROVED PERMITS 1996 THROUGH 1998

3-12

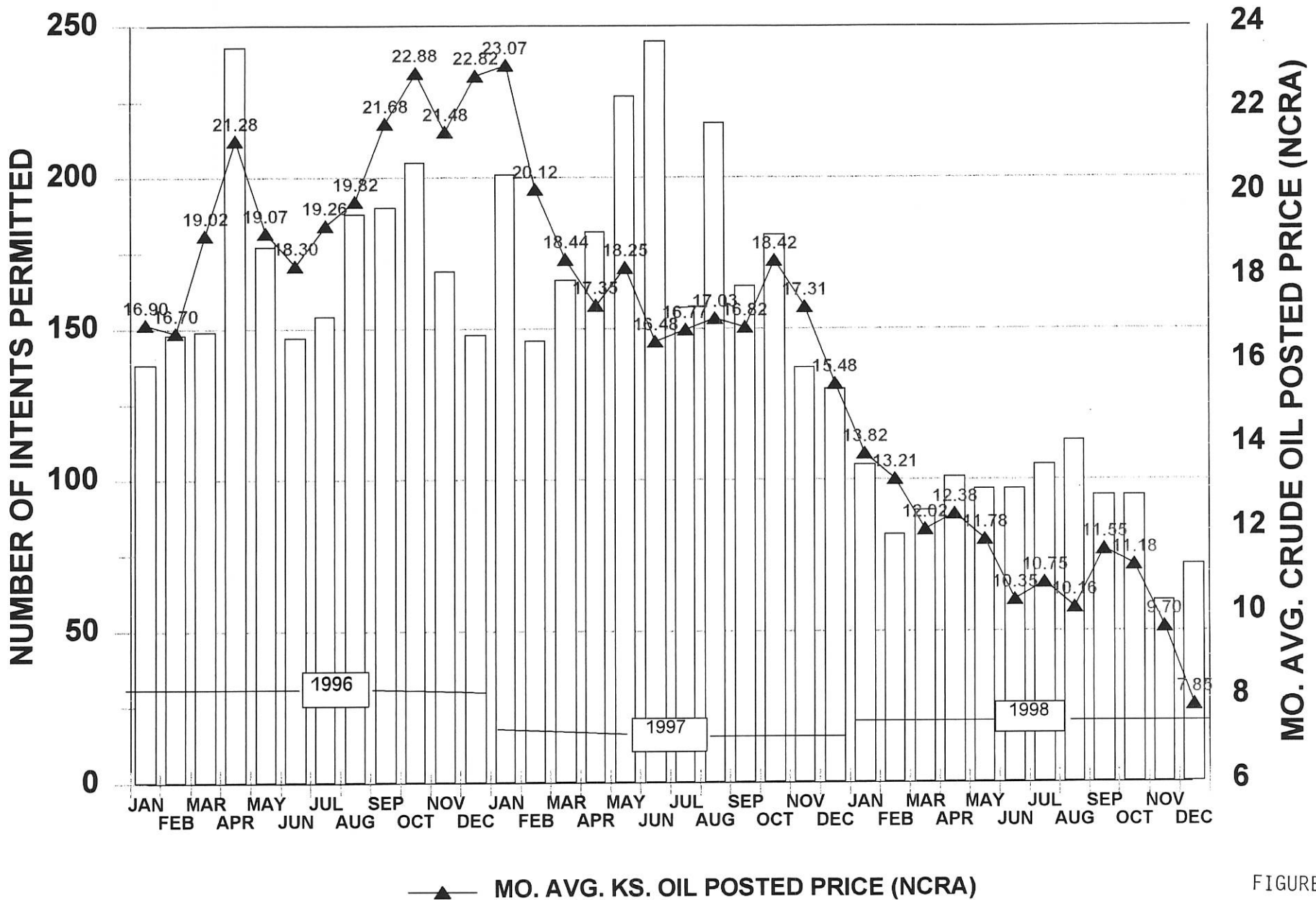


FIGURE 6A

KCC/DPW 1/13/1999. TOTALS INCLUDE ALL OIL, GAS, SWDW, ENH. REC., STORAGE & CATHODIC WELLS.

KANSAS ACTIVE RIG COUNT 1995-1998

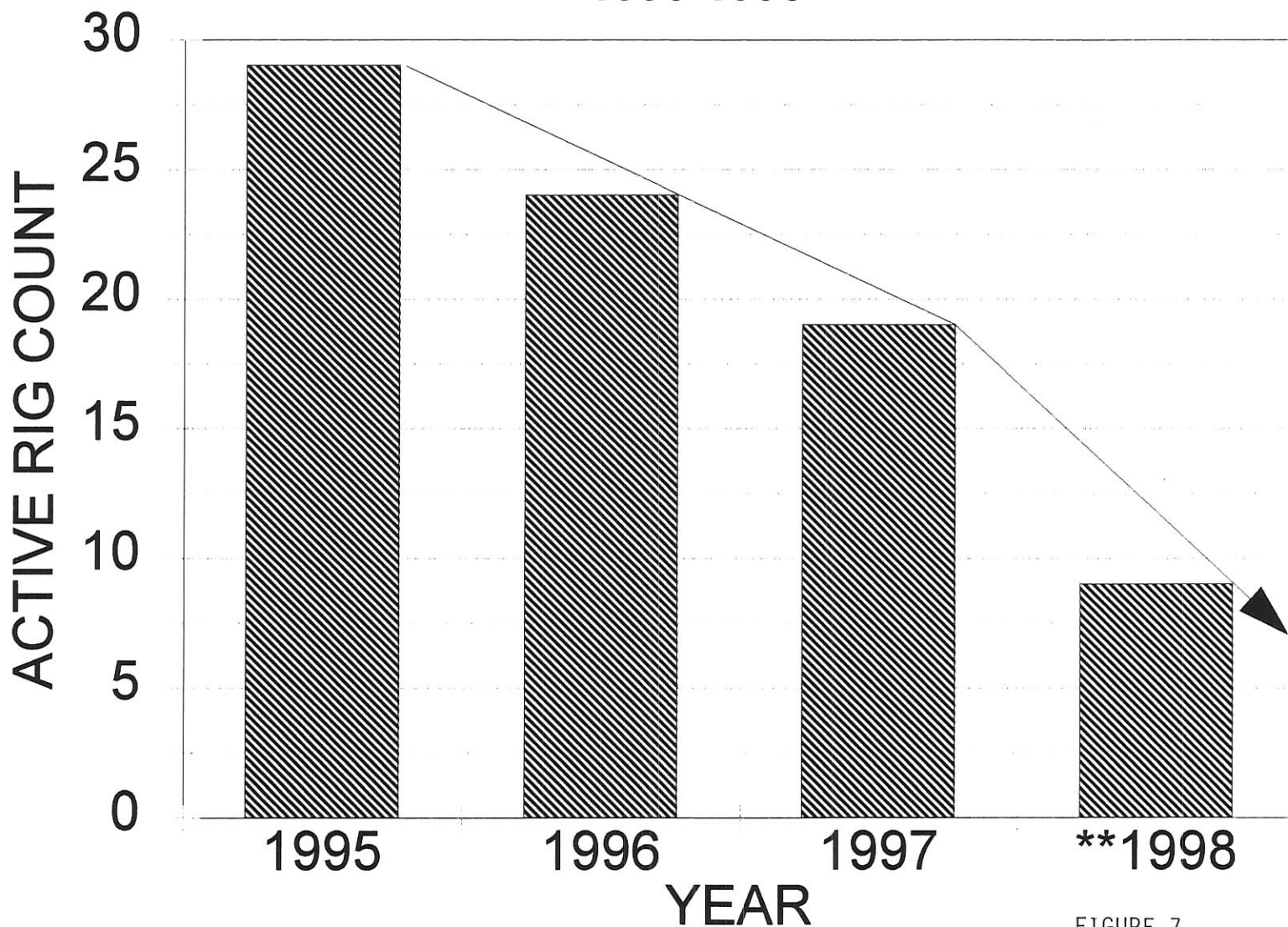


FIGURE 7

KCC/DPW 1/12/1999. ** 1998 RIG COUNT IS ESTIMATED FROM BAKER HUGHES RIG COUNT AS PUBLISHED IN THE OIL & GAS JOURNAL.

YEAR	KANSAS AVERAGE RIG COUNT*
1995	29
1996	24
1997	19
1998	9

* YEARLY AVERAGE BY SOURCE: BAKER HUGHES RIG COUNT AS PUBLISHED IN OIL & GAS JOURNAL.

**1998 AVERAGE TOTAL HAS BEEN ESTIMATED.

3-14

FIGURE 7A

KANSAS WELL PLUGGING SUMMARY 1987 - 1998

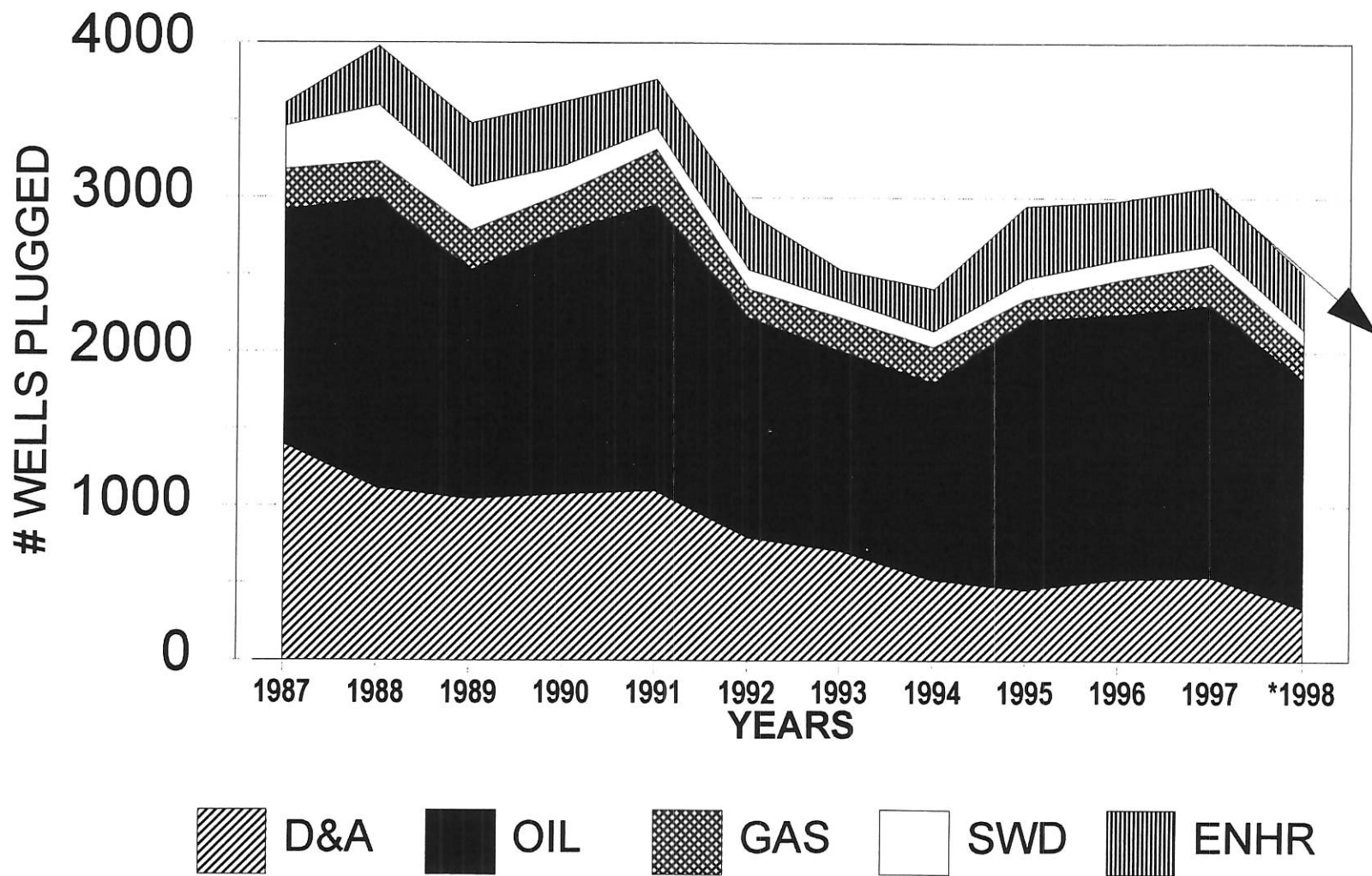


FIGURE 8

KANSAS WELL PLUGGINGS 1987-1998

3-16

YEAR	D&A	OIL	GAS	SWD	ENHR	OTHERS	TOTAL PLUGGED
1987	1396	1521	264	280	150	616	3667
1988	1112	1883	238	363	378	42	4016
1989	1039	1490	254	280	416	13	3492
1990	1073	1704	250	179	414	18	3638
1991	1095	1860	356	136	319	12	3778
1992	792	1427	188	126	367	62	2962
1993	707	1298	213	119	195	7	2539
1994	520	1282	229	104	272	27	2434
1995	456	1749	134	134	470	117	3060
1996	525	1716	226	134	380	16	2997
1997	539	1765	269	123	375	26	3097
1998	340	1480	227	100	360	17	2524

FIGURE 8A

KCC-DPW 1/12/1998. *1998 IS SUBJECT TO KCC REVISIONS AS FIRST TIME TOTAL.

**Kansas, Inc. Testimony before
the House Committee on Taxation
March 9, 1999**

The oil and gas industry (along with agriculture and manufacturing) has long been one of the basic industries of the state. The oil and gas industry is vital to the Kansas economy, and for that reason, Kansas, Inc. has since its inception been deeply involved in issues affecting that industry. Over the years, Kansas, Inc. has provided objective and independent advice on the Kansas economy as a whole and the oil and gas industry as a major component of that economy. We are pleased to continue that tradition today.

However, the topic of discussion today, the severance tax on the oil and gas industry, predates Kansas, Inc.'s involvement and I suspect that of many of you as well. So with your permission, I think it would be helpful to take a look back to 1981 when the severance tax on oil and gas was first being considered. I will briefly review conditions that existed then, and the underlying assumptions presented to the Kansas Legislature in their consideration of enactment of a severance tax on the oil and gas industry.

Assumption #1: Prices will continue to rise

In 1981, the average price per barrel of oil had climbed to \$35.81 and the widely held opinion was that prices would continue to climb. In a statement before the Senate Assessment and Taxation Committee in 1981, Michael Lennen, then Secretary of Revenue under Governor Carlin, predicted the following with regard to the industry's ability to pay a severance tax:

Regarding projected oil prices, he said

"It is estimated that by the 4th quarter of 1981, the average acquisition price for domestic crude oil will increase to \$43 per barrel; that the average per barrel price in 1982 will be \$47.00; and in 1983 it will be \$55.02."

Regarding projected natural gas prices, Secretary Lennen said

"Underscoring the validity of anticipated increases in natural gas prices was an analysis appearing in the March 17, 1981 edition of the Wall Street Journal. There is was noted that the average price for natural gas under the current decontrol plan would rise to \$2.97 by 1985. At this price, natural gas would still be selling for less than half of the current equivalent price of oil. This suggests that after January 1, 1985, decontrolled natural gas prices would experience a further dramatic increase."

Though the widely held conventional wisdom of the time, as demonstrated by Figure 1 in the appendix, high oil prices in Kansas [or for that matter the world], did not last, nor did predictions of still higher oil prices ever materialize. Instead oil prices soon plummeted and have continued to fall for an overall price drop of over 66% since 1981. (These figures have not been adjusted for inflation.)

Likewise, natural gas prices didn't follow predicted trends. As Figure 2 in the appendix illustrates, natural gas prices did increase as projected for one year, then dropped to a low in the mid-80's, not to recover to 1982 prices until 1990. Natural gas never achieved price projections, and prices today are still only 65% of what was projected for 1985. When one adjusts for inflation, that figure looks much worse.

1981's Assumption #2: Federal tax laws allow pass-through of taxes

In addition to ever higher oil prices, Legislators were provided another assumption to support the industry's ability to pay. At that time the Federal Energy Regulatory Commission allowed ad

valorem tax on natural gas [and severance tax if enacted] to be passed on by the producer to consumers (or first purchaser - most of whom would be out-of-state). Theoretically, a severance tax wouldn't "hurt" the industry or its ability to grow and prosper. Assertions presented by the Kansas Legislative Research Division in 1981 were that first,

"The Federal Energy Regulatory Commission has ruled that the Kansas property tax is essentially based on production and has allowed this tax to be "passed-on" to consumers." (Feb. 17, 1981 Revised March 18, 1981)

and second,

"It is assumed that all producers of natural gas have entered into contracts which allow them to pass-on additional taxes to the purchasers of natural gas, and if they do, all of the severance tax would be borne by consumers. . . ." (Feb. 23, 1981)

Today, however, as the result of a 1997 FERC ruling in Public Service Co of Colorado 80 FERC ¶61,264 (1997), neither the severance tax nor the ad valorem tax can be passed on to consumers. This further burdens the Kansas producer. As an additional blow, that same decision ordered Kansas producers to remand approximately \$400 million in ad valorem taxes which had been included in the rates charged since 1988. As in the case with optimistic price projections, a major second assumption underlying passage of the severance tax is no longer applicable.

Assumption #3: Most of the burden would be assumed by out-of-state producers

A third assumption which is no longer as true of the industry as it was in 1981 is that much of the state's production is owned by out-of-state producers, thus an additional tax would be exported. While that was true of the natural gas industry, and still remains largely true, research was not presented at that time for the oil industry with regard to who would bear the brunt of a new tax, out-of-state producers and consumers, or Kansans.

The Kansas Legislative Research Division, Feb. 23, 1981 reported

"The fact that a producer might not be able to pass on the tax does not mean that it will be borne by Kansans because much of the natural gas production in Kansas is owned by out-of-state corporations and individuals. The Department of Revenue has estimated that in 1978 out-of-state corporations accounted for 84 percent of total state gas production."

It went on to say that

". . .no estimate can be made as to the total amount of a severance tax on crude oil . . . that might be paid by in-state or out-of-state consumers. [However,] The Department of Revenue has estimates that 42.6 percent of the Kansas oil production is owned by out-of-state companies."

Since the early 80's, this Kansas industry has experienced a dramatic shift in ownership away from major oil companies and to independent Kansas operators. While precise statistics are not available, we know that since 1981, nearly all major out-of-state oil companies have sold their interests to Kansas producers. These divestitures have included those by Texaco, Mobil, Amoco and most recently, Phillips Petroleum Company and Oxy-USA (formerly City Service).

Today,

"With the exception of the Hugoton field area, Kansas is predominately the province of independent producers, many of whom are quite small." Strategic Analysis of the Oil and Gas Industry in Kansas, Arthur D. Little, April 1990

Current, ownership breakdowns have far less bearing on who actually pays these taxes. As noted by Louisiana State University economist James A. Richardson, in his December 1995 study

Taxing Oil and Gas in Kansas

“Economists now challenge the conventional wisdom that the energy companies have the ability to pass along oil and gas taxes [. . .] to consumers in other states and nations. The ability to pass along oil and gas taxes to consumers was a reality during periods of oil and gas price regulation by the federal government. In a non-regulated energy market pass through of higher taxes will not be possible.”

“Political wisdom claims that the tax on resources will be passed on to the final consumer. Economic analysis suggests that such an answer is probably not true [because] one state, such as Kansas, does not now and never will control the price of oil and natural gas.

“If severance or ad valorem taxes cannot be passed forward to consumers, they must be absorbed by producers or passed backward to producers, developers, explorers, or owners of oil and gas properties.”

Well intentioned though policymakers may have been at the time of imposition of the severance tax, it is clear in retrospect that the several fundamental assumptions underpinning the tax levy were faulty, and that subsequent regulatory and marketplace events have resulted in an environment dramatically different to that envisioned. Yet the taxes imposed on the basis of that set of flawed assumption remain in place.

In 1989, Kansas, Inc.’s Board of Directors made the decision to commission a comprehensive study of Kansas oil and gas. The firm of A.D. Little of Cambridge, Massachusetts was hired under a contract for \$100,000 to conduct a year-long study which compared the Kansas oil and gas industry to those of six other states: Texas, New Mexico, Colorado, Oklahoma, North Dakota, and Illinois. In its report, released in 1990, with regard to the tax structure imposed on the oil and gas industry, Arthur D. Little wrote:

“Kansas taxes on oil and gas production are high relative to other states examined, and are especially high when one considers the characteristics of the Kansas resource relative to most of the other states evaluated. Broadly speaking, this conclusion supports the contention of the Kansas producers that Kansas taxes are high. A Kansas producer would pay considerably higher taxes as a percentage of revenue in Kansas on conventional production than in most of the other states.”
Strategic Analysis of the Oil and Gas Industry in Kansas, Arthur D. Little, Inc. of Cambridge, Mass., April 1990

In 1995, citing the conclusions presented by Arthur Little, James Richardson in Taxing Oil and Gas in Kansas stated that little has changed since that 1990 report.

“This conclusion has been tempered modestly by the recent change in the natural gas severance tax, though no changes in Kansas have directly changed the oil tax comparison.”

In 1993, Kansas, Inc. published “A Kansas Vision,” the state’s strategic plan for economic development. Based in part on the recommendations contained in the Arthur D. Little study, “A Kansas Vision” established as a priority to:

“Assist in stabilizing the Kansas oil and gas industry through policies that enhance the value and the in-state utilization of our oil and gas reserves and provide equitable and competitive tax rates, sensitive to the marginal nature of most Kansas production and the exploration maturity of its basins.”

The 1993 Kansas, Inc. analysis continued

"The oil and gas industry represents one sector of the Kansas economy confronted by a higher tax burden than its peers in other producing states with similar resource bases and production costs.

continuing -

Several measures were implemented in the 1992 session to lower the ad valorem tax burden on marginal oil wells, but this tax relief was offset almost entirely by a new sales tax on the energy consumed to lift fluids from the well. The new classification amendment also has lowered the classification rate on some marginal producing oil and gas properties. Nevertheless, other changes must be made in the taxation of oil and gas production.

and -

Policy makers must be mindful of the marginal nature of most Kansas wells. Severance taxes, county ad valorem taxes, sales taxes, or taxes of any kind which increase the cost of producing a barrel of oil or a measure of gas accelerate the plugging and abandonment of marginal wells. Once marginal wells are plugged those reserves are lost forever."

The 1993 Kansas, Inc. strategic plan continued

"The eastern three quarters of the state has been intensively explored and drilled. The under-explored domains are in the western 1/4 of the state, particularly in horizons beneath producing Chase and Council Grove zones in the Hugoton Basin. Exploration of these domains is primarily stimulated by higher product prices. Incentives modeled after the two year severance tax holiday for new wells would encourage increased drilling and not cost the state any tax revenue unless the wells are successful. The benefits of the newly discovered resource would eventually outweigh the cost of the incentive.

The long life reserves of the Hugoton Basin offer significant wealth building potential for the state if properly managed. After many years of selling gas at federally mandated rates well below their market value, price and pipeline deregulation have now opened the door to new opportunities. Policies which encourage increased consumption of natural gas in Kansas as a transportation fuel, for electrical generation, and for value added process of all kinds enhance the value of Kansas natural gas and have a multiplier effect on state economic growth."

In December of 1993, the Kansas, Inc. Board of Directors recommended that the Legislature

"Increase the competitiveness of the Kansas tax structure, focusing on equity, lifting disincentives, and providing for predictable and stable source of revenue.

An essential element of this recommendation was to

- Reduce, over a period of 3 years, the severance tax on natural gas to 4.3%, the same rate applied to oil."

The 1994 Legislature concurred and enacted the proposed change.

In January 1997, Kansas, Inc. released an updated economic development strategy. "A Kansas Vision for the 21st Century" in which it called for:

"A final strategy to improve tax competitiveness is focused on a specific industry: reduce the total tax burden on the oil and gas industry to a level competitive with

other marginal producing states. For several decades, the Kansas oil and gas industry has been a major contributor to the strength of the Kansas economy. The oil and gas industry has been in decline since the early 1980s. In 1981, the oil and gas industry employment was about 17,000; in 1996, it was less than 7,000. Low producing marginal wells in Kansas are especially sensitive to market prices and operating costs. The Kansas oil industry is particularly vulnerable because of high tax burdens caused by the combined effect of severance taxes and ad valorem taxes. In 1990, Kansas, Inc. released a major report on the oil and gas industry that has led to major improvements in the tax burden on the industry. Tax reductions have been enacted for marginal oil wells and the severance tax on natural gas production was reduced from 7.0 to 4.33 percent, the same as for oil. If the oil industry is to be maintained in Kansas, tax relief based on ensuring that Kansas producers are competitive with those in other states will have to be a continuing objective.”

In October 1997, Kansas, Inc.’s Action Planning Committee on Business Taxation adopted a Policy Statement which called for the elimination of the severance tax. This policy statement was presented to the Governor that same month and to the Kansas, Inc. Board of Directors. The Board adopted a resolution urging the Legislature to adopt the proposals to the “maximum extent possible.” A copy of the entire report was also sent to every member of the Kansas Legislature prior to the 1998 Session. The Action Planning Committee recommend:

“that the severance tax be eliminated for marginal oil and natural gas wells, with a definition of “marginal” that conforms to the federally established standards of 15 barrels per day for oil wells, and 90 mcf of production for natural gas wells (See Internal Revenue Code Section 1613A).

In FY 1996, total state mineral tax collections were \$68.5 million, a 12 percent decline over the previous year. Of that total, \$16.7 million was from oil and \$51.8 million was from natural gas. The amount of state taxes collected on oil production has declined steadily since 1991 when collections totaled \$36 million. This decline reflects the marginal character of oil wells in Kansas, a history of low oil prices, and the resulting lack of economic return for the industry in Kansas. The Kansas oil industry has faced difficult conditions for several years. It has had substantial employment losses and low returns on investment. Current oil prices at \$18 per barrel are not sufficient to promote increased exploration or stimulate new oil recovery projects.

The Kansas Legislature has provided some relief to the oil and gas industry in recent years, especially for marginal wells, depending on current prices and wellhead production levels. However, greater relief is needed to ensure the continued viability of existing wells and to promote further exploration and development of the oil and gas resources in the state.”

Today’s price for oil is \$¹⁸18 per barrel, further disincenting development of this once abundant resource which has played such a vital role in the history of our state. Though prospects for a reinvigorated industry, based on new enhanced recovery methods, appear promising, it will not happen absent a return to higher per barrel prices (something over which we have no power) and further reform to repeal the severance tax (something over which this Legislature has absolute control.)

Well-intentioned, though flawed assumptions, which formed the premise upon which this tax was first imposed now hang as an albatross around the neck of this industry.

From an economic development perspective, the market, not tax policy, should determine whether the oil and gas industry has a future in Kansas.

Kansas, Inc. is therefore, pleased to add its voice to the call to repeal the severance tax during the 1999 Legislative Session.

Thank you Mr. Chairman and members of the committee.

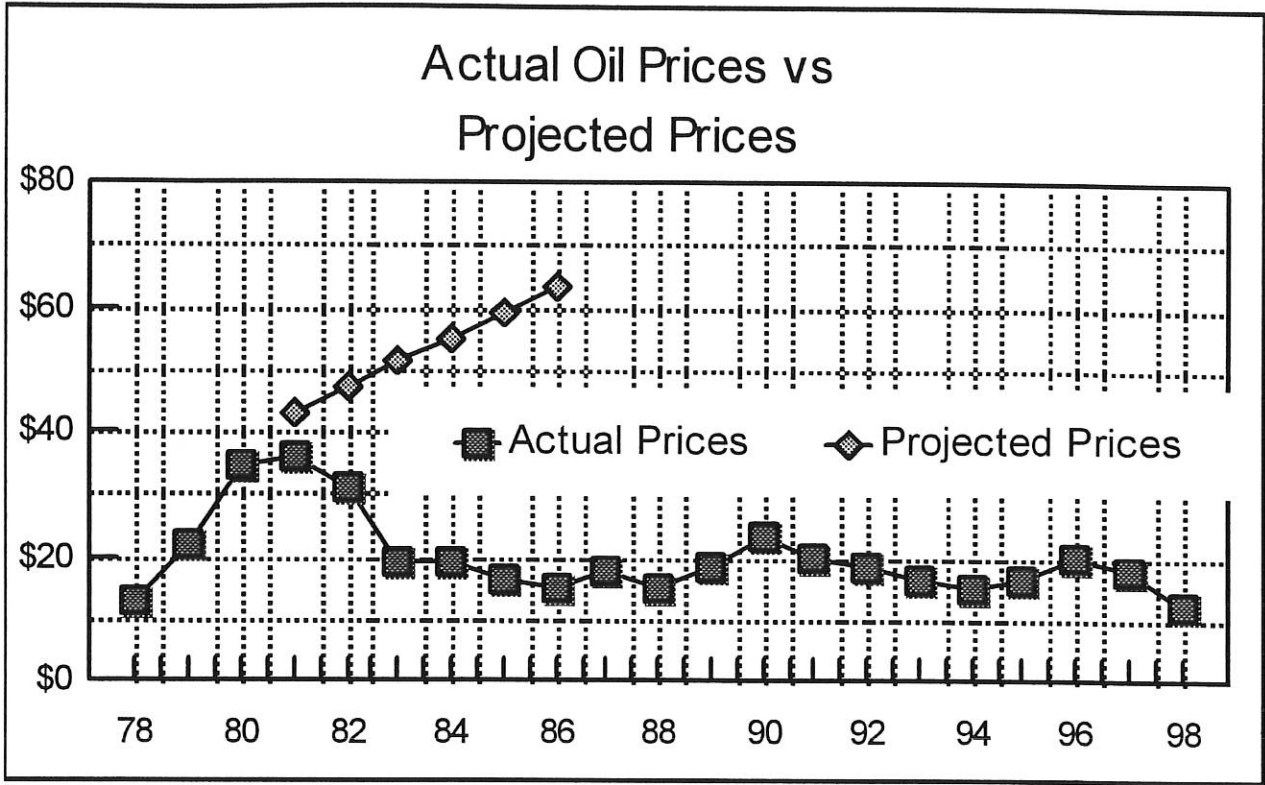


Figure 1

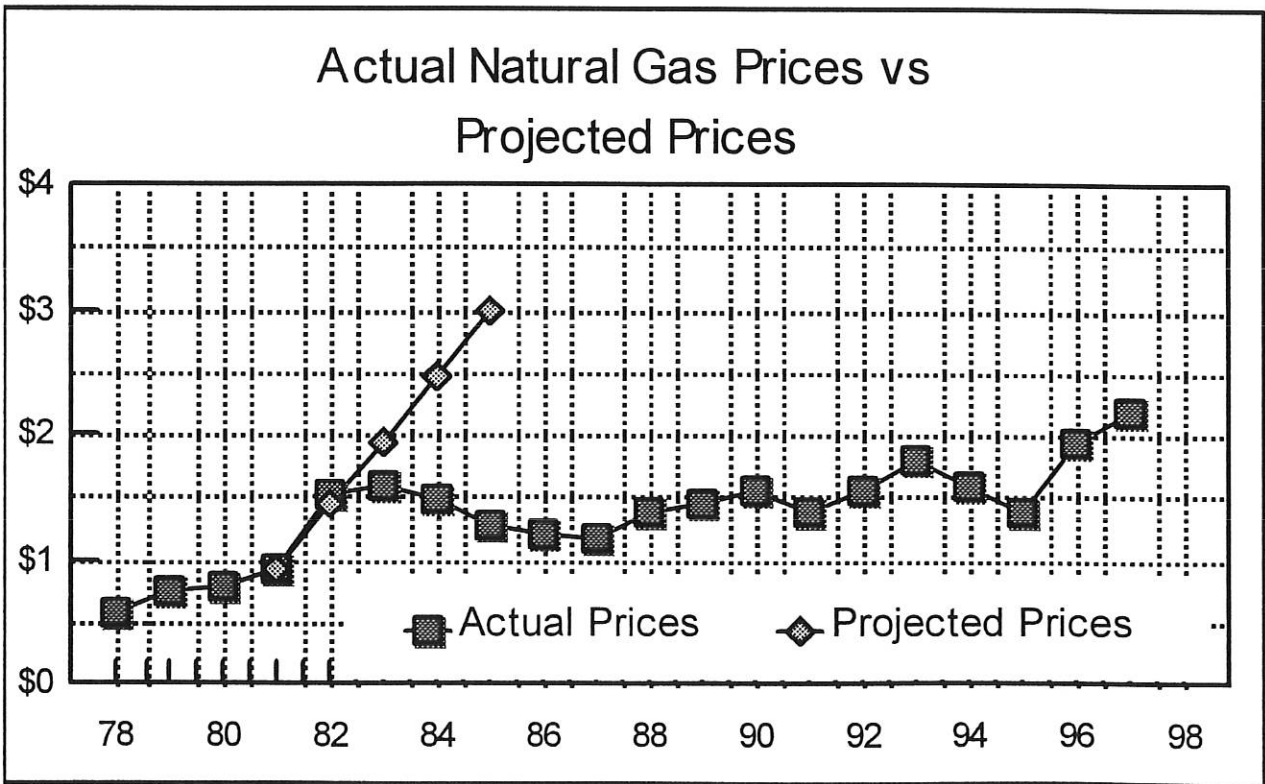
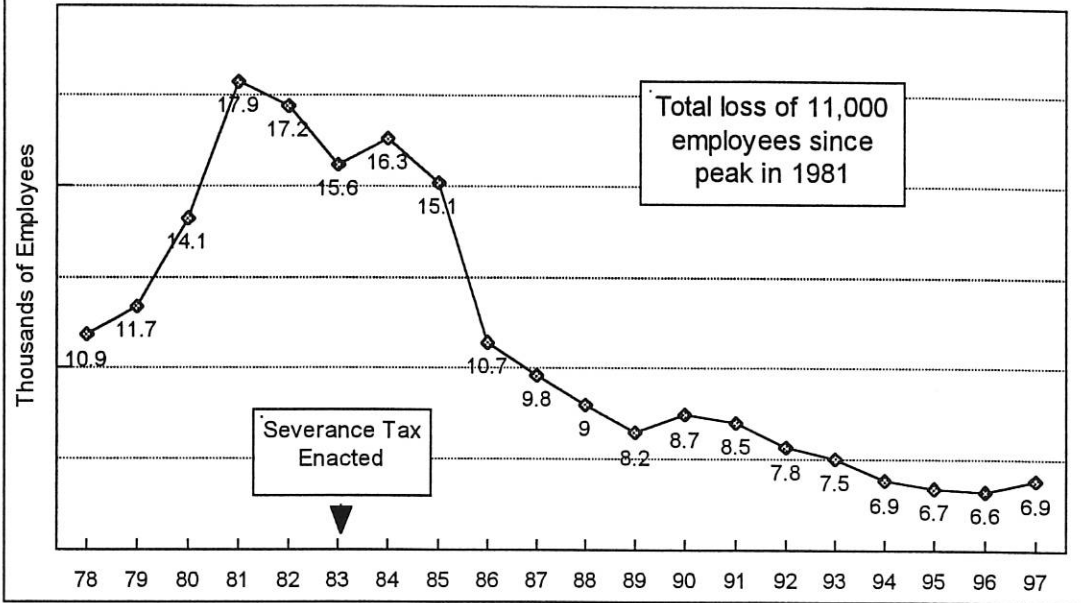
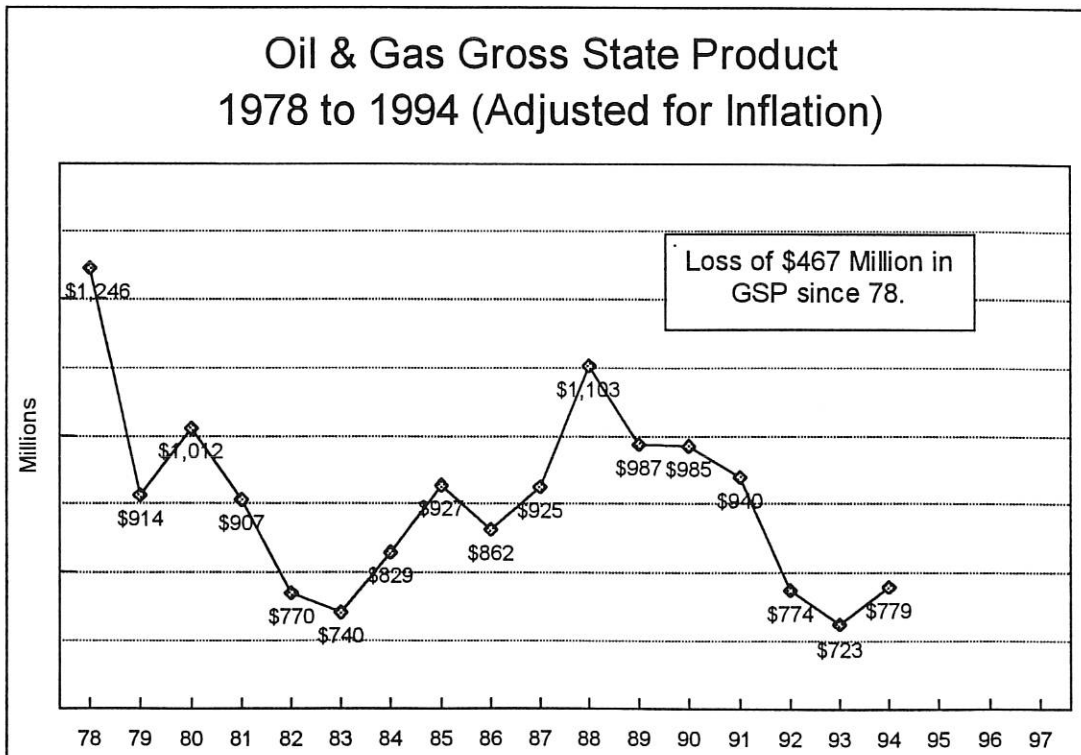


Figure 2

Oil & Gas Extraction Employment 1978 to 1997



Oil & Gas Gross State Product 1978 to 1994 (Adjusted for Inflation)



VESS OIL CORPORATION

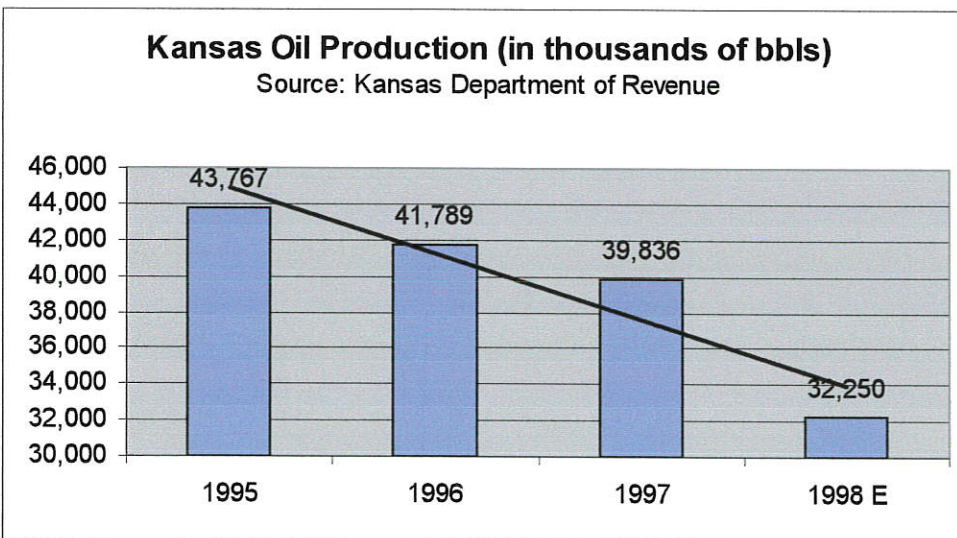
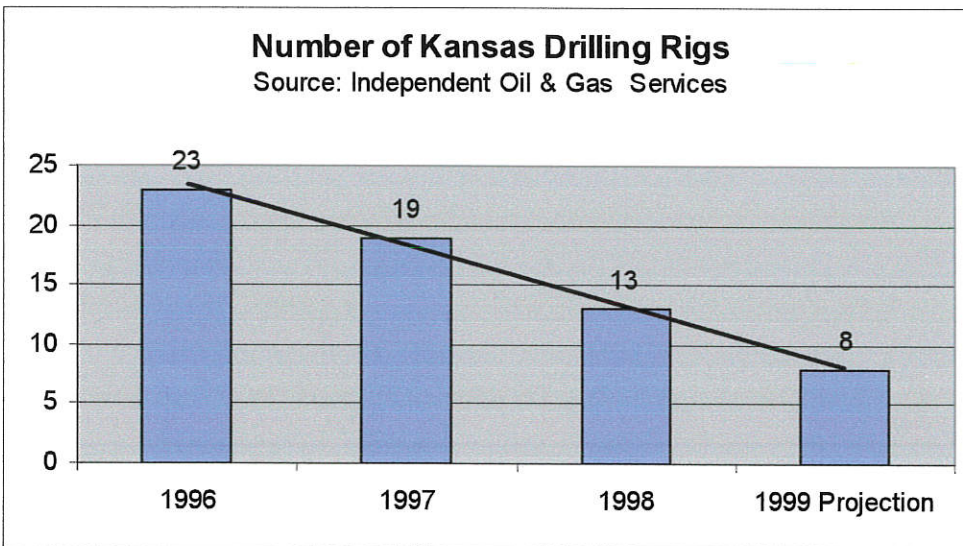
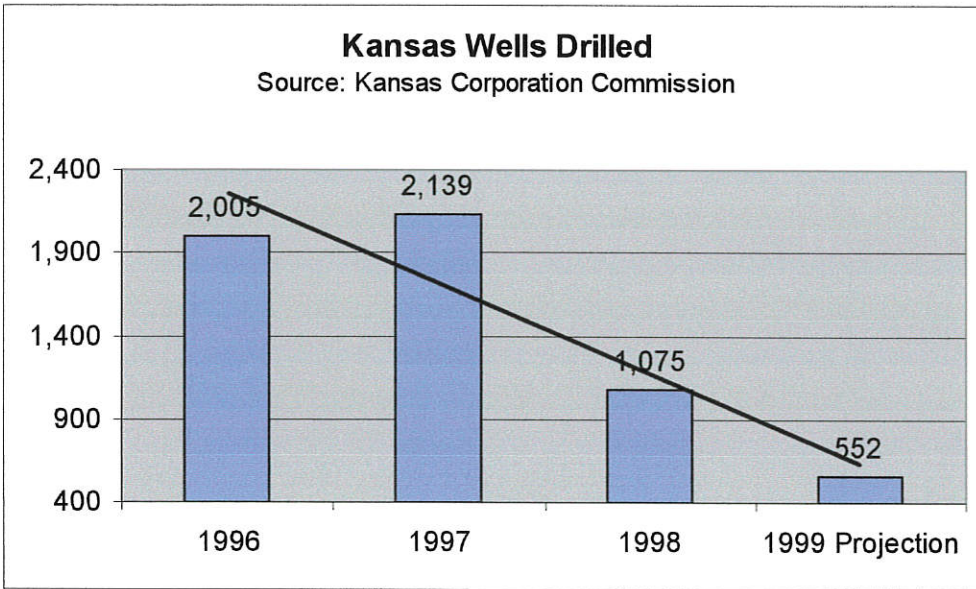
Testimony and Supporting Material
Presented by Richard J. Koll, C.P.A.
Chairman of the Ad Valorem Tax Committee
Kansas Independent Oil and Gas Association

The Economic Crisis facing the Kansas Oil Industry

Before the Kansas House
Committee on Taxation

Presented on March 9, 1999

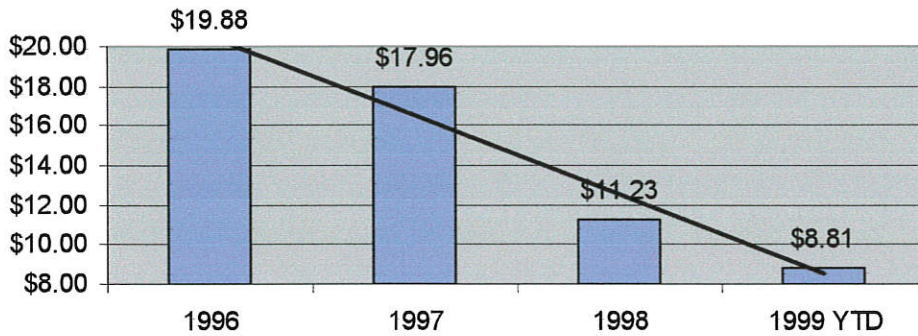
House Taxation
3-9-99
Attachment 5



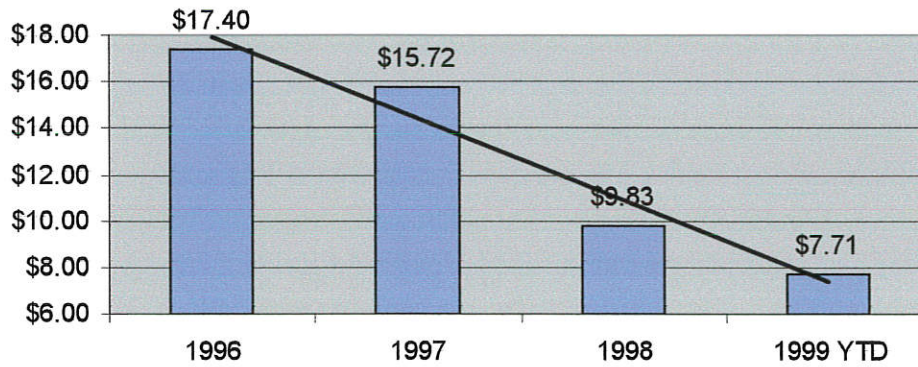
Information provided by Vess Oil Corporation

Kansas Oil Price - Posting for 40 gravity oil

Source: Koch Oil / NCRA Price Bulletins

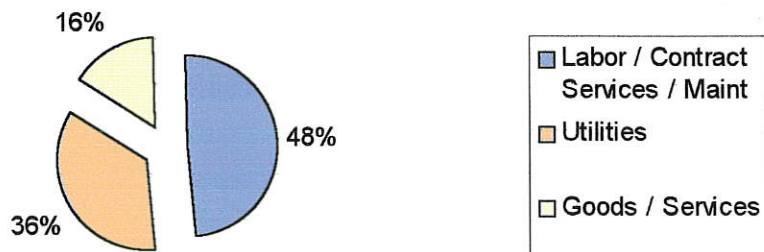


Kansas Oil Price - Working Interest Owner (.875 NRI)



Typical Dollar Expended by a Marginal KS Well

Source: Sample of 760 Wells in 20 Counties



VESS OIL CORPORATION

FACT SHEET - KANSAS OIL AND GAS

INDUSTRY TRENDS/CONTRIBUTIONS AT A GLANCE

TRENDS

- Kansas drilling activity has declined 47% from 1996 - 1998
- Active rotary rigs have declined 43% from 1996 - 1998
- Kansas oil production has declined 47% from 1984 - 1997
- Kansas oil production has slumped to a 63 year low in 1997
- Kansas posted price for oil has declined 44% from 1996 - 1998
- Direct oilfield employment has declined 59% from 1984 - 1997

CONTRIBUTIONS

- Kansas is home to over 40,000 marginal wells
- Each marginal well is a resident Kansas consumer expending approximately \$10,344 on Kansas jobs, goods and services. This amounts to over \$417,000,000 annually.
- It would take over 20,000 new jobs in Kansas to offset the loss of purchase power of the Kansas marginal oil well base.
- Typical dollar expended by a marginal Kansas well is allocated as follows:

Labor/Contract Services/Maintenance	-	48%
Utilities	-	36%
Goods/Services	-	16%
- Marginal wells return over \$60,000,000 annually to landowners in royalty payments. A significant portion of these funds remain in the rural farm community.

FACT.DOC

CURRENT STATISTICS - KANSAS

Kansas Common Oil Price \$ 7.85/Bbl.
(DWA - December 98 - 40 gravity)

Kansas Common Oil Price \$11.23/Bbl.
(weighted average 1998 - 40 gravity)

Active Rotary Rigs (statewide January 1999) 10 rigs

Direct Oilfield Employment (statewide) 6,900 jobs

	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>
Severence Tax - Oil	\$24,538,000	\$19,621,000	\$17,102,000	\$16,704,000	\$19,670,000	\$15,556,000
Severence Tax - Gas	\$74,142,000	\$81,634,000	\$60,034,000	\$51,662,000	\$61,742,000	\$51,690,000

	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>
Ad Valorem Tax - Oil	\$40,306,245	\$23,373,464	\$27,441,610	\$26,500,000	\$32,200,000
Ad Valorem Tax - Gas	\$76,491,934	\$93,582,217	\$85,905,070	\$79,900,000	\$90,300,000

Severence Tax Rate - Oil 4.33%

PERTINENT TAX LAWS - KANSAS

AD VALOREM

- 3 BOPD/well (less than 2,000) - equipment only
- 5 BOPD/well (2000' or greater) - equipment only
- Shut-in leases - equipment only
- 5 BOPD/lease - 25% assessment rate
- 100 MCFPD/lease - 25% assessment rate

SEVERENCE

- 5 BOPD/well - exempt
- 6 BOPD/well - exempt for waterflood
- New pool - exempt first 24 months
- Reactivated wells - exempt for 10 years

5-6

REFERENCE SOURCE DETAIL

Kansas Oil and Gas Industry Trends

	1984	1987	1993	1994	1995	1996	1997	Trend
Kansas Oil Production (in thousands)	75845	60545	49625	46733	43,767	41789	39836	47% Decline

The last time Kansas annual production was less than 50,000,000 barrels was in 1934. This is a 63 year low.

SOURCE: 1984 - Present - Kansas Department of Revenue
1978 - 1984 - Energy Information Administration
1925 - 1977 - Bureau of Mines, Mineral Yearbook
Volumes I and II

	1984	1987	1993	1994	1995	1996	1997	1998
Kansas Oil Price Working Interest Owner \$/Bbl. (.875 NRI)	25.18	15.49	14.39	13.25	14.24	17.40	15.72	9.83

SOURCE: Monthly postings taken from Koch Oil Company/NCRA price bulletins. Kansas Common - 40 gravity.

	1984	1987	1993	1994	1995	1996	1997	
Oilfield Employment	16700	9800	7500	6900	6700	6800	6900	60% Decline

SOURCE: Kansas Department of Human Resources Labor Market Survey.

	1984	1987	1993	1994	1995	1996	1997	1998	
Kansas Wells Drilled	15198	5214	2274	2057	1977	2005	2139	1075	93% Decline

SOURCE: Kansas Corporation Commission

There are over 40,000 marginal oil wells in Kansas according to the National Stripper Well Survey published by IOGCC and Kansas Geological Survey Open-File Report 98-50. A sample of 760 wells in over 20 counties indicated average well expenditures in 1998 of \$862 per well per month. This converts to \$10,344 annual consumption per well. The typical dollar expended by a marginal well in 1998 went to the following:

- Labor/Contract Services/Maintenance - 48%
- Utilities - 36%
- Goods/Services - 16%

SOURCE: Vess Oil Corporation

CALCULATION DETAIL

Direct Oilfield Employment - Marginal Wells

15 BOPD/well or less	$\frac{40329}{41520} = 97\%$	5 BOPD/well or less	$\frac{37,568}{41,520} = 90\%$
----------------------	------------------------------	---------------------	--------------------------------

$\frac{40329}{41520} = 97\%$ of Active Well Base

$\frac{37,568}{41520}$ 90% of Active Well Base

Total direct oilfield employment	6900 (2)
Marginal well base employment (6900 x .97)	6693

Marginal Well Employment Equivalent

Annual Kansas consumption per average marginal well \$10,344 (3)

Annual disposable income per average Kansas job \$20,307 (4)

$\frac{10,344}{20,307} = .51$ marginal well job equivalent ratio

Marginal well job equivalent 20,568
(.51 x 40,329)

ESTIMATED ANNUAL UTILITY CONSUMPTION

Average annual utility consumption per marginal well \$3,636 (3)

Total estimated annual utility consumption \$151,000,000

(1) National Stripper Well Survey published by IOGCC and Kansas Geological Geological Survey Open-File Report 98-50.

(2) Kansas Dept. of Human Resources Labor Marketing Survey (1997 Estimate)

(3) 760 well samples/22 counties

(4) Kansas Dept. of Human Resources Statewide Annual Wage Average (1996)

Total Private Wages	\$24,573
Fed/State WH	<u>4,266</u>
Disposable Income	\$20.307

STATEMENT OF TOM CASEY
MANAGER, EXPRESS WELL SERVICE, INC.
VICTORIA, KANSAS
BEFORE THE KANSAS HOUSE COMMITTEE ON TAXATION
March 9, 1999
Topeka, Kansas

RE: The current economic condition of the Kansas oilfield supply and service companies.

The Honorable David Adkins, Chairman, and Committee Members:

My name is Tom Casey, and I live in Russell, Kansas. I am the manager of Express Well Service, Inc., Victoria, KS, an oil well servicing company that has been in business since 1981. At its peak, our company operated nine well servicing rigs, two mud pumps and power swivels, rented and serviced downhole rental tools, sold oilfield supplies, sold oilfield pipe and sucker rods. The annual gross sales have been over \$2,500,000.00; we have had 33 employees with an annual payroll of about \$1,000,000.00.

We survived slowdowns in the oil business in 1986 (\$11.87/bbl), 1988 (\$12.48/bbl), and 1993 (\$12.54/bbl); but this time things are much different! Previous downturns have weakened all Kansas oil related companies; very few oil related companies have financial reserves to fall back on. Kansas Crude oil prices have plummeted to the \$8/bbl. range and have stayed low for a much longer period than in previous downturns. This has dealt a serious blow to the infrastructure of the Kansas oilfields. Oil companies are definitely struggling to stay alive, but possibly even a more devastating blow has occurred to the related oilfield companies that service the needs of the oil industry.

Some of you might ask, what does an oilfield service company do? We are the companies that provide equipment and workers to go out to the oilfields and do the physical work to get the wells so they can pump, repair them when they break down, and plug them when they become uneconomical to produce. Oilfield service companies could be classified into the following categories:

- | | |
|--------------------------------|----------------------------|
| (a) well servicing rigs | (i) logging & perforating |
| (b) cementing & fluid pumping | (j) acidizing & fracturing |
| (c) drilling rigs | (k) rental tool companies |
| (d) chemical companies | (l) water hauling |
| (e) pumpers & roustabouts | (m) trucking |
| (f) supply stores | (n) dirt moving |
| (g) testers for pipe | (o) production men |
| (h) electric and gas companies | (p) geologists |

There are probably others I may have forgotten to list, but the end result is that all of the above are being financially

House Taxation
3-9-99
Attachment 6

crippled by the low oil price. Many companies in the categories above have already gone out of business. Within an approximate 60 mile radius of Victoria, there have been thirteen well servicing companies shut down. At least four supply companies have closed their doors. One chemical company, three perforating and logging companies, one drilling company, one trucking company, three fluid moving companies, one testing company, three dirt moving companies, two acid companies, one cementing company, and two tool rental companies have gone out of business.

The main company that supplies well servicing rigs with the supplies they need to operate has gone out of business, making well servicing companies go out of state to get some of the supplies they need to operate. All of the remaining oilfield companies have had to scale back considerably or move out of state. Halliburton, one of the world's largest servicing companies, has closed its operations in Hays, Great Bend, and Pratt.

Why have these companies gone out of business and scaled back? Because the low oil price has made it unprofitable to operate the majority of oil wells in Kansas. Many of these wells have been shut down; therefore, very little money is being spent to repair or maintain the oil wells. Oilfield related business sales have plummeted. Most service and supply companies sales have probably dropped 55% to 70%. The collection time for accounts receivable has increased from 30 days to 120 days or more in many cases! Some oil producers are not able to pay the service and supply companies at all. This can cause service companies to go bankrupt, because the businesses service companies buy from want their money in 30 days or less!

How do these companies scale back? They lay off employees because there is not enough work to keep them busy. One may think this is not a big deal, because laid off employees can get jobs in other industries. The problem lies in the fact that highly skilled oilfield employees that took years to train have been lost to the industry, and most likely will never return to this industry of ups and downs! If the price of oil does ever return, related oilfield companies will not have the trained personnel or equipment to rise to the occasion. It will literally take years to train new employees and rebuild the related oilfield service and supply companies. Much of the oilfield service equipment is being sold at auctions and taken out of state, some of it is being taken out of the United States!

How has this directly affected Express Well Service, Inc. the company I work for? We have lost 45% of our workforce, our sales have plummeted approximately 55%, and the remaining employees are making less money because they are working less hours. We are concerned about losing more employees because

they are not making enough money to pay their bills.

Some of you might think its okay to purchase foreign oil right now, because it is cheap! You might think we can cap our wells and save the oil for later. What are we going to do with capped wells, when there won't be anyone around to work on the wells, pump the wells, or plug the wells. The problem is that all of the service companies and related oilfield companies will be out of business. There won't be any trained people or equipment to drill or work on oil wells. Wells that are plugged today are almost totally impossible to re-enter at a later date. We must keep our oil industry infrastructure in place, or we may never be able to resurrect the oil business in Kansas!

Our local towns and communities are affected, because people have lost their jobs. In western Kansas there are not many good jobs with benefits for a family to live on; so several families have moved away. Many non-oilfield businesses, such as restaurants, clothing stores, jewelry stores, gas stations, etc. have closed their doors for a lack of business. Enrollment in schools is dropping, and bright young people are leaving the area. Money that was earned in the oilfield was spent locally. These dollars were recirculated many times in the area economy, and also created tax dollars paid on a local, state, and federal level.

We are asking for your help!!! The oil industry has paid more taxes than any other industry in Kansas for many years! That tax money was used to build highways and make improvements in your neighborhood and all areas of Kansas. Imported oil does not pay any taxes in Kansas, and the money used to buy it leaves the country.

Some of you who might think the State of Kansas can't afford to make tax cuts at this time! But if tax cuts aren't made to help us, we probably won't be in business much longer to pay any taxes or create any jobs or income for the State of Kansas. The concessions you might give the oil industry today, will help keep this industry alive until the price of oil comes back up. I encourage you to make this investment in the oil industry for the sake of the future of all Kansans and Americans. Please don't let us go down the drain, and let our state be totally dependent on foreign oil.

Respectfully submitted,

Tom Casey

Tom Casey
Manager, Express Well Service, Inc.

STATEMENT OF
DANNY BIGGS, VICE-PRESIDENT-SUPERINTENDENT
PICKRELL DRILLING COMPANY, INC.
BEFORE THE HOUSE COMMITTEE ON
TAXATION
MARCH 9, 1999

Mr. Chairman and Members of the Committee:

My name is Danny Biggs and I reside in Great Bend, Kansas. I am Vice-President and co-owner of Pickrell Drilling Company, Inc., an independent oil and gas drilling and production company headquartered in Wichita, Kansas with field offices in Great Bend, Kingman, and Ness City. We have two rotary drilling rigs and three well servicing rigs. Pickrell has been operating in Kansas for fifty years, drilling over 2000 prospects. We operate 280 wells. Today 50 of our wells are shut down and 50 more may be shut down in the near future. Our current employment is at 54.

I have worked for Pickrell for forty years, starting out as a roustabout, pumper, rig hand and truck driver. I have experienced good years and bad years since I've been associated with the oil and gas industry, but the last fourteen months have been the worst ever.

This industry has been devastated by the historically low oil prices. Unlike major companies, our only source of income is at the well head and we have no control of the price we receive for our product.

Large and small independent producers are shutting down wells, laying off employees and slashing budgets.

Great Bend has lost fifteen service and supply companies in the past 12 months. Several more in surrounding areas have gone out of business.

A recent survey indicated that 40% of the marginal wells in Kansas were shut down. If the present condition continues several hundred more will be shut down and the remaining service and supply companies could be lost.

There isn't any repair or maintenance work being done due to the low oil price. If a problem occurs, the well is shut down.

The service and supply companies were the first to go out of business. Now the sustained low oil price is taking its toll on small and large producers.

It's sad to see hard working Kansans that have spent years working in this industry lose their jobs, be forced to move and seek employment elsewhere.

House Taxation
3-9-99
Attachment 7

A friend of mine, a 54 year old engineer and production superintendent with 35 years in the industry, was recently laid off. He's now looking for a job and hoping he won't have to move.

There are producers who have laid off their employees and shut down all their wells. Some have laid off their employees and are attempting to operate their few remaining wells themselves.

For the past several months, almost daily, you hear of someone losing their job and having their salary reduced.

Drilling and exploration is the lowest in 50 years with only 9 drilling rigs operating in Kansas --- and none are drilling for oil.

In Kansas, this industry has lost over 1000 jobs this past year and 3 or 4 thousand more jobs could be lost if present conditions remain and relief doesn't occur.

As the Kansas representative to the Independent Petroleum Association of America and President of the National Stripper Well Association, I made three visits to Washington, D.C. last year. All three were disappointing trips.

With 4% of the world population, we consume over 20% of the oil produced. We now import nearly 60% of oil that we consume.

Over \$50 Billion Dollars a year is spent by taxpayers protecting foreign oil. Imported oil including military cost is estimated at \$80 per barrel.

So what is the real cost of gasoline?

Our Federal government seems to be content with allowing foreign oil to flood our market and dismantle our domestic industry. What is this doing to our National Security and what will the consequences be for future generations?

We believe there are solutions and actions that can be implemented by our State government that could play a major role in the survival of the Kansas Oil Industry.

We hope and pray for your understanding of the seriousness of this crisis. We desperately need your consideration and support of Senate Bill 18 and 46 and HB 2009. Passage of these bills would be a sound investment for the economy and the future of all Kansas.

We have utilized every cost cutting measure possible to continue operating and with your help we can continue to explore for and produce oil and gas for the betterment of this great state.

The lay-offs have been significant and painful. The decline in activity is rippling through our economies.

Please help save this important industry and help retain the jobs of hundreds of hard working dedicated Kansans.

Thank you very much for this opportunity to tell our story.

Testimony of
Lester Town, President
Town Oil Company
before the House Committee on
Assessment and Taxation
March 9, 1999

Mr Chairman and Members of the Committee:

My name is Lester Town and I am an independent oil producer from Eastern Kansas and a member of the Eastern Kansas Oil & Gas Association. I am here as a representative of EKOGA to give you one perspective on the devastating effect low oil prices are having on the oil and gas industry in Eastern, Kansas.

I am sure you are aware of the low oil prices the industry has experienced the past 16 months. I would like to briefly tell you how the low prices have affected Town Oil Company, Town Drilling and Crude Marketing Inc., all of which I am associated with.

Town Oil Co. Was started in 1948 by my father and has been in operation for nearly 51 years in the state of Kansas.

In 1997, Town Oil Co., operated approximately 600 wells which averaged 300 barrels per day of crude oil. We employed 21 people to operate those wells and to complete any new development and exploration.

Currently, Town Oil Co. operates approximately 400 wells which produce an average daily production of 200 barrels per day. This is a 33% drop in our production. We have 14 employees remaining and a considerable amount of negligence on the leases. This represents a 33% drop in our employment.

Town Drilling was also started by my father in 1948 and has continued to operate for nearly 51 years. Town Drilling has owned and operated four drilling rigs in the past but now own and operate only two. In 1997 Town Drilling had ten employees, drilled 46 wells and performed other related drilling services.

Currently, Town Drilling has 5 employees, all are part time. We have drilled only 2 oil wells in the last 14 months. No other drilling is scheduled at this time. Both rigs are idle.

House Taxation
3-9-99
Attachment 8

I am also part owner of Crude Marketing, Inc., which is one of three local crude oil buyers in eastern Kansas. Phil Tearney of Stilwell, KS is the general manager of CMI. In talking to Phil about CMI this past week he related to me the following information.

In 1997, CMI was hauling 3,300 bbls of oil a day with 12 trucks and 17 full-time employees and 2 part-time. By December 1998, volume was down to 1,750 bbls/day. There are 6 trucks operating with 10 full-time and 1 part-time employees. This represents a 50% drop in oil purchases and trucks operated and a 40% drop in employment.

This volume loss by CMI occurred without any loss of producing accounts which reflects that many wells are shut down and there is no new exploration or lease development taking place because of the low oil prices.

The oil and gas industry in Kansas is struggling desperately to survive. We, the producers and service and supply companies need and would appreciate any help the legislature might provide the industry.

The Kansas consumer has saved over 300 million dollars, because of gasoline prices 20 cents lower than in 1997. Our industry is suffering the full brunt of those lower prices. The cost of the help we are asking for comes out to about 1 cent per gallon. Are we really asking for that much to help keep more of this industry around, so that we can again be a productive contributor to the Kansas economy when prices rebound.

Thank you very much for the opportunity to speak to you today.



KANSAS INDEPENDENT OIL & GAS ASSOCIATION

105 S. BROADWAY • SUITE 500 • WICHITA, KANSAS 67202-4262

(316) 263-7297 • FAX (316) 263-3021

800 S.W. JACKSON • SUITE 1400 • TOPEKA, KANSAS 66612-1216

(913) 232-7772 • FAX (913) 232-0917

TESTIMONY OF
ROBERT E. KREHBIEL, EXECUTIVE VICE PRESIDENT
KANSAS INDEPENDENT OIL AND GAS ASSOCIATION
BEFORE THE HOUSE COMMITTEE ON ASSESSMENT AND TAXATION
MARCH 9, 1999

RE: The Economic Crisis facing the domestic oil producer.

Chairman Adkins and Members of the Committee:

Thank you very much for providing the opportunity to be heard. My name is Robert E. Krehbiel and I am appearing on behalf of the Kansas Independent Oil and Gas Association. This Association was organized 62 years ago to speak for the many independent oil and gas producers and supporting service companies throughout the State of Kansas. The subject of this hearing is of vital importance to all Kansas crude oil producers as well and the well being of many Kansas citizens.

The crude oil price crisis, its cause, and the impact on the Kansas producer and the Kansas economy have been well defined by the previous conferees. I would only add the comments of Oklahoma Commissioner Denise Bode presented at the recent Oil Crisis Energy Summit at the request of Governor Keating. Her comments provide an excellent outline of the Oklahoma problem and the solutions they are seeking. Oklahoma's problems are identical to those faced by Kansas, only on a slightly larger scale. I will go on from here to discuss the actions which the industry has taken to address this crisis.

Discussions concerning low oil prices began in early 1998. Newspaper headlines in March of 1998 read "Low oil prices causing U.S. producers to cut back", and "oil prices dive to 9 year low", and "small oil companies sinking with crude prices", and "crude oil prices dive even lower", and "crude sinks to 18 year low". By December of 1998 the headlines were reading "Kansas oil becomes extinct", "declining oil industry affects school districts", and "oil

House Taxation
3-9-99
Attachment 9

crunch causes retailers to experience lower profits". By January of 1999 the Daily Oklahoman reported "Governor Frank Keating calls for special session on oil crisis". It had become painfully clear that something was going on with world supply and demand and this was not a temporary price dip. The word "crisis" began being used to describe the situation for American producers and government began to explore what the impact might be on national security and what, if any, government's role might be.

THE FEDERAL EFFORT

"In December 1998, U. S. Department of Energy Secretary, Bill Richardson formed the Department's Oil Emergency Task Force to assess the effects of low oil prices on the nation's oil production. The Secretary asked the Task Force to report to him on the Industry's assessment of the impact on producers to recover oil and gas, and their ideas on what was most needed from the Federal Government. The Department asked for steps that we could most reasonably and quickly take to prevent the premature abandonment of oil and gas wells across the nation."

The Secretary's Task Force began its work in earnest first attending the annual meeting of the Interstate Oil and Gas Compact Commission in Salt Lake City, Utah, in December, 1998. The Liaison Committee of Cooperating States set forth proposals to improve the price of crude oil. Those proposals included suggestions to put a floor on the price of crude oil, place an import fee on imported crude, place an inspection fee on tankers, stop the dumping of excess crude as they do with other imports such as steel, and the list went on.

A few weeks later a group of Kansas producers conferenced with the Department's task force and offered additional suggestions. My own proposal to enact a target price similar to that used by Agriculture to allow producers to continue to sell crude oil at levels below the cost of production with farm-like subsidies was offered. Numerous other proposals were offered including the one outline in the comments of Phil Knighton in testimony distributed to you.

Then, on January 8, 1999, Governor Frank Keating invited various oil producing states, including Kansas, to an "Oil Crisis Energy Summit" in Oklahoma City. Two of the Secretary's Task Force members were present and further suggestions were made. It was at this meeting that it became perfectly clear that there was no sentiment whatsoever within the political community, federal or state, to do anything that would raise the price of crude oil. Import fees, price floors, tariffs, inspection fees, anti dumping actions, or any other action which might

increase the price of gasoline at the pump is simply not politically doable. It has been estimated that American's saved \$100 billion in reduced fuel costs in calendar year 1998. Kansans save an estimated \$18 million per year for each 1 cent decrease in the price of motor fuel. The price of gasoline averaged \$1.35 per gallon two years ago and \$.77 this year. Kansans' estimated savings are well over half a billion dollars annually. The reality, however, is that they have not saved a dime as the true cost of imported crude oil is estimated to exceed \$80 per barrel. But successful politicians are not fools and in politics, perception is everything.

As a result, this meeting only produced support for filling the strategic petroleum reserve and for tax credit bills introduced by Rep. Wes Watkins of Oklahoma and Sen. Kay Bailey Hutchison of Texas. Last week the Director of the Interstate Oil and Gas Compact Commission expressed some hope to me that Rep. Wes Watkins' bill, which is being supported by the Kansas delegation and other producing states, has some slim chance for passage. This bill would provide a tax credit of \$3 per barrel for the first 3 barrels of oil produced from oil wells making less than 15 barrels per day.

Then on February 23, 1999, the Department of Energy released the Task Force report entitled "Initiatives for Energy Security". A copy is attached. Every thing in the report is much needed and very good for the industry. There is nothing, however unfortunate, in the report to address the crude oil price crisis. However well intentioned, there is nothing that I could find in that report that will save a single Kansas producer in a price crisis situation. The legislation introduced by Watkins and Hutchison was not included.

THE STATE'S EFFORTS

Clearly producing states have been left to resolve the crude oil price crisis on their own. Since states have no control over the world price of crude oil their only potential for resolution is on the cost side. Oklahoma acted immediately with a special session to reduce severance taxes. Texas, Wyoming, New Mexico, North Dakota are all engaged in the same legislative analysis that we are engaging in. Costs of all kinds are being reviewed. Reduction of severance and production taxes, sales tax exemptions for machinery and equipment, and electricity cost relief are all in the mix.

CAN THE PROBLEM BE SOLVED IN KANSAS?

It is difficult to determine how much of Kansas crude oil is produced and sold at prices

below the cost of production at current price levels of \$9 to \$10 per barrel. The cost of production varies from producer to producer and from lease to lease, but it is generally stated that the cost of production in Kansas averages \$12 to \$14 per barrel. Using those assumptions a significant amount of crude oil produced in Kansas, perhaps as much as 15 to 20 million barrels, is losing money and is at risk of being plugged and abandoned. Crude oil production was down by nearly 10 million barrels in 1998 and a survey of producers indicated that as many as 40% of Kansas wells have been shut in. An additional \$60 to \$100 million may be necessary to break even. Can costs be trimmed at the state level by this amount? Absolutely, but it will require a comprehensive approach to cutting costs at every corner. We are proposing a package of bills to reduce costs for the oil producer to levels similar to producers in other industries.

In 1997 oil and gas producers paid over \$203 million in severance and property taxes. In 1998, even with reduced prices, oil and gas producers paid over \$170 million in severance and property taxes. A breakdown of these costs are attached with the heading "Severance and Property Tax on Oil and Gas".

The Property Tax Component: H.B. 2543, like S.B. 18, would provide a refundable credit against a working interest owner's state income tax liability for all property taxes paid for property tax year 1998 and thereafter which is attributable to oil wells which make less than 15 barrels of oil per day. Passage of this bill would allow every working interest owner to recover all of the property taxes paid on qualifying wells when their April 15, 1999 income tax return is filed. It is estimated that this bill would reduce producer's costs by \$8 million and help sustain production from the most vulnerable of oil wells.

The Severance Tax Component: H.B. 2039, like S.B. 46, would repeal the severance tax on crude oil. It is estimated that would reduce crude oil producer's costs by \$4 million in the coming fiscal year, eliminate a tax that can no longer be justified by any stretch of the imagination and reduce the cost of associated producer paperwork significantly.

The Sales Tax Component: H.B. 2009, would exempt the sale of oil and gas machinery and equipment, repairs, replacement parts and all related services from the state's sales tax. This would reduce producer's costs by an estimated \$6 million per year. This would assist producer's by reducing the cost of repairing marginal wells when substantial investments are necessary to sustain production and prevent plugging.

This proposed package of bills would reduce producer's costs by an estimated \$18 million per year and bring taxation of the oil industry to a level more comparable to that applied to other Kansas industries. Will this solve the problem for Kansas producers? It will certainly provide help for those who are able to help themselves. Coupled with efforts to reduce electric rates in proceedings now before the KCC this package of bills will save a substantial amount of Kansas crude oil production. The alternatives are far more costly.

There is nothing contained in any of these bills which will raise the price of gasoline to consumers at the pump. In fact, these bills should help sustain domestic production and help keep crude oil prices low. Politically these bills should be doable.

The industry urgently needs your assistance and action on these bills. Thank you very much for your consideration.

Oklahoma's Perspective
Oil Crisis Energy Summit
January 8, 1999

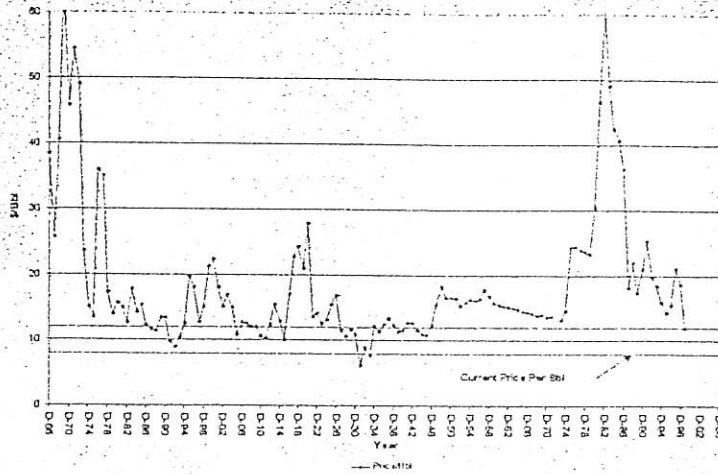
Presented by Denise Bode, Comm
Oklahoma Corporation Commission

The Problem

- ✓ Crude oil prices are at their lowest levels since the Great Depression.
- ✓ The average oil well in Oklahoma needs \$13-14/bbl to make expenses. 80% of the state's wells produce less than 2 bbl/day. Most of them have been losing money for 6-8 months.
- ✓ 50,000 jobs and hundreds of businesses are at risk.

Historic Oil Prices, 1866-Present

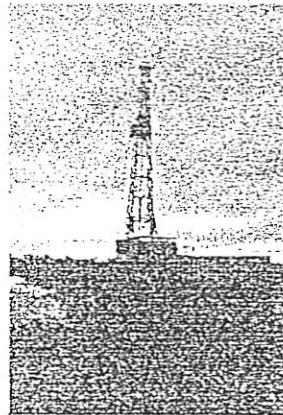
Oil Prices Since the Civil War Adjusted for Inflation



Historic Low Oil Prices

Adjusted for inflation:

- ✓ 1931 - \$6.11/bbl
- ✓ 1933 - \$7.70/bbl
- ✓ December 1998 - \$8.50/bbl



Venezuela Has A Plan...

"Top officials at Venezuelan national oil company Petroleos de Venezuela (PDVSA) are advocating an effort to bring world oil prices down sharply in a bid to gain market share....

"PDVSA officials believe... (i)t would result in some marginal production being shut in and force some... producers, particularly in the United States, out of business."

--Oil Daily, 12/3/97

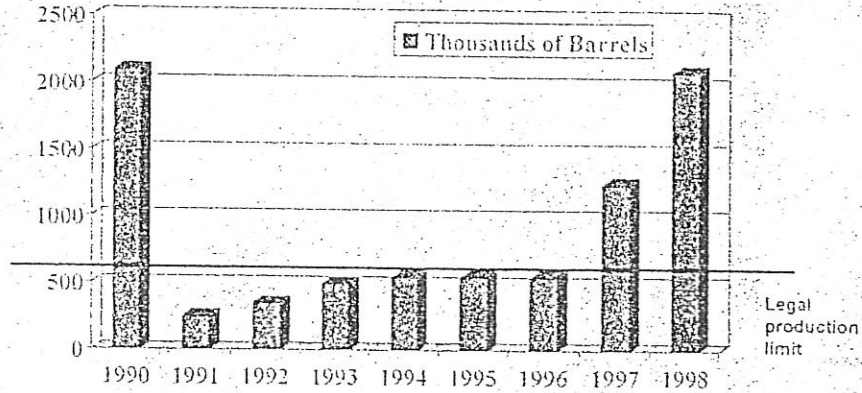
...And It's Working

"Luis Guisti, president of Venezuelan state oil company, PDVSA, said Monday that continued low crude oil prices would drive about one million barrels per day of U.S. and Canadian oil production out of the market in the next few months."

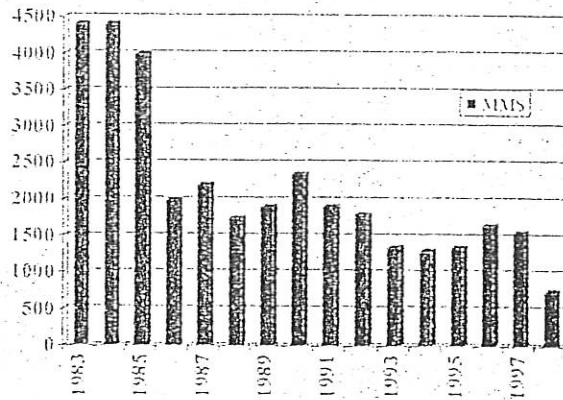
--Reuters, 12/14/98



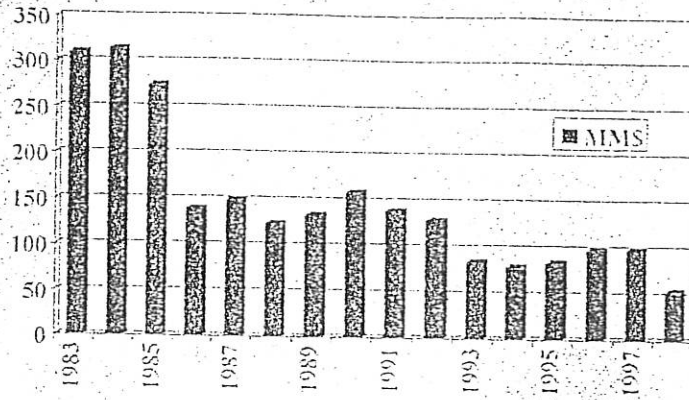
Iraq - Average Daily Production



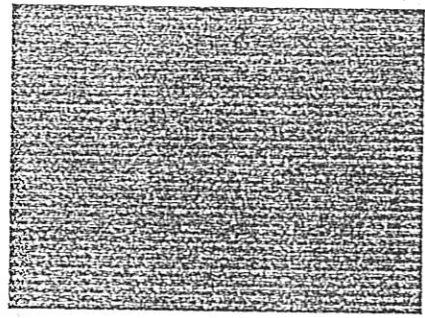
Oklahoma Gross Oil Revenue Since 1983



Oklahoma Tax Revenue Since 1983



The Consequences



The Consequences

- ✓ OIPA estimates oil production in Oklahoma could decline 35-40% in 1999.
- ✓ As many as 20,000 wells may be shut down
- ✓ Gross production tax revenue to the state will decline \$5 million/month at current prices.
- ✓ Overall tax revenue loss due to the oil crisis estimated at \$150-\$200 million/year, as much as 5% of the Oklahoma tax base.

The Consequences

- ✓ People, and jobs, will be lost.
- ✓ High-tech, high-wage, jobs.
- ✓ Equivalent of a factory in every county in Oklahoma.

An Independent Producer's Perspective

- ✓ Small producer with few employees
- ✓ Contract for technical work
- ✓ Exploration orientated
- ✓ Prospect development
- ✓ Break even point - \$12.00/bbl

Action taken

- ✓ Place all exploration prospects on hold
- ✓ Attempt to sell undeveloped acreage
- ✓ Stop all drilling activity for oil
- ✓ Discontinue leasing new prospects
- ✓ Shut-in or plug unprofitable wells
- ✓ Contact other operators and request shut down or plugging of unprofitable wells

Consequences of Action Taken

- ✓ Discontinue hiring contract work
- ✓ Reduced drilling - effect on contractors
- ✓ Less money flowing into our economy
- ✓ Multiplier effect
- ✓ Lost production, taxes and royalty & lease bonuses

Solutions - Oklahoma Task Force Recommendations

Special legislative session to address:

- ✓ Reduction of Gross Production Tax on oil during times of economic crisis.
- ✓ Advancing the refund date under "at-risk oil lease" provisions (existing law).

Oklahoma Task Force Recommendations

Reduction of Gross Production Tax

- ✓ Above \$17/bbl.....7% (current rate)
- \$14-\$17/bbl.....4%
- Under \$14/bbl.....1%

Oklahoma Task Force Recommendations

Advancing refund date under “at-risk oil lease” provisions

- ✓ Under current law, refunds not available until July 1st. Proposal would allow oil interest owners to file for refunds on at-risk leases as of April 1, 1999.

Oklahoma Task Force Recommendations

To be considered in regular session:

- ✓ Sales Tax Exemption on oilfield equipment.
- ✓ Electricity cost relief (Exclusion of “certified at risk oil leases” from the Retail Electric Supplier Certified Territory Act.
- ✓ Permanent reduction of Gross Production Tax.

Oklahoma Task Force Recommendations

Sales tax exemption on oilfield equipment

- ✓ Oil and gas industry one of few “manufacturing” industries without an exemption from state sales tax.
- ✓ Exempting machinery, electricity, fuels, pipe and materials used in the exploration and production of crude oil or natural gas.

Oklahoma Task Force Recommendations

Electricity cost relief

- ✓ Provide open retail competition for electric service, at least to larger users.
- ✓ Eliminate demand charges from oil operations required to run continuously.
- ✓ Eliminate sales tax on electricity utilized in oil operations.
- ✓ Create special "distressed industry" category for oil operations.

Oklahoma Task Force Recommendations

Permanent reduction of Gross Production Tax

- ✓ Reduction from current 7% level to 5%

Solutions - Federal Level

- ✓ Rep. Wes Watkins bill
- ✓ Sen. Kay Bailey Hutchinson bill (1998)

Where Do We Go From Here?

- ✓ Action at state level
- ✓ Concerted effort between the states
- ✓ Action at federal level



Department of Energy

Washington, DC 20585

February 23, 1999

Dear Stakeholder:

I am forwarding to you today the "Initiatives for Energy Security" that were presented to the National Governors' Association by Secretary Bill Richardson on February 21, 1999.

In December 1998, Secretary Richardson formed the Department's Oil Emergency Task Force to assess the effects of low oil prices on the nation's oil production. The Secretary asked the Task Force to report to him on the industry's assessment of the impact on producers to recover oil and gas, and their ideas on what was most needed from the Federal government. The Department asked for steps that we could most reasonably and quickly take to prevent the premature abandonment of oil and gas wells across the nation.

The Task Force received an extensive list of proposals from our industry stakeholders and examined them for short and long-term measures. Many were consistent with the Department's natural gas and petroleum programs which provide the groundwork for the enclosed actions.

The actions contained in the "Initiatives for Energy Security" focus on four key strategies: Enhancing America's Energy Security; Preserving Domestic Oil and Gas Production Capacity; Lowering Costs of Production; and Improving Government Decision Making.

Some of these actions will take time, but the process will be ongoing and we will continue to work on many others in the days ahead. We are committed to work hard to preserve the viability of the domestic oil and gas industry.

Sincerely,

A handwritten signature in black ink, appearing to read "Robert W. Gee", with a long horizontal flourish extending to the right.

Robert W. Gee
Acting Assistant Secretary
for Fossil Energy



Printed with soy ink on recycled paper



AMERICA'S OIL: OUR STRATEGIC RESOURCE INITIATIVES FOR ENERGY SECURITY

This Administration is committed to preserving the production capacity of the domestic oil and gas industry, which is vital to our Nation's energy security.

For the last year, world oil prices have been in a steep unprecedented decline. Current market conditions are threatening our domestic production capacity. Faced with the potential abandonment of our valuable energy resources, I formed the Department's Oil Emergency Task Force to report to me on three areas: (1) the industry's assessment of the impact on producers to recover oil and natural gas and their corresponding solutions to mitigate this condition; (2) the effects of these price declines on domestic oil and gas production capacity and energy security; and (3) what steps the Administration, in conjunction with industry and the states, should take to address this circumstance.

The Task Force received an extensive list of proposals and evaluated them based on short-term achievability. Many are consistent with the Department's natural gas and petroleum technology and policy programs, which provide the groundwork for the attached actions.

This Administration has consistently worked hard to preserve the viability of the domestic industry, and to maintain production and high paying jobs, both through administrative actions and with Congress. Over the past six years, we have supported:

- Heavy Oil and Stripper Well Royalty Relief on Federal Lands.
- Deepwater and Marginal Leases Royalty Relief (Outer Continental Shelf).
- Alternative Minimum Tax (AMT) Relief for Small Producers.
- Full Funding of 32 Reservoir Class Technology Demonstration Program Projects - \$115 million.
- Federal Divestiture of Elk Hills Petroleum Reserve for \$3.65 billion.
- Royalty Fairness and Simplification Act.
- Major revisions of Energy Policy and Conservation Act.

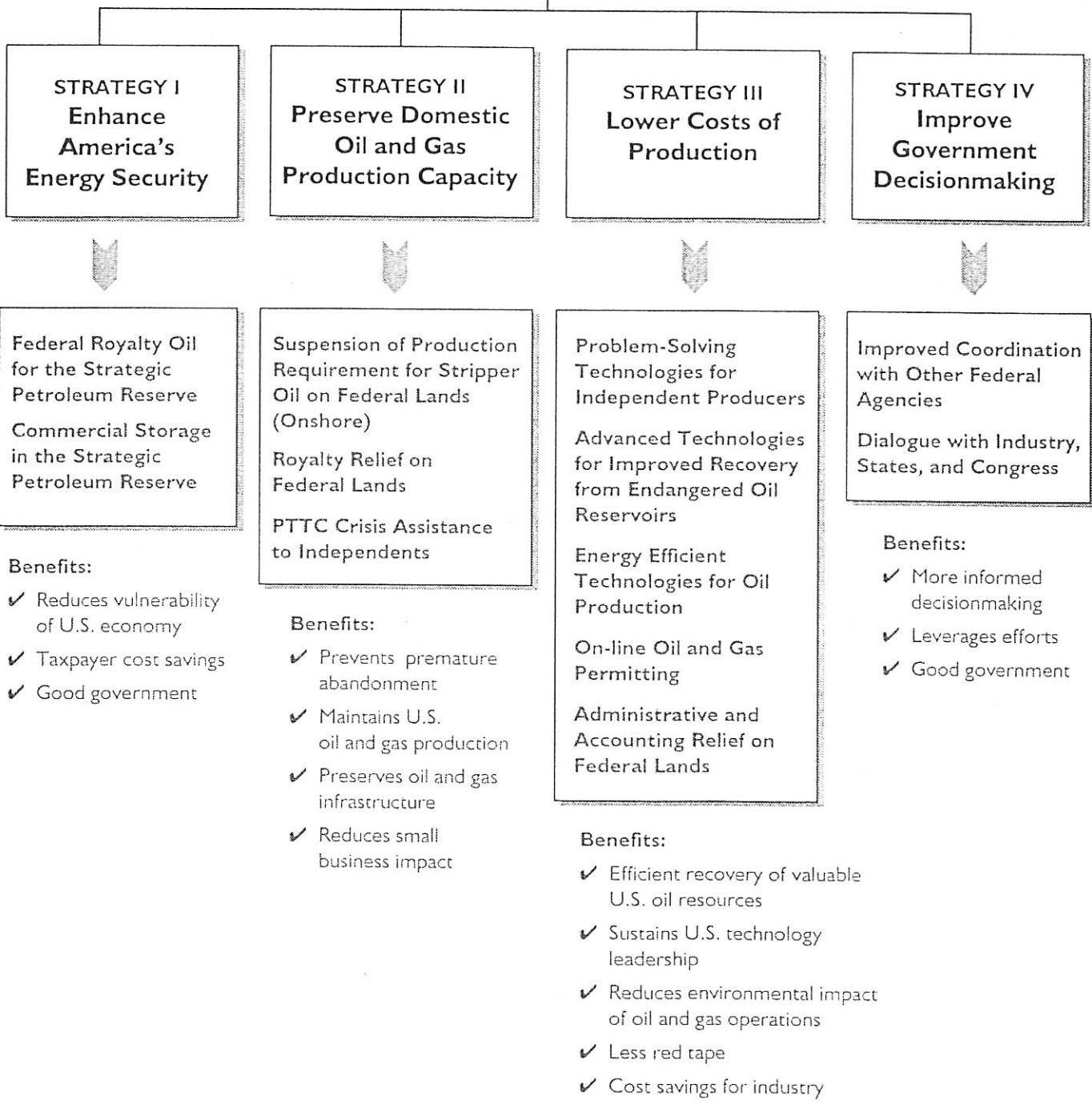
The actions contained in the Initiatives for Energy Security focus on: **Enhancing America's Energy Security, Preserving Domestic Oil and Gas Production Capacity, Lowering Costs of Production, and Improving Government Decisionmaking.**

This process will be ongoing as we continue to work on both mid- and long-term proposals and solutions that will protect the production capacity and capabilities of our domestic oil and gas industry.

A handwritten signature in cursive script that reads "Bill Richardson".

Bill Richardson
Secretary of Energy

Department of Energy
AMERICA'S OIL: OUR STRATEGIC RESOURCE
INITIATIVES FOR ENERGY SECURITY



Strategy I - Enhance America's Energy Security

Action: Increase the Inventory of the Strategic Petroleum Reserve with Federal Royalty Oil

On February 12, 1999, Secretary Richardson announced plans to partially refill the Strategic Petroleum Reserve with federal royalty oil from production in the Central Gulf of Mexico. This action will replace approximately 28 million barrels of oil, which were sold from the Reserve in Fiscal Years 1996 and 1997 for deficit reduction purposes. The Reserve can hold around 680 million barrels, but presently holds only 560 million barrels. This action takes advantage of today's low oil prices. "Buying" low today provides the Nation a high rate of return tomorrow, enhancing national energy security and increasing strategic assets, overall a good deal for the American taxpayers. This action is neither intended nor expected to raise the price of oil.

Benefits:

- ✓ Reduces vulnerability of U.S. economy
- ✓ Taxpayer cost savings
- ✓ Good government

This action entails the transfer of royalty oil from federal offshore leases in the Outer Continental Shelf. Under current law, the U.S. government owns 12.5 to 16.7 percent of the oil produced from federal leases and can either acquire the oil itself or receive the equivalent dollar value. The Department of the Interior implements the federal offshore leasing program and the Department of Energy maintains the Strategic Petroleum Reserve. Matching the authorities of both agencies to take and exchange royalty oil enables the federal government to fill the Reserve without a specific appropriation, and requires no budget offsets. While the details of the transfer must be worked out, it is estimated that the Department of Energy and Department of the Interior would move up to 100,000 barrels per day from points in the Gulf into the Reserve. From industry's perspective, this action creates the equivalent of 28 million barrels of demand over the next year -- a much needed outlet for oil production.

Money has not been appropriated to purchase oil for the Reserve since 1990. Authorized by the Energy Policy and Conservation Act (EPCA) in 1975 as the Nation's insurance policy, Reserve facilities are located in Louisiana and Texas. To put the action into effect, Secretary Richardson on February 11, 1999 transmitted letters to Congress notifying oversight committees of necessary changes in the Administration's Strategic Petroleum Reserve Plan. Storage of royalty oil is authorized under EPCA and can be implemented administratively, but the Department of Energy must formally notify Congress at least 60 days in advance of implementing the royalty transfer plan.

Strategy I - Enhance America's Energy Security

Action: Offer Unutilized Strategic Petroleum Reserve Capacity for Commercial Storage

On February 17, 1999, Secretary Richardson announced a second action to add crude oil to the Nation's emergency oil stockpile. This action entails up to 70 million barrels of unfilled space in the Strategic Petroleum Reserve being made available to companies wanting to store oil for at least one year.

Benefits:

- ✓ Reduces vulnerability of U.S. economy
- ✓ Taxpayer cost savings
- ✓ Good government

The Department expects to negotiate mid- to long-term contracts for the commercial storage of oil from parties possibly including the petroleum industry, oil traders, investment firms, and even foreign governments. Authority to acquire oil is contained in Section 160 of the Energy Policy and Conservation Act.

The public benefits of commercial storage are compelling. All of the fees that will be paid in consideration of the storage service will be paid in-kind. This adds to the size of the Reserve's inventory at a slow but steady rate, and will supplement in-kind pipeline lease payments that will begin in 2000 at a level of about \$2 million per year. Due to the large size of the space available for storage, the oil acquired for the Reserve may be substantial. The result will be a slow increase in the Reserve inventory and the number of days of import protection. The latter is especially important because the United States is, by treaty, obligated to maintain an inventory of 90 days of imports. Although we are in compliance with our obligation, the Reserve currently provides only 60 days of the protection. The remainder is covered by private inventories that are excess to the minimal working inventories of the owners. However, those private stocks are not regulated by the federal government and may shrink in the future without regard to treaty obligations. Over the long-term, satisfaction of the obligation would be best covered by oil owned or controlled by the federal government.

Although the private inventories stored in the Reserve will not be owned or controlled by the government, they will be counted in satisfaction of our treaty obligation to maintain 90 days of strategic oil in storage, and, in fact, will provide almost all of the same benefits as if they were Strategic Petroleum Reserve oil, assuming that the oil would be withdrawn in the event of an energy supply emergency. Specifically, the Nation achieves all of the price dampening effects to buffer the economy from recession, and if the oil is owned by a domestic company it will save the country from a surge in import-export imbalances during a supply emergency.

The closing date for submitting proposals is March 10, 1999. Contract awards are anticipated around late March or early April 1999, and deliveries may begin at any time after that date. Copies of the commercial storage solicitation can be obtained from DOE web sites at www.fe.doe.gov and www.spr.doe.gov.

Strategy II - Preserve Domestic Oil and Gas Production Capacity

Action: Suspension of Production Requirement for Stripper Oil on Federal Lands (Onshore)

The Department of the Interior has the statutory authority to provide relief from production requirements for operators on public lands due to hardship conditions. In the past, the Department has granted this relief for individual properties on a case-by-case basis. On February 4, 1999, the Department acted to provide this relief for all small operators with stripper oil well properties in response to current low oil prices.

Benefits:

- ✓ **Prevents premature abandonment**
- ✓ **Maintains U.S. oil and gas production**
- ✓ **Preserves oil and gas infrastructure**
- ✓ **Reduces small business impact**

This relief would allow operators to suspend operations for up to two years without losing their leases or having to plug their wells. Rental and minimum royalty payments would also be suspended during this period. This suspension policy will be in effect for two years, or until the average price of benchmark West Texas Intermediate oil reaches, or exceeds, \$15 per barrel for 90 consecutive days. Such relief is available to all properties that are qualified to receive stripper oil well royalty relief. Stripper oil properties are those which produce an average of 15 barrels, or less, per day per well. These properties account for a significant portion of oil produced on public lands. In 1997, they produced 32 percent, or 37.4 million barrels, of all the oil produced on these lands.

This action will help to alleviate the economic impact that low oil prices have on small federal stripper oil operations. And, given what small operators are going through, this is the right decision at the right time. **Secretary Richardson has applauded the Interior initiative. Preventing premature abandonment of valuable domestic oil resources is good energy policy -- good for our energy security, and our economy.**

Further information is available from the Department of the Interior's Bureau of Land Management Web Site at www.blm.gov.

Strategy II - Preserve Domestic Oil and Gas Production Capacity

Action: Royalty Relief on Federal Lands

The Department of the Interior offers reduced royalties for several classes of leases on federal lands to encourage development and prevent premature abandonment. These include royalty reductions for:

- **Outer continental shelf deep-water leases** – Royalty payments may be suspended for a specified volume of production from leases in water depths of 200 meters or greater. The suspension volume for leases increases as their water depth increases.
- **Offshore end of life leases** – Royalty payments may be reduced where continued production from leases nearing the end of their productive life would be uneconomic without relief.
- **Onshore leases producing heavy oil and stripper properties** – Royalty relief may be provided to leases producing heavy oil or fewer than an average of 15 barrels of oil per day per well. Relief is based on a sliding scale, with lower royalty rates granted for lower production and heavier oil. A producer with low production heavy oil wells can receive either stripper or heavy oil relief, but not both.

Benefits:

- ✓ **Prevents premature abandonment**
- ✓ **Maintains U.S. oil and gas production**
- ✓ **Preserves oil and gas infrastructure**
- ✓ **Reduces small business impact**

In addition to these categories of leases that qualify for volume suspensions or lower royalty rates, Interior has the authority to grant royalty relief, both onshore and offshore, on a case-by-case basis to operators who can show that their lease operations are not economic without such relief. Both the Minerals Management Service (MMS), for offshore leases, and the Bureau of Land Management (BLM), for onshore leases, are willing to work with producers who believe they qualify for such relief. MMS is currently considering several applications from industry for royalty relief on specific leases.

MMS also is conducting workshops with industry to identify areas where additional relief may be appropriate and is studying the possibility of pursuing new policy initiatives that would increase production and resource recovery. Possible initiatives include:

- Relief for broad classes of leases that could automatically qualify under various streamlined criteria.
- Relief for leases to avoid premature abandonment.
- Streamlined processes and criteria for considering emergency relief.

BLM is concentrating on case-by-case review of leases that do not qualify for the current stripper or heavy oil relief. BLM plans to increase its outreach efforts to make producers aware of this avenue of assistance. **As we have done in the past, the Department of Energy will assist Interior by: (1) providing analytic support that may be needed to define and justify additional lease categories that could qualify for royalty reductions; and (2) supporting BLM's outreach efforts to get the word out that assistance is available and to explain and clarify application procedures.**

Strategy II - Preserve Domestic Oil and Gas Production Capacity

Action: Continued Support of Petroleum Technology Transfer Council's Crisis Management Assistance to Independents

In response to the current economic crisis in the exploration, production, and service sectors of the domestic petroleum industry, the Petroleum Technology Transfer Council (PTTC) has restructured most of its planned 1999 activities to address the survival needs of the industry. Foreseeing the prospect of production shut downs, with a resultant loss of jobs, revenue, and future energy supplies, PTTC initiated an Industry Crisis Action Plan in December 1998.

Day-to-day, PTTC's ten regional centers are providing grassroots assistance to oil producers on technical, legal and business strategies for survival such as improving cost efficiencies, identifying best practices for operating and production shut down under crisis conditions, and preventing lease forfeiture. The Department of Energy applauds these much needed efforts.

PTTC, a nonprofit organization, was formed by industry in 1994 to accelerate the dissemination of technology to independent exploration and producing companies, and to communicate industry's needs to the research and development community. PTTC is funded primarily by the Department of Energy, with additional funding from universities, state geological surveys, state governments, and industry donations. Although independents range from small one- or two-person companies up to very large public firms, the typical independent employs ten full-time and three part-time employees. Independents are small businesses that help fuel their regions' economic activity.

PTTC offers nearly 100 annual workshops throughout the country. Further information on PTTC, its regional centers, and its workshops can be found on the PTTC Web Site at www.pttc.org.

Benefits:

- ✓ **Prevents premature abandonment**
- ✓ **Maintains U.S. oil and gas production**
- ✓ **Preserves oil and gas infrastructure**
- ✓ **Reduces small business impact**

Strategy III - Lower Costs of Production

Action: Problem-Solving Technologies for Independent Producers

On February 16, 1999, the Department of Energy announced it will provide as much as \$1 million in new federal funding for research and development specifically targeted to small, independent oil operators who are facing production problems that might be overcome by applying innovative field technologies.

The initiative will focus on lowering the costs of production and solving specific production problems faced by smaller, independent operators in every aspect of oil field production, from characterizing the reservoir to managing production and environmental compliance.

This initiative builds on the success of an earlier Department of Energy program, **Technology Development for Independent Producers**, with projects in 13 states, to extend the economic production of domestic oil fields by slowing the rate of well abandonments and preserving industry infrastructure, and to increase ultimate recovery in known oil fields using advanced technologies. For example, a project involving gel polymer demonstration in a field, with four of six wells shut-in, allowed all wells to regain or improve production, tripling the daily production.

This initiative is targeted to small oil operators with less than 50 employees. Generally, financial assistance will be \$75,000 or less per project to be at least matched by the producer. Projects will last from six months to two years. Oil field operators will be able to apply for funding by completing a simplified, six-page form. The Department of Energy will accept proposals by four closing dates: March 31, June 1, August 30, and November 30, 1999.

The solicitation is available from DOE Web Sites at www.fe.doe.gov, www.fetc.doe.gov, or www.npto.doe.gov.

Benefits:

- ✓ **Efficient recovery of valuable U.S. oil resources**
- ✓ **Sustains U.S. technology leadership**
- ✓ **Reduces environmental impact of oil and gas operations**
- ✓ **Less red tape**
- ✓ **Cost savings for industry**

Strategy III - Lower Costs of Production

Action: Advanced Technologies for Improved Recovery from Endangered Oil Reservoirs

On February 16, 1999, the Department of Energy announced that it is reopening its Reservoir Class Program, an effort begun in 1992 that has encouraged many domestic oil producers to test and adopt new technologies for prolonging the life of some of the Nation's most endangered oil fields.

In the **Reservoir Class Revisit Program**, DOE will offer up to \$18 million for cost-shared projects that could extend over the next five to six years. Proposals are due May 20, 1999.

Proposals will be accepted from producers operating in three major types of geologic classes of oil reservoirs, which represent about half of the Nation's unrecovered oil. The three classes -- fluvial dominated deltaic reservoirs (Class I), shallow shelf carbonate reservoirs (Class II), and slope and basin clastic reservoirs (Class III) -- contain large amounts of unproduced crude oil that is at risk of abandonment in the next five years.

The new program will build on the success of many of the earlier cost-shared field projects with a strong emphasis on transferring successful technologies to other producers. These earlier projects gave producers the opportunity to apply a host of new or untried technologies, including the first-ever application of 4-dimensional seismic modeling, along with other advanced imaging techniques, the expanded use of horizontal drilling, and innovative methods to enhance the flow of oil. For example, advanced reservoir management methods being applied in the Nash Draw Field in Southeastern New Mexico will enable the recovery of an additional 18.5 million barrels of oil.

Information on the **Reservoir Class Revisit Program** can be obtained on DOE Web Sites at www.fe.doe.gov, www.fetc.doe.gov, or www.npto.doe.gov.

Benefits:

- ✓ Efficient recovery of valuable U.S. oil resources
- ✓ Sustains U.S. technology leadership
- ✓ Reduces environmental impact of oil and gas operations
- ✓ Less red tape
- ✓ Cost savings for industry

Strategy III - Lower Costs of Production

Action: Energy Efficient Technologies for Oil Production

On February 18, 1999, the Department of Energy announced a new partnership with the National Association of State Energy Officials (NASEO) to encourage U.S. oil producers to use cost-saving, energy efficient equipment in the oil patch. This effort will bring together oil producers and electric power companies in a pilot program that would offer utility financing for energy efficient oil production equipment.

Installing more energy efficient equipment in the oil field, for example, outfitting pumping rigs with less energy consuming motors, could offer a way for domestic oil producers confronting record low oil prices to cut costs and keep currently threatened fields in production. In some states, electricity costs account for over 50 percent of the costs of lifting oil to the surface.

To show producers and utilities what might be possible, the Department of Energy will join with NASEO to sponsor a kick-off workshop and a series of field demonstrations of energy-saving oil field equipment. The project will involve independent operators, technology experts, utility companies and the financial community, and will start with a workshop, March 11-12, 1999, in California to select field test sites. At each site, energy efficiency and oil field experts will test a variety of more energy efficient pumps, motors, and other equipment under actual oil field conditions. Results will be compiled and used to encourage local utilities to help finance more widespread use of the energy-saving equipment and practices in oil-producing regions across the Nation. This project will:

- Demonstrate the cost effectiveness of more energy efficient equipment.
- Foster federal, state, and private sector partnerships to address critical cost issues affecting independent oil producers.
- Further the development of practical, cost-effective private-sector financing mechanisms for achieving energy efficiency improvements.
- Extend the productive life of existing oil fields, maximizing domestic oil resource recovery.
- Assist local communities in preserving employment and tax revenues associated with oil production.

A prior five-well trial in Kansas resulted in over 12 percent reduction in energy consumption with a 6.5 month payback of costs. The Department of Energy will provide \$170,000. Substantial in-kind contributions are being provided by NASEO energy offices -- located in California, Colorado, Ohio, Texas, Utah, and Wyoming -- and the regional and local electric utilities involved in the project. Other participants include: the Independent Petroleum Association of America, the Interstate Oil and Gas Compact Commission, the Petroleum Technology Transfer Council, and the National Rural Electric Cooperative Association. The California Independent Producers' Association and the Western States Petroleum Association are also assisting in the California workshop.

Benefits:

- ✓ Efficient recovery of valuable U.S. oil resources
- ✓ Sustains U.S. technology leadership
- ✓ Reduces environmental impact of oil and gas operations
- ✓ Less red tape
- ✓ Cost savings for industry

actions

AMERICA'S OIL: OUR STRATEGIC RESOURCE INITIATIVES FOR ENERGY SECURITY

Strategy III - Lower Costs of Production

Action: On-Line Oil and Gas Permitting

On February 19, 1999, Energy Secretary Richardson set into motion a pilot program in Texas that would replace reams of paper forms with a cost-saving on-line digital processing system. If the all digital approach is successful, an oil and gas producer might soon be able to sit down before a computer terminal connected to the Internet, fill out an electronic permit application, and submit it along with any necessary pictorial or textual attachments. The operator's identity would be authenticated on-line, and permit fees would be handled via secure transactions. Within hours -- perhaps the same day, rather than the days or weeks now required -- the producer would be notified electronically whether the permit application had been approved.

Benefits:

- ✓ Efficient recovery of valuable U.S. oil resources
- ✓ Sustains U.S. technology leadership
- ✓ Reduces environmental impact of oil and gas operations
- ✓ Less red tape
- ✓ Cost savings for industry

The expected savings for each permit may appear to be relatively small -- between \$200 to \$400 for a typical drilling permit, for example. But, in Texas alone, oil and gas operators filed nearly 150,000 permit applications with the Texas Railroad Commission in 1997. Around 15,000 of the applications were for drilling permits. Overall cost savings could run into the millions of dollars. For just drilling permits alone, Texas producers could save \$3 million to \$6 million per year. If the all electronic approach is eventually extended to the full regulatory and compliance process and expanded to other oil and gas producing states, the cost savings could escalate into the hundreds of millions of dollars.

To begin the pilot program, the Department of Energy (DOE) will provide \$700,000 to the Texas Railroad Commission for a two-year development and testing effort. The Commission will match the federal funding. Within the next eight months, the Commission hopes to have a prototype electronic system in place for testing and debugging. By the end of 2001, the system is expected to be on-line and fully functional. Applicants will be able to access the system from their desktop computers or from satellite stations established by the Texas Railroad Commission throughout the state.

The initiative will first focus on applications for drilling permits, the first step in the regulatory process for a new well. Filing and receiving approval of a drilling permit will incorporate all of the key technical challenges likely to be encountered in converting the Commission's entire regulatory and compliance process to an on-line, digital system -- from electronic signature requirements to electronic attachments of forms and plats to electronic processing of fees.

The electronic compliance and approval process moves digital filing a major step forward -- to an on-line system and, perhaps, toward a day when no paper will be exchanged for any compliance requirement. The Texas Railroad Commission has set a goal for a "Paperless Data System" by 2005. If the system is successful in Texas, DOE and the Railroad Commission will encourage other state regulatory agencies to adopt the all electronic approach. DOE has been working with the Interstate Oil and Gas Compact Commission to encourage states to implement modern, on-line permitting and compliance advisory systems.

actions

AMERICA'S OIL: OUR STRATEGIC RESOURCE INITIATIVES FOR ENERGY SECURITY

Strategy III - Lower Costs of Production

Action: Administrative and Accounting Relief on Federal Lands

The Department of the Interior has undertaken efforts on several fronts to reengineer the way it manages oil and gas development on federal lands. These efforts are aimed at saving time and lowering costs for both producers and government agencies, while assuring that the interests of American taxpayers -- the owners of the federal oil and gas resource -- are protected.

In December 1998, the Bureau of Land Management (BLM) issued a draft of a comprehensive revision of its regulations governing onshore oil and gas leasing and operations. In developing this proposed rule, BLM examined all aspects of the way it conducts business and streamlined and improved everywhere it could. The proposed rule was written in plain English, using a question and answer format so that it does not take a lawyer to understand the regulations.

The proposed rule will eliminate redundancies, clarify procedures and regulatory requirements, and streamline processes. In many areas, performance-based standards will replace prescriptive requirements, specifying what the goal is, and letting industry decide the most cost-effective way to achieve it. The rule also incorporates by reference industry standards for certain practices that have been developed and used by industry. A number of changes will improve the economics of low volume wells while reducing paperwork.

At the request of industry, BLM extended the comment period for this comprehensive rule until June 1999. **DOE will examine the rule, provide comments on aspects that may affect the production capacity of or access to federal lands, and will assist BLM with outreach and analysis once the comment period has ended, where such assistance can be helpful.** The Minerals Management Service (MMS) has undertaken a three-year effort to reengineer its business processes. The objective of this initiative is to implement improved processes and automated support systems that will greatly reduce and streamline reporting requirements, administrative burdens, and costs for producers. MMS is working with industry in this endeavor and analyzing their recommendations.

MMS issued two proposed rules in January 1999 that are aimed at simplifying requirements and lowering costs. One would provide royalty accounting and auditing relief for federal marginal properties, i.e., those that produce an average of fewer than 15 barrels of oil equivalent per day per well. The proposed rule would promote production from marginal properties and reduce administrative costs to the operators of those properties. Relief options that are offered include less frequent reporting, consolidating reported information, reduced audit burden, and simplified calculations. MMS estimates that lessees would report over half a million fewer lines of information per year and save over \$1.2 million per year as a result of this rule. The second MMS proposal would improve the administrative process for appealing MMS actions, including resolving disputes over the amount of royalties due on federal oil and gas leases. The proposed rule would establish a streamlined appeals process, set up a 33-month time table for final decisions, and promote increased use of alternative dispute resolution, thereby reducing the cost of the administrative appeals process for all parties.

For more information, see Interior Web Sites at www.mms.gov and www.blm.gov.

Benefits:

- ✓ Efficient recovery of valuable U.S. oil resources
- ✓ Sustains U.S. technology leadership
- ✓ Reduces environmental impact of oil and gas operations
- ✓ Less red tape
- ✓ Cost savings for industry

Strategy IV - Improve Government Decisionmaking

Action: Improved Coordination with Other Federal Agencies

The Department of Energy (DOE) works cooperatively with other federal agencies to enhance the efficiency and effectiveness of federal programs that affect domestic oil and gas production. This cooperation takes several forms:

- Providing sound science for regulatory decisionmaking.
- Conducting cooperative technical projects.
- Supplying technical expertise and advice.
- Estimating energy and economic impacts of proposed regulations, legislation, and policies.
- Facilitating dialogue among federal agencies and stakeholders.

Benefits:

- ✓ More informed decisionmaking
- ✓ Leverages efforts
- ✓ Good government

These activities allow other federal agencies to make use of the Department's unique expertise in oil and gas issues and technology. This will assist the agencies to understand the potential oil and gas supply consequences of alternative regulatory and policy initiatives and ultimately make more cost-effective decisions. For example, DOE has joined with the Department of the Interior in a Federal Lands Technology Partnership, which funds technology projects aimed at improving access to federal lands for oil and gas development without compromising environmental protection. DOE provides its unique technical expertise to support the goals of Interior's land management programs and Interior uses its extensive network of field offices to transfer the results as widely as possible. For example, a project to monitor air quality in Wyoming will collect much needed data on the contribution of oil and gas activities to air quality in that region and will be a model to be used in other regions. The first four projects were funded in Fiscal Year (FY) 1998, and the Partnership will continue with additional projects in FY 1999 and FY 2000.

In addition, the Department of Energy actively participates in federal advisory committees and interagency work groups that provide a national energy perspective and promote cost-effective approaches to protecting the environment. For example, the Department of the Interior's Green River Basin Advisory Committee provided a forum for discussion and cooperative decisionmaking among oil and gas industry representatives, environmental organizations, and local and state government officials on issues that critically affect the development of oil and gas on federal lands in Wyoming and Colorado. The Department of Energy participated in that committee and provided analyses that helped achieve consensus on key recommendations.

While the Department of Energy has been proactive in working with other federal programs, coordination among agencies can be improved. DOE can participate earlier in the regulatory process, providing information that helps shape regulatory proposals in cost-effective ways. Better coordination can also identify emerging issues that will affect oil and gas development and energy security and allow energy concerns to be considered more often in the early stages of discussion. It is DOE's role to raise the awareness of energy issues within its sister agencies and to assure a balanced evaluation of energy, economic, environmental, and energy security concerns.

Strategy IV - Improve Government Decisionmaking

Action: Dialogue with Industry, States, and Congress

Adjusting for inflation, oil prices at the wellhead in the United States are at the lowest level in decades, enabling energy consumers and the United States economy to reap tremendous savings. At the same time, low oil prices are threatening the economic viability of the domestic oil and gas industry. In the long term, persistent low oil prices may threaten our Nation's oil and gas production capacity and may impact our Nation's energy security.

Benefits:

- ✓ More informed decisionmaking
- ✓ Leverages efforts
- ✓ Good government

The situation is one of serious concern across the Nation. According to the Interstate Oil and Gas Compact Commission, as well as other sources, in many oil producing states a vast number of oil wells have become uneconomic to produce. The number of rigs drilling in the United States in 1998 was 60 percent lower than the year earlier. And, according to the Bureau of Labor Statistics, upstream employment levels have dropped to levels not seen in decades.

Low oil prices make **marginally producing wells**, such as those producing less than 10 barrels per day, particularly vulnerable to premature abandonment. In 1997, approximately 436,000 oil wells in the United States were producing less than 10 barrels per day. With 353 million barrels produced, these wells account for almost 15 percent of domestic oil production.

Across America, the Department of Energy is hearing that low oil prices could deny companies sufficient revenues and cash flow to provide the **infrastructure** -- including leases, wells, drilling and service equipment, and a skilled workforce -- necessary to ensure cost-effective energy to meet the demands of future generations. And, industry's ability to meet projected future natural gas demand over the next several decades, given this and other evolving marketplace changes, has been questioned.

Low oil prices pose a particular threat to **smaller domestic companies**, those of insufficient size, diversification, or worldwide presence to weather the storm. In the United States, the vast majority of oil and gas companies are smaller independent firms with less than 20 employees. The independents drill 85 percent of all new oil and gas wells in the country and produce 40 percent of the crude oil and 60 percent of the natural gas.

The Department of Energy will continue to engage in dialogue and to work closely with all interested parties -- including industry, states, state organizations such as the National Governors' Association, the Energy Council, the Interstate Oil and Gas Compact Commission, and the National Association of State Energy Officials, Congress, and the National Petroleum Council -- to ascertain what government and industry actions may be necessary to ensure America's long term economic and energy security, respecting the environment and other shared societal goals.

SEVERANCE AND PROPERTY TAXES ON OIL AND GAS

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
YEAR	WELLHEAD PRICE OF CRUDE OIL	(Add 000) CRUDE OIL PRODUCTION	(Add 000) CRUDE OIL TOTAL VALUE	WELLHEAD PRICE OF GAS	(Add 000) MCF GAS PROD.	(Add 000) WELLHEAD VALUE GAS	(Add 000) WELLHEAD VALUE O & G	OIL & GAS VALUATION	OIL & GAS AD VALOREM TAX	LINE #10 DIVIDED BY LINE #9	SEVERANCE TAX - OIL	SEVERANCE TAX - GAS	SEVERANCE TAX OIL & GAS	LINE #14 DIVIDED BY LINE #8	TOTAL SEVERANCE & PROPERTY TAX	TAX % OF TOTAL PROD.
1983	28.44	71,594	2,036,133	1.59	437,803	696,108	2,732,241	1,909,592,286	125,092,608	6.55%	None	None	None	None	125,092,608	4.57%
1984	27.99	75,729	2,119,655	1.30	466,228	606,096	2,725,751	1,789,397,127	123,591,041	6.90%	70,768	42,926	113,694	4.17%	237,285,041	8.71%
1985	25.33	75,407	1,910,059	1.20	513,030	615,636	2,525,695	1,760,400,865	131,453,506	7.46%	66,490	41,912	108,402	6.74%	239,955,506	9.50%
1986	14.02	67,034	939,817	1.15	448,334	515,584	1,455,401	1,330,454,733	100,817,602	7.57%	56,457	41,713	98,170	6.74%	198,987,602	13.67%
1987	17.37	59,884	1,040,185	1.15	394,906	454,142	1,494,327	1,187,992,419	90,516,911	7.60%	28,273	32,018	60,291	4.03%	150,807,911	10.09%
1988	14.56	58,824	856,477	1.34	470,577	630,546	1,487,023	1,132,541,580	90,452,269	7.95%	34,336	43,319	77,655	5.22%	168,107,269	11.30%
1989	18.18	55,484	1,008,699	1.43	587,099	839,552	1,848,251	1,192,529,546	84,593,778	7.09%	24,031	51,971	76,002	4.10%	160,595,778	8.69%
1990	23.21	55,427	1,286,461	1.54	558,257	859,716	2,146,177	1,366,817,196	113,376,534	5.28%	25,454	57,737	83,190	3.87%	196,566,534	9.16%
1991	19.84	56,929	1,129,479	1.37	604,826	828,612	1,958,083	1,404,560,619	113,332,411	5.78%	36,819	59,242	96,061	4.90%	209,393,411	10.69%
1992	18.50	53,613	991,841	1.63	644,117	1,049,911	2,041,752	1,265,213,198	101,129,364	7.99%	29,491	55,477	84,969	8.16%	186,098,364	9.11%
1993	16.01	49,625	794,496	1.78	667,507	1,187,472	1,981,968	1,390,427,980	116,798,179	8.40%	24,538	74,142	98,680	4.97%	215,478,179	10.87%
1994	14.69	46,733	686,508	1.59	712,522	1,133,156	1,819,664	1,431,603,339	116,955,681	8.16%	19,621	81,634	101,255	5.56%	218,210,681	11.99%
1995	16.19	43,767	708,588	1.37	721,733	992,115	1,700,703	1,361,698,369	113,346,680	8.30%	17,102	60,034	77,136	4.50%	190,482,680	11.20%
1996	20.47	41,789	855,421	1.37	516,389	707,454	1,562,875	1,232,886,177	106,425,782	8.60%	16,704	51,662	68,366	4.30%	174,791,782	11.18%
1997	18.63	39,836	742,144	2.18	678,654	1,479,466	2,221,610	1,622,768,515	122,413,743	7.50%	19,670	61,742	81,412	3.60%	203,825,743	9.17%
1998	11.21	29,082	342,000	2.03	630,000	1,271,000	1,613,000	1,454,821,785	103,552,020	7.11%	15,556	51,690	67,246	4.17%	170,798,020	10.58%

State Assistance Efforts for Oil Producers

Just 18 months ago Jerry Green's oil business in Great Bend, Kansas, was worth \$10 million. Today it is worth \$250,000. Green told the *Topeka Capital-Journal* a few weeks ago "people don't want to see this, but it is happening."

As one of the most active oil production companies in Kansas, Green's *Castle Resources* used to have 10 full-time employees; now it has five part-timers, including Green. It has shut down 75 percent of its wells and has about 15 remaining.

The company is just one example of what \$9-a-barrel oil is doing to the livelihoods of thousands of Kansans. In Castle's case, most of the employees were pumpers—the workers who maintain the wells.

According to a recent report by the Independent Oil and Gas Compact Commission (IOGCC), 1998 was memorable for both energy consumers and producers. With gasoline, fuel oil, jet fuel and diesel prices hovering at record low levels, individual consumers, government at all levels and energy-intensive industries pocketed billions in savings. Meanwhile, domestic oil and natural gas producers and the beneficiaries of the production of U.S. natural resources are warning of an industry in crisis.

Lost in the discussion of the economic pros and cons of low prices are hidden, long-term impacts to the country's energy future. Without question, the United States is losing a segment of a critical domestic industry—production from low-volume, barely economic oil wells. Taken singularly, these wells may not seem significant to some. Collectively, however, they comprise an important hedge against increasing reliance on imports, provide tens of thousands of jobs, millions of dollars in payments to landowners, royalty owners and government, and are a cornerstone industry for hundreds of rural communities.

The United States continues to rely heavily on petroleum as its major energy source. Petroleum demand is projected to grow at 1.2 percent per year through 2020, with 70 percent of the total used for transportation fuel, including gasoline, diesel and aviation fuel. Oil provides 97 percent of the country's transportation fuel.

The U.S. oil and gas industry is particularly susceptible to long periods of low crude oil prices. This is true largely because about three-fourths of the nation's oil wells are marginally economic. About 436,000 of the nation's 573,000 oil wells produce less than 10 barrels per day. On average, these low-volume "stripper" oil wells produce 2.2 barrels per day. At these quantities, low crude oil prices may not cover production costs. During periods of low prices, wells are idled, produced only sporadically to meet minimum lease requirements, or plugged and

abandoned.

In the first six months of 1998, an estimated 48,702 wells were idled or shut in, according to a recent survey of 23 states. If these wells were plugged and abandoned, it would represent a 142 percent increase over the number of wells (20,087) plugged and abandoned in 1997.

The collapse of the oil industry can also cause severe problems on other fronts—including revenue to states.

In Wyoming, for example, the impact is estimated near \$100 million for the first six months of 1998. Severance taxes were down \$17.2 million, ad valorem taxes fell by \$57.1 million, and the effect of 900 lost jobs totaled \$25.5 million. Eight percent—or 1,200—of the wells in Wyoming have been idled or shut in.

In Louisiana, production declined by 8.2 million barrels for the first six months. An estimated 1,375 wells were idled or shut in. Louisiana officials estimate that the treasury loses or gains about \$20 million of direct revenue for each \$1 change in oil prices. With prices falling from a \$17.24 per barrel average for 1997 to \$12.45, the direct loss of revenue exceeds \$95.8 million. Indirect revenue, such as sales tax and income tax, would increase the impact to between \$119 million and \$191.6 million.

In Texas, oil severance tax revenues fell \$94.9 million in the first eight months of 1998. This represents a reduction of 34 percent. About 2,800 jobs were lost and 1,087 oil wells idled or shut in.

In Ohio, about 8,700 wells were idled or shut in, 500 jobs were lost, and oil production dropped 15 percent. Ohio suffered \$128,900 in lost severance taxes.

Kentucky estimates an impact of \$2 million on the state budget, due principally to a decrease in gross production taxes related to lower oil prices.

In Nebraska, state severance taxes have declined by 29 percent.

Just last week in Kansas, my home state, the State Budget Director said all revenue collections for the first eight months of the current fiscal year were \$51.4 million less than estimates—\$31.9 million of that collection deficit was for last month (February) alone.

According to Bob Krehbiel of KIOGA (the Kansas Independent Oil & Gas Producers), 14 million barrels of Kansas crude production a year will be abandoned because of low prices during the past two years. If the price remains between \$9 and \$10 this year and costs are between \$12 and \$15, producers need \$3 to \$5 more a barrel to break even.

Using the average of \$4, multiplied by the 14 million barrel anticipated loss this year, the

Kansas oil industry needs \$56 million to prevent that loss.

In the State of Kansas, there are several bills before the legislature that attempt to help the struggling oil producers.

The bills would eliminate the severance tax on oil, exempt oil producers' purchases of machinery and equipment from the state sales tax, and give small production companies income tax credits to offset their property taxes. Together, these bills could save oil producers about \$18 million a year.

Oil prices have been at less than \$9 a barrel for about a year and have dropped as low as \$7.25 a barrel. Many producers fear they won't survive the year, and they say thousands of Kansas oil industry workers could lose their jobs.

Bills that would eliminate the oil severance tax and create an income tax credit for small oil production companies are before the Senate Assessment and Taxation Committee.

A bill to exempt oil producers' purchases of machinery and equipment from the state sales tax is before the House Taxation Committee. Only small companies producing fewer than 15 barrels of oil a day would be eligible for the relief.

Similar efforts are being put forth in other oil producing states.

Alaska Gov. Tony Knowles has proposed an income tax -- something Alaska hasn't had since 1980, when the oil money started pouring in -- and dip into the Alaska Permanent Fund, the oil-royalty savings account that pays a yearly dividend to every person in Alaska. The booming stock market has swelled the fund to more than \$24 billion.

In Oklahoma, the slowdown has yet to throw the budget out of balance, but Gov. Frank Keating and lawmakers want to save oil producers from going out of business and avoid more serious fiscal problems by enacting \$29 million in tax relief for the industry. Producers fear an estimated 10,000 oil industry jobs in Oklahoma could be lost if prices don't pick up.

Governor Keating has called a special legislative session to discuss the proposal. To pay for the tax relief, spending on everything from welfare and Medicaid to prisons and roads may have to be cut.

In New York, they are testing 55 wells to see if they could be brought back into production with the use of state-of-the-art energy efficient technology. New York State Energy Research & Development Authority (NYSERDA) is working with the Independent Oil & Gas Producers Association of New York (IOGPA).

NYSERDA also found that good field data management was lacking and is working on

ways to provide assistance to producers to improve this efficiency. They also think some of the successes of their Natural Gas Star Program, a joint effort with EPA, may be incorporated into a program for oil producers.

PacifiCorp, an investor owned utility, is working on financing packages that will help in the funding of energy efficient technology. PacifiCorp recently hosted a workshop for oil producers in Wyoming. They (PacifiCorp) are currently discussing with Utah's Office of Energy and Resource Planning about assisting with some workshops for Utah producers.

Louisiana implemented some tax relief efforts a few years ago that addresses low prices. Stripper oil wells are exempted from a severance tax when the average posted price over a 30 day period is less than \$20 per barrel. Horizontally drilled, inactive wells and deep wells can qualify for exemptions for certain periods of time. Severance taxes on certified new oil and natural gas discovery wells are suspended for 24 months or until recovery of payout of well cost.

And many states, such as Wyoming, Texas and others are acting to assist producers.

Here in California, CIPA, the California Independent Producers Association, is very actively involved in addressing the crises. Along with the assistance of the California Energy Commission, a number of initiatives are in progress.

To give a summary of these efforts, I would like to introduce _____ of the California Energy Commission.

Remarks by _____:

SUGGESTIONS FOR THE PREVENTION OF WASTE OF A NATIONAL RESOURCE

By Philip M. Knighton, M.S. Geology, J.D.
December 14, 1998

Author: In the past thirty years I have operated oil and gas production, served in the industry as a Consulting Geologist, and lawyer practicing in oil and gas related matters both in State Courts and Administrative bodies; and, before the Federal Courts and Federal Energy Regulatory Commission. My special interest is in natural gas and its regulation. I am fourth generation in the mineral extraction business. My paternal great grandfather was a side-kick of William F. Cody's and together they mined copper in Arizona. My paternal grandfather was a mining engineer who practiced in the Tri-State Mining district near Joplin, Missouri. My father is a geologist and operates a successful small independent oil company of which my brother, a Petroleum Engineer is now manager. I married a second generation geologist. We've been in and around this business a while.

Problem is Waste of a Resource: My suggestions for things the government can do to help are presented in the context that *domestic* oil and gas production needs to be somehow protected from the wasteful shutting down and plugging of thousands of marginal wells that are economic to produce when oil is above \$14.00 to \$17.00 per barrel, and which will be sorely needed if there are "shortages" created by political events such as the famous Arab Oil Embargo of the 1970's. Many of these wells drilled in Central and Western Kansas represent almost \$150,000.00 to \$200,000.00 each in capital investment when drilled, and are worth barely the cost of plugging them (\$6000.00) when plugged. The \$ 150,000.00 to \$200,000.00 in capital investment really represents energy that it took to make the concrete, steel and the energy used to drill the borehole (diesel and gasoline to run the engines on the drill rig). Once the well is plugged, that energy is wasted forever. With today's high environmental protection standards requiring cementing the boreholes instead of leaving them full of old drilling mud, there's no going back into these holes ever again. I don't suggest we change the environmental standards at all. I suggest we must look at ways to prevent plugging stripper wells due to temporarily low oil and gas prices to prevent wasting this resource for our future generations. Specifically, for example, I own interest in a number of wells that are almost 70 years old producing 1/2 to 1 3/4ths barrels of oil per day. They will produce another 70 years to provide this oil for our economy, for employment, tax base, income taxes, etc., if we aren't forced to "waste" them now by plugging them as uneconomic.

It will be a loss our grandchildren will curse us for as surely as I was cursed at service stations by people who say my bumper stickers that identified me as an oilman, during the oil crisis. "What the heck is the matter with you oil people...Isn't this a contrived deal just to get the price up...You're a bunch of thieves..." I heard it all. The truth is we have a responsibility to future generations not to waste this resource and be good stewards of the

national treasure we have been blessed with. The public will rightly curse us if we don't act now.

Remedy: There are several legal, simple, and effective mechanisms the government has previously used to prevent economic upset from rapidly rising prices in times of economic disruption for the common good. Now that the situation is reversed, the nation should consider protecting this resource through the least burdensome and similar methods of price protection. **It won't affect the price of energy or hit the consumers at the gas pump.**

(1) **Restore the economic incentives to participate in oil and gas investments by the traditional investors.** It is a fact that most Mid-continent production as a whole in the State of Kansas has never been a big money maker. Figures my father developed for a talk to the Kansas Academy of Sciences showed that Kansas Oil and Gas production has netted only 4 to 8% rate of return given all the money spent on exploration (including dry holes) and all the money produced by the oil and gas. In short it is why the major oil and gas companies left the Mid-continent in 1954. They used their own money to explore for oil and gas, and with that kind of a rate of return it just wasn't economic to stay here and look further. They went overseas where the deposits were larger and they could do better. They diversified into other businesses with 14% or better typical industrial rates of return. Small wonder Mobil Oil bought Montgomery Wards in the 1960's, etc. That left the Mid-continent to the "independents" who drilled for the tax oriented investor. With the 27.5% depletion allowance, intangible drilling cost as immediate write-offs and depreciation, these investors in high tax brackets would prefer to roll the dice in the oil game rather than give the money to the government. It was a socially wise policy because it provided consumers and industry with years of cheap energy. These incentives have been limited in past years and with lower income tax rates these investors dry up until the attractiveness of oil in the \$22.00/bbl. and up range, appears. It's simply a risk-rewards decision. Therefore restoring the tax incentives, and even adding tax credits, is essential to return of investor interest.

(2) This will not protect against oil pricing disruptions, obviously. I suggest we address that with a **sliding scale tax credit that increases as the price falls below a benchmark price** we determine is necessary for a lease to be economic. Such a mechanism as the determination process using the various State regulatory agencies application process as existed under the NGPA of 1978 would be efficient and have the necessary expertise to make these determinations. Thus each dollar necessary to keep a lease economic would come out of the public treasure via tax credits only so long as necessary. It would be a great incentive for an investor to own such properties and know that one won't get penalized by price fluctuations caused by gluts and temporary market disruptions such as futures trading.

The main moral rationale for giving the tax credits is prevention of waste. But, it's fair in light of the way oil pricing has been treated by law in the recent past. It is fair play because when the prices were rising, President Nixon put on **wage and price freeze that**

created three tiers of oil pricing. It severely penalized the Kansas Oil and Gas producers because most of our production was 'old' oil and was priced lower than newly discovered oil. Whereas, the coastal cities were importing foreign oil at a world price. Then to rub salt into the wounded local economies and producers receiving less revenues, the government created a **refinery feedstock equalization plan** that required Kansas refineries buying mostly lower priced oil to write a check every month to the FERC who distributed the monies to the coastal refineries to "equalize" the refinery feedstock oil price and theoretically treat all the consumers in the nation equally. If it was fair that way, it should be fair when conditions are reversed to help against economic disruption. Now the consumers ought to be writing producers a check to help keep these wells going. The easiest way to do that is through the tax credit which would only apply when the oil price slid below economic levels. In case someone ask, I would include in the "economic" definition a reasonable profit margin of 14%, the same as the New York Times.

Thus I urge enactment of energy legislation to **restore the tax incentives that historically have driven the private investor to participate** in the oil and gas exploration area, and without which they simply won't do it. I think 27.5% depletion allowance is minimal, full intangible write-offs, and rapid depletion all should be re-enacted with a 10% investment tax credit for new equipment, pipelines, recompletions, workovers, drilling deeper, and new wells.

I urge enactment of a '**Oil and Gas Marginal Well Waste Prevention Act**' that would create tax credits below \$17.00 per barrel, dollar for dollar, or put into such an act a mechanism for determining the credit threshold such as an NGPA type application process. This would create also a check and balance that would 'keep it honest', just as it did under the NGPA.

3. As a sub-point in my comments, I'd like to suggest we consider taking oil and gas off the futures markets. I see nothing "real" about these legal gambling forums. One trades pieces of paper and no way can one get delivery of a commodity on these markets. I have watched as they have robbed producers and cost consumers the last several years due to "weather" and perceptions of glut or shortage that artificially ran pricing up or down beyond reason. These markets become feeding frenzies of rumor. I think oil and gas should be subject to the free market, but the futures are so short term oriented, and impacts so adversely long term contracts, on long term contractual supply and demand relationships, that I simply don't think it is a good thing for the economy and pricing stability either for the producer nor consumer.

Conclusion: It's simple. Save our resources from waste and return to the investors a reason to stay in the existing production and keep looking for more. The USA can count on the OPEC countries about as much as they can cooperate to control their own production...almost not at all. We really don't have anyone to rely upon but ourselves. Politically, practically and economically this is no time for inaction and I urge that the Department propose and support legislation along the lines I suggested here.

Why do this?

- *We owe our grandchildren our best judgment on how to solve the dilemma and assess the impact if we do not act.
- *Every day is another round of plugging of wells in our “oil patch”. It is for the common good of consumers and producers alike that we prevent the waste of this resource.
- *It’s also the best thing for our economy to keep these producing wells to limit the drain of capital for foreign oil purchases.
- *It is a question of National Security to preserve our ability to produce as much of our own oil as possible in case of curtailment and threats of embargo of foreign supplies. The price we pay if we don’t act is vulnerability, both economically and politically to foreign countries with populations full of folks that would love to put us down as the ‘great satan’ for religious and political reasons. This is no time to waste any asset that will preserve our independence and freedom from such consequences.

These long range issues rarely receive the consideration needed in our crisis oriented governing processes. Well, we’ve got a crisis right now. Time to act.

Government agencies, industrial groups and individuals should see this as an absolute necessity to protect ourselves as we should, come together and make it happen. I come in hope of collective wisdom acting, but in dread that if we won’t do these things, then I fully expect to live long enough to see us rue the day we failed to act, because it won’t take many years to be so vulnerable, having plugged so many marginal wells, that we are 70% to 90% dependent on foreign imports. I expect to be asked by my grandsons and granddaughters why didn’t we do something. You tell me, what will I answer? We lacked the resolve? The crisis was unheard by our government? The politics of the time was to save the taxpayers a few dollars for a short period of time during a crisis...and we blew it. It’s our choice. I fervently hope we will be able to brag we met the challenge and crafted a practical solution that prevented waste of our marginal well resources and revitalized an industry thus preserving our energy independence. It was a marvel of government and industry cooperation and wisdom. I’d like to say: ‘Ya should have been there!’

Respectfully Submitted,

Philip M. Knighton