

Jerry Jordan's Testimony to the House Resources Committee

Jerry Jordan On Behalf Of The Independent Petroleum Association of America And The National Stripper Well Association Before The Resources Committee U.S. House of Representatives

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Statement Of Jerry Jordan for The Independent Petroleum Association Of America and The National Stripper Well Association and

**American Association of Professional Landmen
California Independent Petroleum Association
Colorado Oil & Gas Association
East Texas Producers & Royalty Owners Association
Eastern Kansas Oil & Gas Association
Florida Independent Petroleum Association
Illinois Oil & Gas Association
Independent Oil & Gas Association of New York
Independent Oil & Gas Association of Pennsylvania
Independent Oil & Gas Association of West Virginia
Independent Oil Producers Association Tri-State
Independent Petroleum Association of Mountain States
Independent Petroleum Association of New Mexico
Indiana Oil & Gas Association
Kansas Independent Oil & Gas Association
Kentucky Oil & Gas Association
Louisiana Independent Oil & Gas Association**

**Michigan Oil & Gas Association
Mississippi Independent Producers & Royalty Association
Montana Oil & Gas Association
National Association of Royalty Owners
Nebraska Independent Oil & Gas Association
New Mexico Oil & Gas Association
New York State Oil Producers Association
North Texas Oil & Gas Association
Ohio Oil & Gas Association
Oklahoma Independent Petroleum Association
Panhandle Producers & Royalty Owners Association
Pennsylvania Oil & Gas Association
Permian Basin Petroleum Association
Texas Independent Producers and Royalty Owner Association
Tennessee Oil & Gas Association
West Central Texas Oil & Gas Association
Wyoming Independent Producers Association**

Mr. Chairman, members of the committee, I am Jerry Jordan, President of Jordan Energy, Inc. of Columbus, Ohio. Today, I am testifying on behalf of the Independent Petroleum Association of America, the National Stripper Well Association, and 32 cooperating associations of the IPAA that represent state and regional interests. These organizations represent independent oil and gas producers, the segment of the industry that is damaged the most by the lack of a domestic energy policy that recognizes the importance of our own national resources. NSWA represents the small business operators in the oil and natural gas industry, producers with "stripper" or marginal wells.

This Committee's jurisdiction is fundamental to addressing one of the key issues facing the domestic oil and natural gas industry in improving domestic oil and natural gas production – access to natural resources. However, before I address this specific issue it is essential to understand the current state of domestic energy and its production. We have an economy that is based on energy – from transportation to manufacturing to the Internet. More specifically, it is based on petroleum – crude oil and natural gas. And, like it or not, despite all the efforts to change the mix of energy sources, petroleum remains the predominant source and will continue to do so for the foreseeable future.

Domestically, we import about 56 percent of our crude oil demand. The issue is how to try to limit our foreign dependency and to emphasize the most reliable of our foreign suppliers. Natural gas – on the other hand – is largely a domestic resource, and imports are mainly from other

North American sources. In the future domestic oil and natural gas production will be more and more dependent on a healthy independent exploration and production industry – major oil companies began shifting their new production from the United States after the oil price crisis in 1986, and this pattern will continue.

Oil prices are set on a world market. The U.S. is a price "taker." Independent producers are the most susceptible to shifts in prices. We were damaged the most severely during the low oil price crisis of 1998-99. We are recovering slowly, but we need stability and we need policies designed to bolster of our industry because it is critical to our country.

The current situation is not stable and we need to understand how vulnerable the US economy is to decisions by foreign governments. As a result of the extended low oil prices in 1998-99, capital investment in oil production throughout the world declined. Existing production was lost. In the U.S., production dropped from 6.5 million B/D to 6.0 million B/D. Worldwide, new projects were delayed which limited increases in production capacity. Meanwhile, demand continued to increase.

Excess near-term capacity worldwide is limited. Experts placed it between 3 and 4 million barrels per day before the recent OPEC action – probably closer to the lower figure. Everyone is still trying to assess exactly what production increases will result from OPEC's decisions. But, the key point is that – in the short term – the world is not awash in oil that can be supplied by opening the spigots.

Moreover, the wild card becomes Iraq. In late May or early June, the UN sanctions review is scheduled. If Iraq pulls its exports off the market – as it has before – prices can again increase to well above current levels. Depending on the severity of the situation, the United States' only recourse could be use of the Strategic Petroleum Reserve – and that is not a long term solution. It is this threat that argues against releases from the Strategic Petroleum Reserve to respond to the price spikes that have now been eliminated, or swaps of crude oil today that may be needed in the future.

Clearly, Saddam will use his country's oil resources to try to extricate Iraq from the straight jacket of UN sanctions. Many knowledgeable experts already want to end the sanctions. If Iraq withdraws its oil from the market, it could erode what little resolve exists in the world to constrain his actions. Then, Iraq will be in a position to sell as much oil as needed to rebuild its oil industry, its armaments, and worst of all, to terrorize the world with its weapons of mass destruction.

Taken together, this shows that this important factor of our economy is in the hands of foreign rulers. We end up relying on a kingdom in Saudi Arabia to work with a radical Iranian government to stabilize oil prices. We have effectively handed Saddam Hussein the control of world oil prices that he sought when he invaded Kuwait.

These policies make no sense. But, if not these policies, what should we do? There is no single answer.

First, we must continue to work with foreign producer nations to move toward oil policies that produce the stability needed to maintain and enhance our domestic production. And, as we do,

we cannot assume that other countries are willing to sacrifice their national incomes to meet our expectations that product prices should be low in the U.S.

Second, we must develop better policies to enhance and maintain domestic oil and natural gas exploration and production – we need both. Frequently, oil and natural gas are discovered and produced together. We must begin treating domestic oil and natural gas production as a critical element of national economic security. To do this at the federal level we must direct our efforts at the two areas where they can have the greatest effect – access to capital and access to domestic natural resources from government controlled lands and waters.

Land Access

This committee's jurisdiction is at the heart of developing policies that address the complicated issues of access to the nation's resources under government controlled lands. Recent successful laws that have addressed access are the Deepwater Royalty Relief Act, The Royalty Fairness and Simplification Act, and moratoriums on rules for illegally assessing new oil royalties. We are pleased to announce that in a recent decision, *IPAA v. Armstrong*, the District Court ruled that in fact the government doesn't have the legal right to require producers to market at no cost to the lessor, a matter at the heart of the oil royalty rulemaking. These actions have enhanced the development of federally controlled resources.

The legislative requirements of the Deepwater Royalty Relief Act are expiring. The authority to continue royalty relief will rest in the hands of the Minerals Management Service. IPAA believes it is critical to continue to provide a royalty structure that encourages offshore development. The Deepwater Royalty Relief Act has proven that its approach works. However, while its benefits have largely flowed to the major integrated oil companies, independents are now moving more aggressively into the offshore generally and the deepwater more specifically. Major integrated companies are moving toward the ultra-deep water where their cutting edge technologies are allowing them to go. IPAA and other associations, and companies involved in the offshore have begun working with MMS and the DOE to look at how royalty policies can enhance domestic offshore production. Hopefully, these efforts will lead to administrative actions to create a royalty structure throughout the offshore that will enhance domestic production. However, if this result does not occur, this committee should revisit and revitalize the Deepwater Royalty Relief Act.

At the same time it is equally important to recognize that a larger aspect of access to natural resources involves opening access to that which is not now available and halting the trend of further embargoes of western lands. Unfortunately, the Administration avoids dealing with the clear need to open federal lands to exploration and production. It hides behind an environmental sensitivity argument that is proven wrong by its own DOE report. It focuses on arguments against opening ANWR and avoids dealing with access issues offshore and in the Rockies where its own National Petroleum Council *Natural Gas* study concludes that over 200 trillion cubic feet of natural gas is either off limits or difficult to permit.

It is important to understand that access issues differ between these areas. ANWR and offshore activity off of California, the Eastern Gulf of Mexico, and the Atlantic are constrained by policy decisions, both executive and legislative, through prohibitions and moratoriums. These are based

on outdated reactions to spills occurring in the past. The Administration's own study, *Our Ocean Future*, concluded unequivocally that offshore oil and natural gas production is a success story. We need to move into the 21st century and make enlightened decisions to use these critical national resources.

Access in the Rockies won't be resolved by a single act. Here, we are dealing with a mosaic of limitations. Some involve land that is completely excluded from oil and natural gas exploration and production.

- The Antiquities Act of 1906 has been used to declare areas as national monuments placing land completely off limits.
- In other areas, the Department of Agriculture is proposing to expand roadless areas in national forests that will preclude oil and natural gas development.
- Some national forests, like the Lewis and Clark National Forest, projected to be a world class gas source, have been administratively closed to oil and natural gas development
- Wilderness areas have been created without an understanding of the resources that might be lost.

We must also deal with permitting limitations and other indirect actions of federal agencies.

- Because these are federal lands, it is necessary that federal agencies issue permits for the exploration and production activities. These agencies are charged with the task of developing environmental management plans for areas under NEPA. NEPA can be used to create effective, environmentally sound management plans, or it can be used to delay and deny access. Frequently, the results reflect the attitude of the agency and its leaders. For example, in the Powder River basin the development of coal bed methane has first been delayed by the inability of the BLM to process permits. But, as the magnitude of effort was more clearcut, BLM fell back to the excuse that the EIS for the area was outdated and required a new plan under NEPA. This has led to further delay. BLM then argues it needs additional funds, requiring Congress to act and resulting in further delay. In the San Juan basin, BLM has tried to argue that its management plan needs updating and permitting needs to be delayed until another plan can be developed despite repeated assessments of the plan that demonstrate its adequacy.
- NEPA is only one of many laws that are involved in the planning or permitting processes and BLM is only one of the agencies that must be dealt with. Others include the Endangered Species Act and the Fish and Wildlife Service, the Clean Water Act that can involve both the Environmental Protection Agency and the Corps of Engineers when wetlands are concerned, and even the Clean Air Act.
- For example, many areas in the Rockies are limited during certain times of the year because of management plans designed to protect various species. While each plan individually provides opportunities for resource development, collectively, they interact to effectively prohibit oil and natural gas extraction.

If we are to provide the country with the domestic energy it deserves, we need to create national policies that allow environmentally sound development of these resources. No one can expect that this mosaic of limitations can be instantly revised, but we need to start the process.

First, we can determine where the most likely resources lie. Congress should compel the development of such an inventory, an action advocated by this committee. When actions like this have occurred in the past, they allow the disputes to be better focused. They allow the issues to be discussed in a real rather than hypothetical context. And, this can lead to real solutions for specific areas.

Second, we need a clear understanding of the impediments that we are encountering. We need to know how many laws, regulations, conflicting management plans, and whatever else are in play. This perspective is essential to provide a real sense of how these actions can result in effectively foreclosing any development. A recent assessment of one area of the Rockies showed how a mixture of management plans for various species effectively foreclosed any oil or natural gas development, but no single plan would result in such denial (a graphical presentation is attached to this testimony).

Third, we cannot expect to meet our nation's needs for clean burning natural gas without reasonable access to the resource. The NPC *Natural Gas* study and all other analyses conclude that the Rockies contain significant extractable reserves of natural gas. Yet, in the Rockies access is being limited. It is either the unanticipated outcome of laws, regulations, and plans that unintentionally deny access or the manipulation of these laws to produce that outcome. In either case, access limitations are not the result of a clear policy decision. Consequently, we need a commitment from Congress and the Administration that these types of constraints will be eliminated or restrained and proper funding will be provided a continued basis to allow environmental documents, leases, and drilling permits in a timely fashion..

Clearly, there are environmental extremists who will not support this essential development. But, as the DOE has demonstrated in its report, it can be done and in an environmentally sound manner. It will take effort, and it will also take courage.

Access to Capital

The federal government also needs to look at actions it can take to improve capital flow into this critical industry. Generally, there are two areas for possible action – tax reforms and federally backed financial instruments. The most immediate focus is on tax reforms.

Following his recent radio address, President Clinton released documents indicating that he intended to propose legislation to allow expensing of geological and geophysical (G&G) costs and of delay rental payments. These are sound first steps, but more must be done.

He also indicated that he was evaluating proposals dealing with marginal wells. Action regarding these wells is essential to preserve existing production and we believe there are four key elements that should be enacted immediately:

- A 5-year net operating loss carryback;

- Eliminating the net income limitation on percentage depletion for marginal wells;
- Eliminating the 65 percent net taxable income limit on percentage depletion; and,
- Creating a countercyclical marginal wells tax credit.

All of these have been introduced or passed in some form over the past two plus years. Most recently, Senator Kay Bailey Hutchison introduced S. 2265 incorporating the expensing proposals and the marginal wells tax credit in one bill. We are at a rare juncture. Both Congress and the Administration are moving in the same direction regarding tax reforms for domestic oil and natural gas exploration and production. Both are looking toward such provisions that will encourage exploration. Both are looking at ways to extend the life of domestic marginal wells – our true strategic petroleum reserve. Now is the time to act.

Will these steps guarantee that domestic production will rebound? Nothing is certain but it will guarantee that more capital will get into this industry when it is needed. And it will avoid the mistakes of 1986 when Congress enacted Alternative Minimum Tax provisions, just as the industry needed capital to rebound from low oil prices. This was one of many factors that have resulted in the loss of about 2 million barrels per day of domestic production from 1986 to 1997.

This is not all that we need to do. We should also look at other tax reforms that can help bring capital to this industry like modification of the AMT. And, we should look at federal financial instruments like the PADDIE MAC concept that would create a FANNIE MAE-like program to help lower the capital costs to the smaller producers so essential to maintaining the nation's marginal wells.

But, right now, some of the keys are available to improve the status of domestic oil and natural gas production. And, we should use them.