

IPAA's Testimony Before the Energy and Power Subcommittee

Testimony Of John Swords On Behalf Of The Independent Petroleum Association of America And The National Stripper Well Association Before Committee on Finance U.S. Senate July 18, 2000

**Statement Of John Swords
for The Independent Petroleum Association Of America
and The National Stripper Well Association
and**

**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
Tennessee Oil & Gas Association
Texas Independent Producers & Royalty Owners Association
West Central Texas Oil & Gas Association
Wyoming Independent Producers Association**

Mr. Chairman, members of the committee, I am John Swords, Partner-Independents of PricewaterhouseCoopers LLP and Chairman of the Independent Petroleum Association of

America (IPAA) Tax Committee. Today, I am testifying on behalf of the IPAA, the National Stripper Well Association (NSWA), and 33 cooperating state and regional oil and gas associations. These organizations represent independent petroleum 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 petroleum and natural gas industry, producers with "stripper" or marginal wells.

Today's hearing is examining a critical issue confronting domestic petroleum and natural gas production – the role of the tax code with regard to the enhancement or deterioration of domestic exploration and production of natural gas and petroleum. To put this issue in a clear perspective all we have to do is look to the recent National Petroleum Council Natural Gas study. This study concluded that U.S. demand for natural gas would increase by about 40 percent over the next ten years. It also identified four general areas that must be addressed to assure that this clean burning fuel will be adequately supplied to America's consumers. These are: access to capital, access to the national resource base, access to technology, and access to human resources. The federal government is a significant – if not pivotal – factor in two of them: access to the resource base and access to capital. The federal tax code plays an integral part in providing access to the capital essential to develop domestic resources – both natural gas and petroleum.

Federal tax policy has historically played a substantial role in developing America's natural gas and petroleum. Early on, after the creation of the federal income tax, the treatment of costs associated with the exploration and development of this critical national resource helped attract capital and retain it in this inherently capital intensive and risky business. Allowing the expensing of geological and geophysical costs and percentage depletion rates of 27.5 percent are examples of such policy decisions that resulted in the United States extensive development of its petroleum.

But, the converse is equally true. By 1969, the depletion rate was reduced and later eliminated for all producers except independents. However, even for independents, the rate was dropped to 15 percent and allowed for only the first 1000 barrels per day of petroleum produced. A higher rate is allowed for marginal wells which increases as the petroleum price drops, but even this is constrained – in the underlying code – by net income limitations and net taxable income limits. In the Windfall Profits Tax, federal tax policy extracted some \$44 billion from the industry that could have otherwise been invested in more production. Then, in 1986 as the industry was trying to recover from the last long petroleum price drop before the 1998-99 crisis, federal tax policy was changed to create the Alternative Minimum Tax that sucked millions more dollars from the exploration and production of petroleum and natural gas. These changes have discouraged capital from flowing toward this industry. And, without capital the ultimate result is lower production. Since 1986, domestic petroleum production has dropped by over 2.5 million barrels per day.

Now, independent producers are recovering from the low prices of 1998-99 that starved the industry of funds to maintain existing production and to explore and generate new production – production of both petroleum and natural gas. Today, we look at a world where petroleum production is perilously close to petroleum demand – where all but three or four producing countries are at full production. Today, we look at natural gas supply struggling to meet demand in the United States primarily because of the loss of capital when petroleum prices fell. Today,

we have a domestic industry ready to find and produce energy for the nation's consumers, but this inherently risky industry must compete for funds against high flying technology investments and the lure of lower costs to produce foreign oil.

Hearings throughout Congress have echoed with the statements of members from producing and consuming states alike that more must be done to increase domestic production. The question is how. Much of that answer lies within this Committee.

Short Term Actions

In the short term there are a number of actions that can be taken. In fact, there is wide agreement on these actions from the Administration and the Congress, in the Senate and the House, between Republicans and Democrats. Numerous bills have been introduced in the House and Senate with substantial sponsorship. In the Senate they include S.2557 by Senators Lott and Murkowski, S.2265 by Senators Hutchison and Breaux, S.1833 by Senators DASHCLE, Baucus and Kerrey, S.1042 by Senators Hutchison and Breaux, S.595 by Senator Domenici, and S.325 by Senators Hutchison and Breaux. These bills are cosponsored by many Senators including many on this committee; a complete list of current cosponsors follows this testimony.

First, action should be taken to clearly allow expensing of geological and geophysical costs and of delay rental payments. President Clinton has endorsed these changes. Congress has passed these changes. They are included in S.2557, S.2265, S.1833, S.1042, S.595, and S.325. These changes would clearly aid the development of new wells and they reflect historic practice in treating these costs. (IPAA Fact Sheets detailing these issues follow this testimony.)

Second, there is wide support for a countercyclical marginal well tax credit. This approach was recommended by the National Petroleum Council in its 1994 Marginal Wells study. Energy Secretary Richardson has spoken of it repeatedly. It has been introduced in many bills, including S. 2557, S. 2265, S. 1042, S.595, and S.325. This tax credit today can be crafted with a negligible impact on the federal budget, but at the same time create an important safety net for the most vulnerable American producing wells – wells that produce petroleum roughly equivalent to imports from Saudi Arabia – wells that are the nation's true strategic petroleum reserve. (An IPAA Fact Sheet detailing this issue follows this testimony.)

Third, Congress has suspended the property taxable income limitation on percentage depletion for marginal wells through 2001. The tax bill passed by Congress last year would have suspended this provision through 2004. S.1833, S.1042, and S.595 would eliminate this limitation. The suspension that was in place in 1998 and 1999 saved many marginal wells during the price crisis. This provision should be eliminated to provide domestic producers of these wells an incentive not to plug the wells during a low price cycle. Once the well is plugged, the potential to produce the remaining reserves is lost forever. (An IPAA Fact Sheet detailing this issue follows this testimony.)

Fourth, last year's tax bill also suspended through 2004 the 65 percent net overall taxable income limit on percentage depletion. S. 2557 would similarly suspend this provision. S.1833, S.1042, and S.595 would eliminate this limitation. This constraint on independent producers limits the amount of capital that can be retained for reinvestment into existing and new production. In an

industry that typically reinvests 100 percent of its profits back into the industry, this constraint means less domestic petroleum and natural gas. It too should be eliminated. (An IPAA Fact Sheet detailing this issue follows this testimony.)

Fifth, last year's tax bill extended the net operating loss carryback period for independent producers to five years. S.2557 and S.1833 also include this provision while S.595 would provide for a ten-year net operating loss carryback. Taken together with the changes passed regarding percentage depletion, millions of dollars would be made available based on costs and losses already incurred to enhance domestic production.

Collectively, these provisions have wide support. They would be of significant national value. They should be enacted now. Equally important, they must be crafted in such a manner to assure that the Alternative Minimum Tax does not nullify the benefits that they would create. The mistake of 1986 should not be repeated. When the industry is in desperate need of capital, it should not be stripped away.

Next Steps

In the longer term the country needs to look toward tax policies to encourage domestic production of its petroleum and natural gas. Some of this focus needs to be directed to getting more out of existing resources. For example, while the Enhanced Oil Recovery tax credit exists, it is based on technologies that are twenty or more years old. This provision should be restructured and updated. S.595 and S.325 include changes that would address this problem. (An IPAA Fact Sheet detailing this issue follows this testimony.)

Equally significant, policies need to address encouraging more new development. Proposals to encourage domestic exploration and production should be created. A number of concepts are already in play and need to be more fully evaluated.

For example, the Section 29 tax credit for unconventional fuels proved to be a strong inducement to developing those resources. It applies to wells drilled prior to 1993 and uphole completions thereafter. Just last week, the Federal Energy Regulatory Commission acted to reinstate its certification process to address many wells that would otherwise qualify for the Section 29 tax credit. But, the existing credit expires in 2003 and provides no incentive for current development since the qualifying wells had to have been drilled before 1993. S.595 contains a new development incentive proposal by creating an investment tax credit of 20 percent of the costs of new wells up to one million dollars per year and 10 percent thereafter. This type of proposal would reduce the cost of development of domestic wells and encourage capital formation provided it was immediately beneficial. Therefore, it would have to be creditable against both regular and AMT tax and any excess available for carryback and carryforward. S.595 contemplates such treatment. In the past, proposals for tax credits based on the first amount of new production have also been introduced. Which of these is the best approach or whether a better one exists is subject to debate. But, the key issue is that some approach needs to be created.

Conclusion

If Congress wants to see more domestic petroleum and natural gas production, it must recognize that federal tax policy plays a critical role in whether capital will flow toward this industry and the production of this resource. That has always been the case and it will continue to be. Domestic producers have always been “risk takers”. During these times of plentiful investment opportunities, they need some assistance in attracting capital (or retaining it for use internally). There are immediate actions that can and should be taken. The time is right. The nation is seeking a more stable energy supply. Congress should act.

Thank you for this opportunity.

**Cosponsors of Energy Bills
Referenced in Testimony
S.2557, National Energy
Security Act of 2000**

Lott
Abraham
Allard
Craig
Hutchison
Murkowski
Santorum
Voinovich

**S.2265, Marginal Well Preservation
Act of 2000**

Hutchison
Bingaman
Breaux
Brownback
Campbell
Cochran
Domenici
Gramm
Helms
Hutchinson
Inhofe
Landrieu
Lott
Nickles
Roberts
Smith, Bob
Thomas

**S.1833, Energy
Security Tax Act of
1999**

Daschle
Baucus
Bayh
Bingaman
Byrd
Inouye
Kerrey

**S.1042, Domestic Energy
Production Security and
Stabilization Act.
Hutchison**

Allard
Bingaman
Breaux
Brownback
Cochran
Domenici
Gramm
Landrieu
Lott
Thomas

**S.595, Domestic Oil and Gas Crisis
Tax Relief and Foreign Oil Reliance
Reversal Act of 1999**

Domenici
Allard
Bennett
Breaux
Brownback
Burns
Cochran
Hutchison
Inhofe
Landrieu
Lott
Murkowski

**S.325, United States
Energy Economic
Growth Act**

Hutchison
Allard
Bingaman
Breaux
Brownback
Burns
Cochran
Conrad
Domenici
Enzi
Gramm
Inhofe

Nickles
Roberts
Thomas

Landrieu
Lott
Murkowski
Nickles
Roberts
Rockefeller
Stevens
Thomas

Fact Sheet

Geological And Geophysical Costs

Geological and geophysical (G&G) surveys are used to locate and identify properties with the potential to produce commercial quantities of oil and natural gas, as well as to determine the optimal location for exploratory and developmental wells.

Proposal

Allow current expensing of geological and geophysical costs incurred domestically including the Outer Continental Shelf.

G&G expenses include the costs incurred for geologists, seismic surveys, and the drilling of core holes. These surveys increasingly use 3-D technology rather than the conventional 2-D technology used for most of the last seven decades. Previously only very large companies were able to utilize this state-of-the-art, computer-intensive, 3-D technology because of its high cost and the considerable technical expertise it requires. However, as the costs of computer technology have declined, more and more domestic independent producers are making use of this technology. Still, while 3-D seismic provides a vastly superior tool for exploration, it is far more expensive than 2-D technology. 3-D seismic surveys usually cost between five or six times more per square mile onshore than the older technology and, in some instances can account for two-thirds of the costs of some wells. Encouraging use of this technology has many benefits:

- More detailed information. Conventional 2-D seismic is only able to identify large structural traps while 3-D seismic is able to pinpoint complex formations and stratigraphic plays.
- Improved finding rates. Producers are reporting 50-85% improvements in their finding rate. In prior years a producer might have to drill three to eight wells in order to find commercially viable production.
- Reduced environmental impact. Because the use of advanced seismic technology significantly improves the odds of drilling a commercially viable well on the first try, this reduces the number of wells that are drilled and, thus, reducing the footprint of the industry on the environment.

- Investment capital. Many investors are requiring producers to provide 3-D seismic surveys of potential development before committing their capital to the project in order to minimize their risk

Current Law Treatment

G&G costs are not deductible as ordinary and necessary business expenses but are treated as capital expenditures recovered through cost depletion over the life of the field. G&G expenditures allocated to abandoned prospects are deducted upon such abandonment.

Reasons For Change

These costs are an important and integral part of exploration and production for oil and natural gas. They affect the ability of domestic producers to engage in the exploration and development of our national petroleum reserves. Thus, they are more in the nature of an ordinary and necessary cost of doing business.

These costs are similar to research and development costs for other industries. For those industries such costs are not only deductible but a tax credit is available.

Crude oil imports are at an all-time high, which makes the U.S. vulnerable to sharp oil price increases or supply disruptions. The National Petroleum Council Natural Gas study concluded that natural gas supplies need to increase by about 40 percent by 2010 to meet demand. Domestic exploration and production must be encouraged now to offset this potential threat to national security, to meet future needs, and to enhance our economy. Allowing the deduction of G&G costs would increase capital available for domestic exploration and production activity.

The technical “infrastructure” of the oil services industry, which includes geologists and engineers, has been moving into other industries due to reduced domestic exploration and production. Stimulating exploration and development activities would help rebuild the critical oil services industry.

Encouraging the industry to use the best technology available and to reduce its environmental footprint are important public policy reasons to clarify that these ordinary and necessary business expenses for the oil and gas industry should be expensed.

Status

The Taxpayer Refund And Relief Act Of 1999 included a provision to allow expensing of G&G costs. Unfortunately, the bill was vetoed. However, in March 2000, President Clinton announced his support for allowing expensing of G&G costs. Congress needs to pass legislation now to implement this common objective to enhance and preserve domestic oil and natural gas production.

July 2000

Fact Sheet

Tax Treatment of Delay Rentals

Delay rental payments are made by producers to an oil and gas lessor prior to drilling or production. Unlike bonus payments (made by the producer in consideration for the grant of the lease) which generally are treated as an advance royalty and thus capitalized, producers have historically been allowed to elect to deduct delay rental payments under Treasury Regulations 1.612-3(c). However, in September 1997, the IRS issued a coordinated issues paper stating that such payments are preproduction costs subject to capitalization under Section 263A of the Internal Revenue Code. The legislative history of Section 263A is unclear and subject to varying interpretation.

Proposal

Clarify that delay rental payments are deductible, at the election of the taxpayer, as ordinary and necessary business expenses.

Reasons For Change

In passing the Section 263A uniform capitalization rules, Congress broadly intended to only affect the “unwarranted deferral of taxes.” Congress did not intend to grant the IRS the authority to repeal the well-settled industry practice of deducting “delay rentals” as ordinary and necessary business expenses.

Treas. Reg. 1.612-3(c) states that, “a delay rental is an amount paid for the privilege of deferring development of the property and which could have been avoided by abandonment of the lease, or by commencement of development operations, or by obtaining production.” Such payments represent ordinary and necessary business expenses, not an “unwarranted deferral of taxes.” Given the clear disagreement over the legislative history and the likelihood of costly and unnecessary litigation to resolve the issue, clarification would eliminate administrative and compliance burdens on taxpayers and the IRS.

Status

The Taxpayer Refund And Relief Act Of 1999 included a provision to clarify that delay rental payments could be expensed. Unfortunately, the bill was vetoed. However, in March 2000, President Clinton indicated his support for allowing expensing of delay rental payments. Congress needs to enact legislation to implement this common position if the Administration is unwilling to correct the current confusing interpretation of the tax code.

July 2000

Fact Sheet

Marginal Well Tax Credit

Summary of Legislation

The Marginal Well Production Tax Credit amendment to the Internal Revenue code will establish a tax credit for existing marginal wells. Marginal oil wells are those with average production of not more than 15 barrels per day, those producing heavy oil, or those wells producing not less than 95 percent water with average production of not more than 25 barrels per day of oil. Marginal gas wells are those producing not more than 90 Mcf a day. The amendment will allow a \$3 a barrel tax credit for the first 3 barrels of daily production from an existing marginal oil well and a \$0.50 per Mcf tax credit for the first 18 Mcf of daily natural gas production from a marginal well.

The tax credit would be phased in and out in equal increments as prices for oil and natural gas fall and rise. Prices triggering the tax credit are based on the annual average wellhead price for all domestic crude oil and the annual average wellhead price per 1,000 cubic feet for all domestic natural gas. The credit for the current taxable year is based on the average price from the previous year. The phase in/out prices are as follows:

OIL – phase in/out between \$14 and \$17

GAS – phase in/out between \$1.56 and \$1.89

The amendment would allow the tax credit to be offset against regular and the alternative minimum tax (AMT). In addition, for producers without taxable income for the current tax year, the amendment would provide a 10-year carryback provision allowing producers to claim the credit on taxes paid in those years. The carryback credit may be used to offset regular tax and AMT.

Actions Taken

When oil prices fell below \$14.00 per barrel in March 1998, IPAA initiated efforts to develop a marginal well tax credit bill based on legislation that had been introduced in previous Congresses and consistent with the recommendations of the National Petroleum Council's Marginal Wells report in 1994. This legislation was introduced April in the House by Representative Wes Watkins (R-OK) and in the Senate primarily by Senator Kay Bailey Hutchison (R-TX). During the remainder of the 105th Congress, IPAA pressed for passage of this legislation. A letter from IPAA and NSWA leadership was sent to President Clinton. Meetings were held with the Department of Energy to discuss the importance of the tax credit. In July 1998, IPAA sponsored a call-up of members to press for action on the tax credit if tax legislation was considered during this Congress.

The Dept. of Energy has evaluated the benefits of a bill and believes that it could prevent the loss of 140,000 barrels per day of production if fully employed during times of low oil prices. Energy Secretary Bill Richardson wrote to Treasury Secretary Robert Rubin expressing his support for the proposal and seeking a coordinated effort with the Treasury Dept. In November and December 1998, IPAA met with members of Energy Secretary Richardson's emergency task force urging action on Administration support for a marginal wells tax credit bill.

As the 106th Congress convened the bill was introduced in the House of Representatives by Rep. Wes Watkins with 12 original cosponsors as HR 53. In the Senate, the bill was introduced as a part of a larger bill (S. 325) by Sen. Kay Bailey Hutchison with 18 cosponsors. It was also included in other tax legislation addressing oil and gas production tax reform. IPAA testified before the Senate Energy and Natural Resources Committee, the House Committee on Commerce, and the House Ways and Means Committee regarding the need for tax reform, including the marginal wells tax credit. When the Department of Commerce initiated its Section 232 analysis under the Trade Expansion Act, IPAA urged consideration of a marginal wells tax credit as a component of a tax reform package. The Taxpayer Refund And Relief Act Of 1999 did not create any new tax credits and therefore did not include a marginal wells tax credit in the package of oil and gas tax reform measures in that bill.

In March, President Clinton stated his support for tax reforms to allow expensing of geological and geophysical costs and for delay rental payments. He also stated that the Administration was continuing to evaluate alternatives to maintain the nation's marginal well production. Subsequently, Sen. Kay Bailey Hutchison and 8 cosponsors introduced S. 2265 which includes the marginal wells tax credit, the expensing of G&G costs, and the expensing of delay rental payments. It has also been included in S.2557 and HR 4805, comprehensive energy policy bills. Congress, in response to the high oil prices of the past winter, continues to consider a legislative response, including tax reforms.

As Congress continues to evaluate tax reforms for the oil and gas production industry, IPAA will continue to advocate a marginal wells tax credit as a component of those reforms.

July 2000

Fact Sheet

Eliminate The Net Income Limitation On Percentage Depletion

The net income limitation severely restricts the ability of independent producers to use percentage depletion, particularly with respect to marginal wells. Percentage depletion is already subject to many limitations. First, the percentage depletion allowance may only be taken by independent producers and royalty owners and not by integrated oil companies. Second, depletion may only be claimed up to specific daily production levels of 1,000 barrels of oil or 6,000 mcf of natural gas. Third, the deduction is limited to 65% of net taxable income. These limitations apply both for regular and alternative minimum tax purposes.

The net income limitation requires percentage depletion to be calculated on a property-by-property basis. It prohibits percentage depletion to the extent it exceeds the net income from a particular property. The typical independent producer can have numerous oil and gas properties, many of which could be marginal properties with high operating costs and low production yields. During periods of low prices, the producer may not have net income from a particular property, especially from marginal properties. When domestic production is most susceptible to being plugged, the net income limitation discourages producers from investing income to maintain marginal wells.

Proposal

Eliminate the net income limitation on percentage depletion.

Reasons For Change

Marginal oil wells – those producing on average 15 barrels per day or less or producing heavy oil – account for approximately 20 percent of domestic oil production, an amount roughly equivalent to imports from Saudi Arabia. The U.S. is the only country with significant production from marginal wells. Once wells are plugged, access to the remaining resource is often lost forever. Eliminating the net income limitation on percentage depletion would encourage producers to keep marginally economic wells in production and enhance optimum oil and natural gas resource recovery.

The current requirement creates a paperwork and compliance nightmare for taxpayers and the Internal Revenue Service. Eliminating the net income limitation on percentage depletion would simplify recordkeeping and reduce the administrative and compliance burden for taxpayers and the IRS.

Current Status

The Taxpayer Relief Act of 1997 created a two-year suspension of the net income limitation on percentage depletion; this suspension has been extended through 2001. However, it is time to make this suspension permanent. If the country learned anything from the high oil prices of 2000, it is that America needs to maintain and enhance its domestic oil and natural gas production. This tax reform allows more capital to be retained by producers where it can do the most good – producing more domestic oil and natural gas.

July 2000

Fact Sheet

Percentage Depletion Expansion and Carryback Proposal

Current tax law limits the use of percentage depletion of oil and gas in several ways. One of these, for independent producers and royalty owners, limits the allowance for percentage depletion to 65 percent of a taxpayer's taxable income for the year. Percentage depletion in excess of this 65 percent limit may be carried over to future years until it is fully utilized. Many independent producers have been limited in the past because they have spent their income on continuing development of their properties, thereby reducing their taxable income. When oil prices dropped to historically low levels independent producers are unreasonably constrained by these tax provisions limiting their cash flow. They cannot use these carried over deductions. Due to the alternative minimum tax (AMT), even if they could use the deductions currently, they may not benefit to the fullest extent possible from actual tax savings. This proposal would alleviate these limits by implementing the following changes:

- By annual election, the 65 percent taxable income limitation would be reduced or eliminated for current and future tax years.
- Carried over percentage depletion could be carried back for ten years subject to the same annual election on taxable income limitation.

Status

In the Taxpayer Refund And Relief Act Of 1999, Congress included two provisions that addressed these issues in a somewhat different manner. The bill included a 6 year suspension of the 65 percent taxable income limitation and a provision allowing independent producers to carryback net operating losses for 5 years. Unfortunately, the bill was vetoed.

Congress needs to include similar provisions in future tax reform bills and the Administration needs to support such provisions to enhance and preserve domestic oil and natural gas production.

July 2000

Fact Sheet

Enhanced Oil Recovery

Section 43 of the Internal Revenue Code provides an enhanced oil recovery (EOR) credit equal to 15 percent of the qualified enhanced oil recovery costs incurred in a tax year. Existing Treasury guidelines for the section 43 tax credit are very narrow, generally including only expensive EOR processes -- many of which are no longer in use. It excludes, however, many EOR processes that are the result of technological advances now considered common in the industry.

The Petroleum Technology Transfer Council (PTTC) in March 1997 compiled a list of EOR methods that should be included under section 43. This study was part of an industry effort to expand the EOR definition to include technologies that have proven potential for mitigating well abandonment and increasing oil production and resource recovery.

Proposal

Have the IRS review and expand the definition of methods qualifying for the EOR tax credit.

Reason for Change

The existing Treasury guidelines are based on 1979-vintage technology. This list has not kept pace with technology. A second rationale is the incentive generated by allowing domestic producers to position themselves to glean existing reservoirs in order to maximize production of existing reserves.

Two additional categories to the EOR list are proposed. Those categories include Enhanced Gravity Drainage (EGD) and Marginally Economic Reservoir Repressurization (MERR). Included under EGD would be horizontal drilling, multilateral well bores and large diameter lateral well bores. Included in MERR would be natural gas injection and waterflooding. Certain qualifiers and limiting factors include economic criteria for approved projects and incremental production limitations on each project.

By redefining the definition of EOR projects to include both EGD and MERR technologies, the EOR tax credit will encourage conservation measures to expand recovery of existing crude oil reservoirs and promote new drilling activity. This will enable the industry to recover more than 238 billion barrels of oil currently defined by the Department of Energy as “immobile.”

July 2000