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Testimony
Before the Committee on Resources
United States House of Representatives

Hearing on
Domestic Energy Production through Offshore Exploration and Equitable Treatment of State Holdings Act of 2006
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SUMMARY

Mr. Chairman, Mr. Ranking Member, and distinguished members of the House Committee on Resources, thank you for your gracious invitation to appear before your Committee.

The time is past due for us to get serious about energy supply and use in this country. Energy supply issues cannot be discussed seriously without addressing offshore production, and offshore production in America would be almost insignificant if it were not for the State of Louisiana. In 2005, the Louisiana OCS (that is, the federal offshore Outer Continental Shelf off of Louisiana's coast) produced 89% of the oil and 70% of the natural gas production in the U.S. Gulf of Mexico OCS and 85.4% of the oil and 69.5% of the natural gas production in the entire U.S. OCS. Since the beginning of time, Louisiana OCS territory has produced 85.4% of the 15.9 billion barrels of crude oil and condensate and 81.1% of the 162 trillion cubic feet of natural gas ever extracted from all federal OCS territories.

The current volume of Louisiana OCS production, which has been reduced due to hurricane damaged infrastructure, amounts to 24.0% of total U.S. domestic crude production and 19.2% of total U.S. domestic natural gas production from all locations. Prior to the recent run-up in prices, federal production off Louisiana's shores alone contributed an average of $5 BILLION a year to the federal treasury. And, that was when the price of oil was even less then one-half of the $70 per barrel it is selling for today.

The availability to the American people of this prodigious energy and revenue source would not be possible without the cooperation and participation of Louisiana and its citizens. While all but four other coastal states refuse to allow any new exploration or production off their coasts, Louisiana has pioneered offshore development and continues to do more than its share to develop and make available onshore and offshore energy to all Americans.

Louisiana incurs tremendous infrastructure and environmental costs to make all of this OCS production possible. A discussion of infrastructure costs is provided later in this presentation. For the moment, it is sufficient to state that Louisiana has TENS OF BILLIONS OF DOLLARS of requirements to repair, rebuild, and maintain the infrastructure needs of roads, ports, flood protection, environmental damage from old practices of the past, onshore disposal of offshore

production wastes, and other infrastructure, including restoring protective coastal wetlands that are being lost at a rate of more than 24 square miles per year.

The deterioration and damage to all of this infrastructure, and the lack of financial assistance through revenue sharing with the state needed to maintain and improve the infrastructure, threaten the viability of this offshore energy and revenue production capability to continue. The recent devastating impacts of Hurricanes Katrina and Rita have demonstrated the vulnerability of this critical infrastructure.

Inland states like Wyoming, New Mexico, Colorado, and others host drilling on federal lands onshore, they receive 50% of those revenues in direct payments, and consequently have the financial resources to support that infrastructure. In Fiscal Year 2004, Wyoming and New Mexico together, received about $928 million from those revenues, which IS an appropriate revenue sharing procedure. In contrast, for example in 2001, of the $7.5 BILLION in revenues produced in the federal OCS area that year, only a fraction of one percent came back to those coastal states. The inequity is truly profound.

Louisiana's OCS production complex dwarfs all other energy production centers in the country, onshore or offshore; yet, the pocket change the state receives in revenue from it is almost insulting, considering that Louisiana makes all of this revenue and energy production possible. The miniscule amount of revenue the state receives from its colossal OCS production is what is called Section 8(g) funds, which amounts to about $30 million per year to Louisiana out of a $5 billion revenue stream. It gets even more humiliating when one realizes what 8(g) money really is. This money is derived from the mineral revenues from a band that extends from each coastal state's offshore boundary seaward for three miles into federal waters. Federal revenue from this zone is shared, 27% with the coastal producing state and 73% to the federal government. Beyond that, the state receives zero revenue. Unfortunately, even this paltry revenue is revenue sharing in disguise. Section 8(g) funding was created to COMPENSATE coastal producing states for drainage from oil and gas reservoirs on the state side of the boundary from wells drilled on the federal side of the border.

This so-called revenue sharing is all the revenue a coastal producing state like Louisiana receives, in contrast to the 50% sharing onshore. It is not any wonder that no states other than Louisiana, Texas, Mississippi, Alabama, and Alaska are willing to allow oil and gas production off their coasts. Why do even these few states allow any federal offshore production?

Louisiana has recently pondered this and weighed these issues long and hard, carefully examining the cost / benefit ratio for the state. The infrastructure damage from the recent hurricanes dangerously weakened the already deteriorated coastal eco-structure of the state. For continued and expanded OCS development off the coast of Louisiana, business as usual cannot continue. Enormous investments of capital are required to ensure the continued viability of the OCS industry off Louisiana's coasts without sacrificing the integrity of Louisiana's onshore and coastal habitat.

Louisiana does not have the funds for the needed improvements, but the funding can and should be made available by sharing 50% of the revenues from Louisiana OCS production with the state.

To prove to the entire United States Congress that Louisiana is serious about applying the OCS funds to coastal restoration, during the 2005 regular session prior to the storms, the Louisiana

Legislature passed the Revenue Lock Box Amendment. This Constitutional amendment now awaits voter approval in the Fall of 2006. It was tweaked in the November, 2005 special session, and it requires the deposit of all OCS revenues into the Coastal Restoration and Protection Fund. I felt very strongly about this when I proposed this idea, even before the storm. It was obvious that all state leaders were asking for these funds for the purpose of coastal restoration but I noticed nothing in the law that actually required that it be used for that purpose. Governor Blanco and I thought it was so important that we set up this lock box before obtaining any OCS revenues so there would be no temptation to use it for something else. While health care and education are very important, as are many other needs of the state, I think it is appropriate that we use these anticipated funds to rebuild and protect our coast, a national treasure.

Governor Blanco has complete support of our community leaders, Parish Presidents Against Coastal Erosion. We believe it is only fair that Louisiana receives the same deal given to western states beginning in the 1920s, which now gives them 50 % of the royalties of mineral produced on federal lands. Doesn't it make sense for Congress to reinvest in infrastructure that makes domestic energy possible, like investment in our ports and port facilities, roads, barrier islands and as a means of fighting erosion of our land?

SUPPLYING THE NATION
LOUISIANA — AMERICA'S ENERGY CORRIDOR

Louisiana – Energy Producing State for the Nation

Louisiana's first well (a dry hole) was drilled in 1868. The state's first oil well was drilled in 1901. The first oil well over water in the world was in Louisiana in 1910 in Caddo Lake. The first well drilled off the coast of Louisiana was in 1938 near Creole, Louisiana. Louisiana was the site of the first well drilled out of sight of land in 1947.

34% of the nation's natural gas supply
30% of the nation's crude oil supply
is either
produced in Louisiana,
produced in the Louisiana OCS, or
moves through the state and its coastal wetlands.

2 of the 4 nation's Strategic Petroleum Reserve storage facilities are located in Louisiana.

The state is home to the Henry Hub NYMEX natural gas price and trading terminal.

Over 40,000 miles of large transmission pipelines traverse the state to transport oil and gas from production centers to consumption markets throughout the country.

Together with the infrastructure in the rest of the state, this production is connected to nearly 50% of the total refining capacity in the United States. Based on its energy producing value to the nation, acre for acre, Louisiana is the most valuable real-estate in the nation.

Including Louisiana OCS production, Louisiana's rank among the 50 states is:

1st in total crude oil production
1st in OCS crude oil production
1st in OCS natural gas production
1st in OCS revenues generated for the federal government
1st in mineral revenues from any source to the federal government
1st in LNG terminal capacity
1st in foreign oil import volume
2nd in total natural gas production
2nd in total energy production from all sources
2nd in petroleum refining capacity
2nd in primary petrochemical production

Louisiana – Refining State for the Nation

Louisiana has

- 17 operating petroleum refineries, most large world-scale facilities
- 16.2 % of total U.S. refinery capacity
- 2.77 million barrels per day refinery capacity
- 2nd highest refinery capacity in the nation

and produces

- 42.1 million gallons of gasoline per day
- 29.9 million gallons of distillate (jet fuel and diesel fuel) per day

Louisiana – OCS Revenue & Energy State for the Nation

Without Louisiana, there would be little OCS production and, therefore, little OCS revenue for the Federal Government

Louisiana OCS (federal) territory is the most extensively developed and mature OCS territory in the U.S. and most developed and mature offshore area in the world.

Prior to the recent run-up in prices, federal production off Louisiana's shores alone contributed an average of $5 BILLION a year to the federal treasury, and, that was when the price of oil was even less then one-half of the $70 per barrel it is selling for today.

Louisiana's share of this revenue, $ZERO

The current average $30 million Section 8(g) payment to the state is not real revenue sharing, but is compensation to the state for drainage of reservoirs underlying state water bottoms from wells drilled on the federal side of the state's offshore boundary line. For this band that extends from the state offshore boundary seaward three miles, 27% of the OCS revenue from that 8(g) zone is "shared" with the state.

Annual Market Value of Oil & Gas Produced in the Louisiana OCS

Natural Gas : Approximately $30 Billion (based on $9 per MCF and pre-Katrina & Rita production volume)
Oil : Approximately $33 Billion (based on $60 per barrel and pre-Katrina& Rita production volume)
For a total of approximately $63 Billion per year

Historically, Louisiana OCS territory has produced
85.4% of the 15.9 billion barrels of crude oil and condensate, and
81.1% of the 162 TCF (trillion cubic feet) of natural gas
extracted from all OCS territories from the beginning of time through the end of 2005.

Currently (Preliminary 2005 data), Louisiana OCS territory produces
89% of the oil, and
70% of the natural gas
produced in the Gulf of Mexico OCS,
85.4 %of the oil, and
69.5% of the natural gas
produced in the entire U.S. OCS, and
24.0% of total U.S. domestic oil, and
19.2% of total U.S. domestic natural gas production.
Note that current Louisiana OCS production as a share of total domestic production is down by several percentage points due to damaged production that is temporarily or permanently shut-in due to Hurricanes Katrina and Rita.

All of this infrastructure is vulnerable to accelerated destruction from coastal erosion and land loss.

Louisiana and Energy Are Synonymous.

The importance to the nation of energy production and use in Louisiana is further highlighted in the following rankings in which Louisiana is (2003 EIA data latest available):

3rd in industrial energy consumption
3rd in natural gas consumption
5th in petroleum consumption
8th in total energy consumption
But, only 22nd in residential energy consumption

Usually, when national energy issues are discussed, Louisiana is cast in the image of a rich producing state floating in a sea of oil and gas that is being inequitably shared with the consuming states. Often misunderstood or overlooked, is the fact that more than two thirds of the production from the state is in the Louisiana federal OCS territory and, hence, produces no revenue for the state, while at the same time incurring significant infrastructure support costs to the state, which is discussed in more detail later.

Also often overlooked or not explained, is the fact that, though Louisiana is the 2nd highest energy producing state in the nation, Louisiana is also 8th highest in total energy consumption. Therefore, Louisiana is more of a consuming state than 42 other states! This story is never told, nor are Louisiana's difficulties as a key consuming state given much concern at the federal

energy policy level. Thus, when Louisiana, the energy producing state speaks, it is also Louisiana, the energy consuming state speaking. Louisiana is inexorably tied into the issues of all states in the nation, whether considered producing states or consuming states.

Louisiana's Role as a Through-Processor of Hydrocarbons for the Nation

All of the preceding represents only the direct supply line of oil and natural gas. Additionally, Louisiana's 8th highest ranking among the states in energy consumption is attributable to the fact that Louisiana is consuming most of this energy as a through-processor of energy supplies for the rest of the nation, consuming colossal amounts of energy for their benefit.

An example of how Louisiana is consuming energy resources for the primary benefit of other states is petroleum refining. The energy equivalent of 10% of Louisiana's entire petroleum product consumption is required just to fuel the processes that refine crude oil into gasoline, diesel fuel, jet fuel, heating oil and other products consumed out of state. The oil refining industry employs only about 10,400 workers in the state; whereas tens of millions of jobs throughout the country are dependent on the affordability and availability of the products from the continued operation of these refineries and associated petrochemical facilities in Louisiana.

Many other examples could be cited of the numerous energy intensive natural gas and oil derived chemical products Louisiana (and also Texas and Oklahoma) through-processes for the rest of the U.S. Per unit of output, these industrial processes in Louisiana are characterized as capital (equipment), energy, raw material, and pollution discharge intensive, and low in labor requirements and dollar value added, essentially the opposite of the downstream industries in other states that upgrade these chemicals into ultimate end products. Much of the energy Louisiana technically consumes is really the transformation of oil and gas into primary chemical building blocks that are shipped to other states where the final products are made, whether it be plastic toys, pharmaceuticals, automobile dash boards, bumpers and upholstery, electronic components and cabinets, synthetic fibers, or thousands of other products dependent on this flow of energy and high energy content materials out of Louisiana.

OCS INFRASTRUCTURE AND ITS IMPACTS AND NEEDS

It is important to understand that there is no free lunch. Louisiana, like other coastal producing states, sustains impacts on coastal communities and bears the costs of onshore infrastructure required to support this production activity.

Saving Louisiana's Wetlands that Protect Offshore and Onshore Production Infrastructure

Louisiana's unique and fragile coastal wetlands introduce yet an additional issue: land loss. Prior to Hurricanes Katrina and Rita, Louisiana was losing more than 24 square miles of coastal land each year. In fact, if what is happening today in coastal Louisiana were happening in the nation's capital, the Potomac River would be washing away the steps of the Capitol today, the White House next year, and the Pentagon soon after that. In fact, during the course of this morning alone, Louisiana will lose a football field wide area from the Capitol Building to the Washington Monument. It is feared that the ferocity of Hurricanes Katrina and Rita may have accelerated the land loss by several years.

There are many causes of this coastal erosion in Louisiana, including oil and gas development and what may be the most significant factor: building levees and channeling the Mississippi River. Whatever the cause of its demise, the health and restoration of Louisiana's coastal wetlands are vital to protecting the offshore and onshore infrastructure that is essential for the continuation, as well as the expansion, of offshore energy production in the Gulf of Mexico.

Once the state realized the magnitude of the coastal erosion problem, Louisiana got serious about doing something about it. In 1980, the coastal restoration permitting program was moved to the Department of Natural Resources (DNR). In 1981, $40 million of state oil and gas revenue was set aside in a legislative trust fund for coastal restoration projects. The State has a dedicated revenue stream of up to $25 million per year, depending on the level of revenue collections from oil and gas production within the state, to replenish the fund. In the past few years, that replenishment stream has been at the $25 million level. In 1989, the Office of Coastal Restoration and Management was created in DNR, and the magnitude of the program was greatly expanded.

The Fight against the Elements

Prior to Hurricane Katrina, Louisiana needed a minimum of $14 billion (in today's dollars) over the next 20 to 30 years for coastal restoration projects. Louisiana has quite a unique geology relative to the rest of the country. The Louisiana coast is geologically the youngest part of the U.S. and, prior to manmade interference from leveeing and channeling the Mississippi River and other activities, was still accreting land mass faster than it was losing it to subsidence, erosion, salt water intrusion, sea level rise from global warming, and other causes. The science of coastal geology and the expertise of coastal engineering to counter these forces is in its infancy, as it has never in the history of civilization, been attempted on the scale it must be implemented in South Louisiana. Also, we are dealing with a situation that is continuously subject to changing dynamics, such as more frequent and more powerful hurricanes, the apparently increasing effects of global warming, etc.

Extent of Louisiana Infrastructure Supporting OCS Production

The total value of the Louisiana OCS infrastructure and the onshore infrastructure supporting it is difficult to ascertain. The estimated depreciated investment in offshore production facilities is over $85 billion, depreciated offshore pipeline infrastructure is over $10 billion, and public coastal port facilities is $2 billion, for a total of approximately $100 billion, depreciated, and not counting highways, sewer, water, fire and police protection, schools, and other public works structures that also have ongoing operation and maintenance costs. The replacement of all of this would be several times the $100 billion depreciated figure. It also does not count the onshore coastal infrastructure of pipelines, storage facilities, pumping stations, processing facilities, onshore disposal facilities for offshore production wastes, etc.

This infrastructure is vulnerable if not protected by the State's barrier islands and marshes. As these erode and disappear, infrastructure is exposed to the open sea and all of its fury. As the coast recedes, near shore facilities become further offshore and subject to greater forces of nature, including subsidence, currents, and mudslides. Erosion in the coastal zone is already beginning to expose pipelines that were once buried.

Research at Louisiana State University shows that every 2.7 miles of healthy marsh can reduce storm surge by a critical 12 inches. This is why the state has been pleading for years for funding of the state's $14 billion, 20 to 30-year coastal restoration program. The inability to implement needed projects to protect the coast from storms up to now may mean that the costs will be even greater as a result of the devastating hurricanes in 2005.

As more of the protection from Louisiana's barrier islands and coastal wetlands wash away, increasingly more onshore and offshore production will be damaged or destroyed by even less powerful storms than Katrina and Rita, and particularly by storms whose paths directly pass through the producing areas off of Louisiana's coast, as did Katrina and Rita. Direct hits to the prime production area by hurricanes and tropical storms cause incalculable damage to this production infrastructure, as well as to the onshore support infrastructure, as Katrina and Rita are proving.

HOW TO INCREASE OFFSHORE U.S. ENERGY PRODUCTION

Share Offshore Revenue with the States that Allow Offshore Production

The most effective way to help is to assist those states that make offshore energy production possible off their coasts. This can be accomplished by sharing with those coastal producing states some of the offshore revenues generated off their coasts. This would encourage those states to pursue more development, and it would help offset infrastructure costs those states incur that is associated with that development. Louisiana, like other coastal producing states, sustains impacts on coastal communities and bears the costs of onshore infrastructure to support this production activity.

When states like Wyoming, New Mexico, Colorado, and others host drilling, coal mining, and similar activities on federal lands onshore, they receive 50% of those revenues in direct payments, and consequently have the financial resources to support that infrastructure. In Fiscal Year 2004, Wyoming and New Mexico together received about $928 million from those revenues, which IS an appropriate revenue sharing procedure.

In contrast, for example in 2001, of the $7.5 BILLION in revenues produced in the federal OCS area, only a fraction of one percent came back to those coastal states. The inequity is truly profound.

We are pleased this committee is investigating offshore exploration and equitable treatment of states. The need to sustain the existing supply that Louisiana provides must simultaneously be addressed. The most effective answer to both issues is to share offshore revenues with the coastal producing states that make that production possible. It is critical that coastal producing states receive a fair share of revenues to build and maintain onshore infrastructure and, in Louisiana's case, to help stem our dramatic land loss, which is occurring at a rate believed to be the fastest on the planet.

Production off Louisiana shores alone contributes an average of $5 BILLION dollars a year to the federal treasury. And, that was when oil was less than half of the $70 plus per barrel price it is selling for today.

Does it not make sense to encourage the coastal producing states which provide that revenue for the benefit of the rest of the nation? Does it not make sense, that when so many, like the U.S. Ocean Commission, are targeting offshore OCS revenues to pay for worthwhile preservation of natural resources, that this nation first protect those who make these resources possible?

Prior to Hurricanes Katrina and Rita, in Louisiana's coastal zone, many of the pipelines and other infrastructure that our wetlands have historically protected become exposed to open Gulf of Mexico conditions. Dire measures are required to stem this destruction. To maintain, much less increase, production from off our coasts, we must reinvest in the infrastructure that makes all of the activity possible, whether it be port facilities, roads to transport equipment and supplies, erosion control, or barrier island and wetlands storm protection.

Assistance from the Energy Policy Act of 2005

The Coastal Impact Assistance Money provided in the Energy Policy Act of 2005 that Congress passed last year is tremendously good news for the state's coastal restoration efforts. Yet, the $540 million provided over four years for coastal restoration is only a drop in the bucket compared to the total of $14 billion needed, prior to Katrina and Rita, over 20 to 30 years for Louisiana's unique coastal restoration needs.

CONCLUSION

It is vital to the nation's security and prosperity that new energy sources be developed. The federal government has the ability to steer investments. Louisiana's OCS significance is demonstrated by its producing 24% of oil and 19.2% of natural gas produced domestically, which is down several percentage points due to permanently and temporarily shut-in production from 2005's hurricanes. The Louisiana OCS, along with that of Texas and all of the U.S. OCS areas off limits to exploration and production, is the single most promising area for the U.S. to obtain significant new supplies of energy. These supplies, whether conventional oil and gas, imported oil, imported LNG, wind and ocean energy, or natural gas hydrates, need the support and cooperation of coastal states to enable that activity to take place and to supply and maintain critical production and support infrastructure.

LNG facilities are being built where the existing U.S. pipeline infrastructure exists (essentially Louisiana and Texas) in order to get the gas from the coast into the delivery system to supply the nation. The same will be true when the technology is developed to commercialize methane hydrate production off the coasts. This Louisiana and Texas infrastructure will also be used when deep and ultra-deep shelf production comes on stream. This is another reason why offshore revenue should be shared with the coastal producing states that are allowing onshore and offshore drilling and allowing the siting of LNG facilities to make energy available to the rest of the country.

With effective policies and incentives, the federal government can steer investment into the offshore areas, and by receiving an equitable share of revenue generated offshore, the coastal producing states can be in a position to ensure that this production will be made available to the rest of the nation. Louisiana desperately needs immediate revenue sharing financial assistance from a source not subject to annual appropriations, to continue to maintain existing, and to develop future energy supplies for the nation.

It is a travesty that the Congress enacted national energy legislation without substantial OCS revenue sharing in the form of direct payments to the coastal producing states from the revenue derived from offshore production, and without giving the coastal states a 50% share in offshore production revenue from off their coasts, similar to the automatic payments for drilling and coal mining on federal lands onshore, and before any other dispersal of those monies.

Now that Hurricane Katrina has laid waste to Louisiana's largest city, the entire southeastern portion of the state, much of the southwestern part of the state, the state's coastal oil and gas infrastructure, and its once protective wetlands, a massive rebuilding program is imperative to repair and rebuild Louisiana's critical infrastructure and protective wetlands to enable the state to continue to supply a critically needed portion of this nation's energy needs.

When it comes to Louisiana continuing its role in leading the nation's offshore energy development, the bottom line is that the state cannot afford, and is not willing to continue to sacrifice our vital and fragile protective wetlands.

Thank you for this opportunity to appear before you.

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