

Bob Baumann - LSU Center for Energy Studies

Thank you. I do want to set the record straight and I'm not with any of the oil and gas associations. I know I'm going to hear about that after this meeting's over. Well, I just have a few brief comments. Yesterday, New York Merk, price of WTI, West Texas Intermediate, closed at \$11.68 a barrel. That's the good news. That's a paper barrel, or I guess maybe in today's jargon, it's an electronic barrel. Real prices are a lot lower. Yesterday, a delivery was made from a state lease in Breton Sound, 37 to 41 degree gravity weight oil, net to the producer, net of transportation costs and from which we, you receive royalties, was \$6.38. That's a barrel of oil for a Big Mac meal. Posted prices yesterday, Louisiana, \$8 bucks for South Louisiana Sweet, \$6.50 for sour and on it goes. In Lafayette, I was in Lafayette two weeks ago, both my boys play for a high school soccer team. We went over there. And there was gasoline selling for 72.9. Now 38.4 cents of that is tax. So net retail price of gasoline is about 35 cents. Had to get them some oranges and stuff at the Albertson's for the game. Price of a gallon of water, local brand - 95 cents. Almost three times the price of gas of gasoline. Nationally, gasoline's about 94 cents. 57 cents net of excise tax. If you go back to the tables and adjust for inflation and figure out how long has it been since it's that cheap, the best we can figure is never. And that's what the U.S. Energy Information Agency has also concluded. NEVER. That's pretty old. Why? Well I think we all know why. It's an oversupply. All demand was expected to be around the world about 2.5% last year as of 18 months ago. There's only about three quarters of one percent. That doesn't sound like a lot, but 1 and 3/4 percent of a billions of barrels is a lot of oil. So the demand wasn't there. Over the long run, that's good for the world. That means that economies are growing with progressively less incremental energy inputs. The other aspect of it is the increase in supply. Now I remember in 1973, and a lot of people said jeez, there's only 25 years of oil left at then current rates. Well, it's 26 years later and we've got 40 something years at current rates and we've got about twice as many exporters of oil around the world than we did back in 1973. And it's a policy of some countries to try and maintain market share or increase market share. So they put out more oil. We won't go into naming who they are. But then there's other aspects like Iraq – you know Iraq is allowed to sell some oil in order for humanitarian needs, but the target there is an amount of money. So this country, for example,

was receiving 600,000 barrels a day of Iraqi oil. And, of course, that additional 600,000 barrels a day put the world market out of kilter a little bit more, so what happened? The price dropped. The price dropped, they ain't getting as much money. So guess what? Now they put out a million barrels a day to here, and what happens then? We get out of whack again and the price goes down in a spiral. Well it's kind of a sad story and I think that's sort of enough, but you know, is there anything you can do realistically? Is there anything the feds can do realistically? And I think there probably will be some tax relief for marginal wells. I guess oil wells are marginal right now. That's sort of a bad term, but for stripper wells, perhaps, incapable wells. But in this state only about 5.5% of the total production is stripper wells. And on state leases, particularly bays and waterbottoms, there are very few stripper wells. You know marginal wells are about 40 barrels a day even in good times because of the cost of operating on a state lease. What can the feds do? Well let's think about that. Other than some of these tax relief or some of these really small producers who's only source of income is the price of that oil and they are in serious, serious trouble. Well, last year, it's estimated that there was a \$40 billion dollar transfer from the oil and gas sector of the United States to other sectors of the economy. About 2 billion alone of that was the savings on fuel that the airlines have. But this proportionate amount of that savings coincided with the fourth quarter of 1998. It's tied of course to the big drop in prices in the fourth quarter of 1998. But it also happened to be the quarter where the gross domestic product of the United States grew at the highest rate in 14 years. And there's a connection. Low energy prices is darn good for the national economy. And if you're an elected politician, boy it's hard to go against that. So in the big picture, I don't see that the feds can really do a lot, nor have they ever had a history of ever doing a lot. Now we get down to your level. Can you really do anything? Actually, I think you can. Each step may be small, but accumulatively, they can have an impact. And I'd like to go back to something that did happen to try and prove the point. From 1994 to early 1998, things were pretty good in the oil patch, in general. Prices are high or certainly a lot higher, and in 1996 I think they averaged over \$20 a barrel here in Louisiana. Of course, higher prices float all the ships up. It means the rate return on oil and gas investments improve relative to all other types of investments and it attracts capital. So everybody's happy. But Louisiana did a heck of a lot better than a lot of other states. During that time period our recount went up faster or at a greater rate than the other states on average. Our employment in

the oil and gas sector went up at a higher rate than the other states on average. And guess what, I gave you a little table there. This table claims, this comes out of Oil Daily, if you look down that list on the right hand column, you'll see nothing but negatives. Except for one zero and two plus threes. That's production from 1998. Nationally, it was down five percent. The only two with pluses was the Gulf of Mexico and Louisiana. Now, to be honest with you, I think when the final numbers come in, this Louisiana number will go down somewhat. But prior to 1994, when we were losing 4 to 5 percent every year, and since 1994 we were about even, so that's 4 years where we gained 4 to 5 percent over the longer term trend. That's pretty good. That's a lot of oil. That's 20% of our total production. Why was it better here than some of our competitors? Well it's because the Mineral Board, the legislature, two different governors did do some small things individually that made the state more competitive against every other place that you can invest gas dollars. I can give you examples, one was Act 2 of 1994, of which this Mineral Board was directly involved or some of your predecessors, but you were also involved in the renewals in 1996 as well as the renewals in 1998. Act 2 targeted certain wells for certain short-term tax relief and the net analysis of all of it was the state actually gained money. It certainly gained a lot of investment dollars and that program worked at least during times when prices were decent. A couple of other kinds of things that I think we have to take into account that we didn't have control over that same time period was technology. Particularly 3-D seismic. Of course, the technology is universal, but it seemed to work better at least in South Louisiana 3-D seismic than a lot of other areas and made us somewhat more competitive. A third sort of contributing factor – that trend, I think, was at least certain components of the Texaco Global Settlement Agreement of which you were certainly involved in. In which you made them commit to a drilling program of \$150 some odd million dollars over a period of, I think, five years I think it was. Well, Texaco actually spent more than that amount of money, which tells me that it must have been a good rate of return for them to spend more than what they were required. And all of that was on south Louisiana state leases. And that contributed to jobs and dollars and royalty income. So collectively, you can do some things. Well, what can you do? Well, I think that's industry's job to tell you what they think you can do. I've heard a few comments and I'll give – I see them in two categories. I'll give an example in each. One, I see some of the things that you may want to look at on an emergency basis. And the other group or things that I think you should look at,

regardless of the price of oil. The price is ten here, it's ten everywhere else basically. To give us a competitive advantage or keep us in the competitive game. On the first component, under emergency, and I go back to something that's certainly an old idea. We talked about it in the mid 1980's and that is to allow operators on state leases to nominate shut-ins. Now we didn't do it back in the mid 1980's because the state was so dependent on oil and gas income that we were going to reduce it even more by allowing shut-ins. We don't know how much could be shut-in. Not all of it could be shut-in. We know that. Well, the state's a lot less dependent. And I'll tell you from my two boys that played soccer, I hate seeing us sell that oil at \$6.48 and the royalty we're getting on that. I sure would like just to shut it in and sell it back when the times are better and price is better and the citizens of this state get what the value of oil really should be in this world. And not give it away. On a competitive factor, regardless of price, we have an issue I think really needs to be looked at. You don't have total jurisdiction, but you look at – you grant a seismic lease and seismic has certainly been, and in 3-D, seismic has been a critically important tool in the marketing of state leases. And you charge basically \$2 an acre for access on that seismic lease, which is relatively moderately priced compared to other states by a buck or two an acre. Of course, with the idea that you're going to make it up on the end with making properties more attractive. But we do have a situation where a lot of those state leases that your two dollars – sixty dollars more is being added to that. And believe me, that clearly puts us in a non-competitive position. So I guess I'll turn it over to industry and listen to what they have to say. And I'll take notes just like you. I'll answer any questions you may have.

State Data Show Sharp Nationwide Decline in Oil Production

It took a while, but state-by-state data are now trickling in that show U.S. oil production last year was much more vulnerable to sustained low oil prices than national data have indicated.

Rather than the widely reported, barely perceptible, 1% decline, soundings at the state level show a massive 240,000 b/d — or 7% — slide in onshore production outside Alaska, from a 1997 average of 3.8 million b/d.

With declines in Alaska and offshore California more than offsetting Gulf of Mexico increases, overall U.S. production looks to have averaged only 6.1 million b/d in 1998, down 5% from 1997, or 330,000 b/d. Moreover, latest data and estimates from state governments show double-digit decline rates in many states in the second half of 1998.

Marginal wells, many of which have lifting costs of up to \$15/bbl, have been the biggest casualty.

In Kansas, where stripper wells account for 98% of production, output last year fell 27%, or 30,000 b/d, from 1997. Oklahoma dropped 22%, or 48,000 b/d (OD, 1-20-99, p.1). New Mexico is on track for a 13%, or 25,000 b/d, decline. Texas fell 84,000 b/d, or 6%, mostly from the Permian Basin. In Wyoming, where marginal wells account for half of output, production fell 9%, or 16,000 b/d.

These data support results from a recent survey by the Independent Petroleum Association of America that confirmed earlier Na-

tional Petroleum Council findings that 319,000 b/d out of 1.3 million b/d of total marginal well flows are uneconomical with

mentum this year.

Onshore oil drilling has almost completely dried up, and many states haven't issued permits for several months. Nationwide, only 117 rigs are drilling for oil, down from 430 a year ago, according to *Land Rig Newsletter*. It estimates a 65% drop-off in Permian Basin drilling, a 60% decline in the Rockies and a 45% decline in the region surrounding the intersecting borders of Arkansas, Louisiana and Texas.

Permits in New Mexico's portion of the Permian Basin are down 45% from the 1997 high. North Dakota has issued no permits in two months. In those states that have issued a large number of drilling permits, such as Colorado, almost all have been for natural gas.

For those few states where output increased — or at least held steady — last year, the odds for continued success seem small.

Horizontal drilling made Louisiana one of last year's few onshore gainers. But little oil drilling has been going on lately, and output from horizontal wells tends to fall sharply after a brief peak.

Production from North Dakota's prolific Red River play, which has buoyed otherwise declining output, may be stalled by a court case concerning unitization of the fields.

And in California, prices dropped below break-even costs only in November, making steeper decline rates seem imminent.

Ⓜ Jay Saunders

U.S. Production Slides

(thousands of b/d)

	1998	1997	Change	%chg
Texas	1,224	1,308	-84	-6%
California	718	724	-6	-1
Louisiana	313	305	8	3
Wyoming	176	192	-16	-9
New Mexico	165	190	-25	-13
Oklahoma	164	212	-48	-22
North Dakota	98	98	-1	-1
Kansas	79	109	-30	-27
Colorado	61	66	-5	-8
Mississippi	56	59	-3	-5
Utah	54	54	0	0
Montana	42	44	-1	-3
Illinois	37	44	-7	-16
Michigan	23	28	-5	-16
Ohio	18	24	-6	-25
Other states	133	143	-10	-7
Onshore Lower 48	3,361	3,599	-238	-7
California Offshore	185	209	-24	-11
Gulf of Mexico*	1,386	1,340	46	3
Alaska	1,181	1,298	-117	-9
Total	6,113	6,446	-333	-5%

Note: * Includes state offshore production.

Source: State data and EIG estimates.

prices at \$12/bbl. At \$10/bbl, shut-ins threaten nearly 500,000 b/d of output.

Lifting costs average about \$14 in Oklahoma, \$11 in Kansas, and \$13 in Wyoming.

Decline rates will likely gain further mo-

Slump . . .

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Although not yet hinting at the survey's results, an IPAA executive noted last week in Houston that many producers may prefer to keep their wells on stream to generate much-needed cash flow even at low prices, rather than incur the additional costs of plugging them.

That's especially true with waterflood programs and steam-heated heavy oil fields where it would be extremely difficult and expensive to bring wells back on line later, he said.

Low prices have produced no cutbacks of existing oil and gas production in the Gulf of Mexico, although there have been some reductions because of mechanical, regulatory or "other reasons," said a spokesman for the U.S.

Minerals Management Service in New Orleans. In fact, the first evidence of any impact of low prices on offshore operations may not appear until the next federal lease sale this

spring. The Gulf is still the bright spot for U.S. drilling activity, especially in the expensive deep-water frontier where producers stand the best chance of making giant discoveries.

The U.S. oil and gas producers who are still working today are survivors of the 1982-92 depression, the worst downturn ever to hit the U.S. energy sector. They got through that by learning to work "lean and mean."

But even they were surprised by the latest collapse in world oil prices, which was faster and sharper than ever before. Only 18 months ago, many in the industry were predicting at least five years of higher oil and gas prices and increased drilling.

Industry sources note that all other commodity prices — including steel and grain — also are down. What influence that may have on spot prices for oil and gas, which

now are tied to daily fluctuations in the futures market, has not yet been investigated.

Meanwhile, the shakeout of producers will continue. "The best companies are patient and selective in letting the best opportunities come to them. No one is ready to jump on anything," Morris said.

Mega-mergers, like the combination that produced BP Amoco plc and the proposed tie-up between Exxon Corp. and Mobil Corp., are less likely, because less capital is available, sources said.

However, Morris said stock prices for upstream energy companies are supported by expectations of a rebound. "I think we have passed the bottom for oil and gas," he said. "Investors are looking for opportunities to step back in."

Ⓜ Sam Fletcher