

Comments by Fred Palmer
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Thank you Jim. Mr. Chairman and Members of the State Mineral Board, my name is Fred Palmer and I am Texaco's Regional Manager for Public and Government Affairs for the Southeast United States. I am also Chairman of the Louisiana Mid-Continent Oil and Gas Association's External Affairs Committee and I am here this afternoon as a representative of Louisiana Mid-Continent, a trade association representing more than 100 companies from the exploration, producing, refining, pipeline and marketing segments of our industry.

On behalf of both Louisiana Mid-Continent and Texaco I want to thank you for this opportunity to discuss with you a subject important to all of the people of this state--the oil and gas industry.

Unfortunately, I must tell you that conditions in the industry are bleak, some might say devastating and probably as bad as they have ever been during our Industry's 100-year history in Louisiana.

This is not the first time the industry has gone through a major downturn. Most of us remember what happened in the 1980's. We remember the massive layoffs, double-digit unemployment, companies going out of business and government services being cut. We remember all too well.

We have been down this bumpy road before. We are traveling down it again and will likely negotiate it at some point in the future. That is the cyclical nature of this industry. We are not going to change that reality today. We are part of a global community where actions and conditions on the other side of the world, not just in neighboring producing and refining states, affect our domestic industry. Oil prices will fall. Oil prices will rise. No one knows exactly when, how much or for how long.

Today's low price environment of crude oil has revealed some long-standing problems that the industry has been facing and which must be corrected. If we can take the steps I will be listing shortly, the industry will be better able to weather future downturns. The reality is, regardless of strong or weak crude oil prices, Louisiana is competing with other states, even Countries, for investment dollars. These are not unlimited resources and every oil and gas company, regardless of size, has more investment opportunities available to it than financial resources.

Louisiana is in many ways ahead of several other producing states. The Louisiana Legislature has in the past taken some positive steps, such as the enactment of the 1994 Act 2 incentives. The Act 2 incentives have helped retain as well as attract industry investments to the State. However, conditions have changed since those incentives were adopted thus requiring new ideas and new approaches to the problem.

First, however, we need to appreciate that the bust or downturn we are experiencing today is fundamentally different than the prior boom-bust cycles. For example, the problem in the 1980s was basically a matter of too much crude oil on the market. Supply exceeded demand and forced the price down.

Today we have a similar excess supply of crude oil exacerbated by the downturn of the Asian economy, which has robbed the industry of a major market. As a result, there is an excess supply of both refined products and crude oil. Margins on gasoline are razor thin at a time when the refining industry has had to invest in major environmental and fuels manufacturing upgrades. No longer does the downstream carry the upstream through these cycles, or vice versa, when margins at both ends of the industry price pipeline are so thin. It is not unusual to find gasoline selling for 78 cents per gallon. After subtracting federal and state taxes, you have gasoline selling for 40 cents a gallon. I challenge anyone to purchase bottled water, milk, soft drinks or any other liquid in a one gallon size for that price--it can't be done.

Other conditions are also different. The downturn in the industry, as well as the downturn in parts of the world economy, has dried up investment dollars. The only investment funds come from cash flow. With oil selling for about what it cost to find and get out of the ground there is little, if any, cash to invest in new projects.

Knowing these things helps to understand the problem. But, knowing the facts does not take away the pain being caused by the downturn. My company is reducing its worldwide exploration and production workforce by 1,000 people. In my office building where I work in New Orleans, the staff is being reduced by 161 people. Many of these individuals voluntarily elected to retire at this time but many did not and were involuntarily separated. These are very difficult decisions for everyone involved. These are good, dedicated, and talented people. If they had not been, they would not have been in the industry in the late 90's.

The oil and gas industry is not what it used to be. The industry today is much leaner and more efficient than it was in the 1980's. Technological advances have helped the industry be more efficient. Today when we pursue a new project, we will ask ourselves, how low can crude oil prices drop and not how high will they go. Back in the 1980's we made cuts--severe cuts. Because of that, there is less to cut today, making the problem that more difficult to solve. If we cut the fat in the 1980's, we are cutting to the muscle and bone today.

The industry was preparing for a downturn. We knew it would come. We just did not know when. We also did not know that it would be as devastating as it has been. No one expected oil prices would drop to \$10 a barrel.

To give you an example of how bad conditions are, if you compare the value of oil to the value of the S&P 500 index you will see that the value of oil has dropped by 94 percent since 1980. Conditions are dismal.

To bring the matter a little closer to home, imagine yourself in the following scenario. Your annual income has been cut in half. There is no immediate prospect that it will improve. You still have to pay your mortgage, your other bills and provide food for your family. You have to put off needed repairs to your house because the cash isn't there. You find out your property taxes are going up and new government regulations will cause you to remove a tree near the sidewalk, replace a fence or undertake some other project you just cannot afford.

The oil and gas industry is facing the same problems. Our revenues are down 50 percent or more. We still have operating expenses to pay. Our property taxes have increased. We have to postpone new projects, because the money is just not there while we are forced to undertake other mandated but not really necessary activities.

The problems are not limited just to the production segment of the industry. The refining segment, which has an \$8 billion economic impact on this state, is facing stagnation. This is because of sometimes excessively burdensome regulatory requirements, which often prevent refineries from making improvements that will grow the business and create new jobs. We need a policy that understands and recognizes that oil refining and petrochemicals are extremely important to our state. We must not do anything to harm these industries. Yes, we can demand good environmental stewardship based on good science and reasonableness. But we must provide a climate that will not discourage or prevent future growth.

You may hear that there is not much oil left to find in Louisiana and that the industry is leaving anyway, so why do anything to help them. That would be a myopic point of view. When looking at the whole picture you will see that Louisiana has a definite connection with the Gulf of Mexico, which is the only domestic frontier available to the oil and gas industry. The offshore industry has a \$3 billion annual impact on the state economy.

The industry employs approximately 10,000 Louisiana residents in the offshore area. The offshore does business with more than 4 percent of all the businesses in the state. The state must recognize that it has a partnership with the offshore industry in the Gulf of Mexico and must work to keep that industry centered in Louisiana.

I know I have spent a lot of time telling you how bad conditions are in this state. I did this so you can fully appreciate how imperative that some type of relief or assistance is provided to the industry. We have given this serious thought and are cautious in appearing to ask for anything let alone too much. When times are good in the “oil patch” and some policy makers have a bullseye on our industry, we ask to be left alone and ask that policies impacting our industry be predictable, reasonable and consistent so that we can attract as much investment to our region as possible.

When times are tough, like they are now, we need to be consistent in our policy approach. The following suggestions, which other speakers today may address in greater detail, are policy areas where we may be able to find solutions that benefit everyone and build off of our existing policy of oil and gas development to create a stronger environment in the future for investment in our state. Many of these proposals may benefit the smaller independent more than the large or “major” oil and gas companies but a healthy industry in our state and country, independents and majors alike, is good for everyone. One of the strengths Louisiana enjoys is a great working relationship between these two critically important segments of our industry.

The State should consider:

1. A graduated severance tax system, which would respond to changing oil prices.
2. The ability to shut-in all production on a state lease without risk of losing the lease, until price recovers.
3. Examining rental and royalty requirements for new leases.
4. Encouraging the Louisiana Tax Commission to roll back its 27 percent increase in ad-valorem taxes on oilfield equipment would certainly help.
5. Addressing the taxation issues regarding lease use and plant use gas.
6. Modifying the Act 2 incentives regarding depth requirements for new wells.
7. Establishing a trigger point at which the severance tax on incapable wells is suspended.

The oil and gas industry is an important part of this economy. Look at what other states have done to attract jobs of the caliber that we already have. Look at what Tennessee did to attract the auto industry. We are a well-established industry in Louisiana but we are in the midst of a fragile rebuilding. Help is needed. Consistency and predictability are needed. A healthy business climate, a flexible tax system and recognition of just how important this industry is to this state will go a long way to helping the industry weather this and future storms.

Again I want to thank you for the opportunity to be with you today. The Louisiana Mid-Continent Oil and Gas Association stands ready to work with you in developing the details for any of the suggestions we have outlined today.

If you have any questions, I would be happy to answer them at this time.

Thank you.