George Gibson - Attorney, Bois d'Arc Operating Corporation

Thank you, sir. My cup runneth over. My second opportunity today to address the Board. Mr. Chairman, Madam Chairman, Mr. Secretary, Ladies and Gentlemen of the Committee. I have the honor to represent this little company called Bois d'Arc. They have several companies and several names but it's basically Bois D'Arc Operating Corp. They, for some years now, have focused attention on operations in the State waters primarily and the shallow waters in the federal area across the line but mostly with state leases in the State bays and open waters in the Gulf. While we can't give you the viewpoint of different types of operators we felt that we had some thoughts that might be useful for you to use in your studies. These are based on actual experiences of this company and I'm authorized and instructed to appear for them. I also feel certain that the remarks that I make have the approval and support of my other primary client. That's, Jack, as you know, one that you can bill every month, Comstock Offshore. But, first place, there's not a great deal that anyone can do about the price that we get. Now, Jim Porter had this excellent idea of selling this " HOP" program. Wouldn't that be wonderful but I have enormous respect for the work that you're doing. Even so, I don't believe that you have the power to get those prices up. If you could, I'm sure you would have done so already, not wait until now. And, second, there's a lot of discussion of what needs to be done for marginal wells and so forth. Right now, with the price where it is, just about every well is marginal, to tell you the truth, but in the areas where Bois d'Arc operates, in the coastal waters, when a well gets down to say 50 barrels a day or 500 MCF a day, it's a marginal well because of the enormous cost of transportation, operation, and so forth. So many, many wells that you wouldn't think of as marginal wells are actually marginal wells today. Now, not being able to do anything about the price of oil or gas, maybe we can do something about the cost, though, that these operators incur and I wanted to briefly mention several things that Bois d'Arc has experienced. One thing, to start off, it's not often mentioned, but ad valorem taxes. It is a fact that the vast majority of this type well in the coastal waters becomes marginal after about 5 years of production. The taxes, though, are based on a life of about 25 years. Ends up, you are having towards the last, the end of the really productive life of a well, with an enormous ad valorem tax burden which just could be 25 - 30% of the operator's net income from the well. We would suggest that there should be some relief there by placing some sort of reasonable cap on the amount that that tax could rise to, and it's further aggravated by the fact that the tax is based on the value last year and last year the well was, unfortunately, better than it is this year. The next thing is that there are certain fees that are charged. These are not great but I throw it in just to complete the record. You've got a DEQ fee of $2000 for each discharge permit ever issued. You've got a $2000 fee charged, I believe, I'm not sure, it's for the gill, the net deal, or whatever it is. Every year it seems like every lease whether it's 5 acres or 5000 acres or 500 acres, costs you $2000. A right-of-way, $2000 every year. Now, here's one that really, really stumps me. I believe, a year or so ago, the DEQ banned the discharge or dumping of drill cuttings in the open waters and now operators, such as Bois d'Arc and Comstock, are required to capture those drill cuttings and transport them to an improved disposal system. That doesn't sound too bad. It sounds like good government but, you know, that the average cost of this average well we're talking about, say a 10,000 foot well in the coastal waters, drilling costs are about $680,000. Do you know how much this cost for the new disposal of these drill cuttings amounts to? $170,000 per well. What is that? 20%? An additional cost on those wells. Then we have, I ought not complain, because maybe the school children benefit, we have sales tax. Roughly 8% on all your costs of drilling. Then we come to severance tax and royalties. Well, I don't know what can be done. We've heard a lot of good suggestions here today and I certainly think that Bois d'Arc and I would endorse them and commend those folks for bringing them up. Let's look at, just for comparison purposes, let's look and see, out there in the shallow waters, oh what, 35 feet, right across the 3-mile line in the federal waters, you can have a well and then back on State waters you can have a well. Identical in all respects - 10,000 feet, drilling to the same Miocene sand, what have you. Just look at what it would cost you. Well, I think first, what you want to see the operator having to deal with. First, considering just the royalty and the severance tax. We start off with 100%. Well, knock off 21% right off for the State well because that's the royalty average we've experienced at Comstock, I mean at Bois d'Arc. That brings it down to 79%. Over on the federal side, the royalty's 16 and 2/3's, that brings it down to 83 and 1/3. Then severance tax, 12.5% of the 79% is about 9.875. That reduces the take to 69.125%. Now, he's got, this operator has got to pay for that well and everything else out of that 69%. On the Federal side, there's no severance tax. He's getting 83 and 1/3% compared to 69.125%. Now let's look at an example and to show you that these oil and gas people are eternal optimists, thank goodness. I guess that's why I want to keep being involved with them. They keep me young. They rigged this example up for me using a price of $15 a barrel. Isn't that wonderful? It doesn't distort this example, it's just a hopeful gesture. We're talking about this typical well, 10,000', 35' water depth. We're talking about a well that produces over a period of 5 years, 500,000 barrels of oil. Let's look at the cost then of this well. On the State side, the drilling cost is $680,000. The Federal side, the same thing. It's only a thousand feet away. Cuttings disposal - State side = $170,000; Federal side = $0, they don't require it. Completion cost - State side = $600,000; Federal side = same $600,000. Mud disposal - $10,000 State side; $0 - Federal side. Facility cost - $2 million on both sides; so it balances out. Sales taxes - State side = $276,800; Federal side = None. Add and subtract and you come up with this figure. The well on the State side cost $3,736,800. That same well a thousand feet away cost $3,280,000 or $456,800 less - the same well, same conditions, everything but just a few feet away. Now let's look at the revenue strain. State side, gross revenue 500,000 barrels over this five year period at that beautiful figure of $15. They thought maybe it would be even more than that before the five years runs out but they are eternal optimists, thank goodness. But both sides, $7,500,000, State and Federal. List the royalty - average - State 21, Federal 16-2/3. That royalty amounts on the State side to $1,575,000; on the Federal side $1,250,000. Severance tax - State side $740,625; Federal side - $0. At this point, we come up with net revenue then of State side of $5,184,375; Federal side is $6,250,000. Now, let's look at this ad valorem tax. $25,000 a year or rather – no $50,000 average a year; $250,000 on the state side; $0 on the Federal side. The DEQ fees - $10,000 on the State side; Federal side $0. The other State fees - State side $10,000; Federal side $0. The remaining revenue: State side $4,914,375; Federal side $6,250,000. The field operating costs are all the same, both sides. It's just a thousand feet, a few feet away from each other, these wells but that's roughly $900,000 on both sides. And that reduces the net revenue to the operator - State side $4,014,375; Federal side $5,350,000. You deduct the cost which we've seen above and you come up with a profit then for the operator on the State side of $277,575.00 compared to Federal side, the same well 660 feet away, of $2,030,000. That's a 7.4% return on the State side. A 63.1% on the Federal side. These folks are optimistic that things are going to get better and I really believe that myself. I think that this industry still has a long and active life in this State. I know that the majors are looking for elephants elsewhere but we're still very successful at rabbit hunting here in the State waters and the State lands and I think that we ought to keep trying. I don't want to give up. I believe that there's little we can do about the price but there are things that can be done to help us curb these costs other than firing people or letting them go. That's the harshest way of doing it in this world. But if we could modify some of these heavy charges of taxes and royalties and fees – anything along that line would be a boom to the industry. Now I can't speak for the industry. I yield to the gentlemen from LIOGA and Mid-Continent because they do speak for the industry and speak well for the industry, and I endorse what they had to say. As a matter of fact, I used to sometimes be a speaker for Mid-Continent. I worked a long time for Amoco but since then I found out that there is life beyond Amoco. I don't know if there's Amoco life beyond George, though. When I retired from Amoco fifteen years ago, a friend of mine said, "George" – and I told him I was going to hang up my own shingle – he said, "George, I know you're going to do well" but he says, "I'm really fearful about Amoco". Now look, there is no more Amoco. Thank you very much.