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Testimony to the Joint Committee on Energy and Environmental Policy

Comments on Pending Federal Energy Legislation Oil & Gas Producers and Refiners Perspective

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Good morning Chair McGinn and members of the committee. I am Edward Cross, President of the Kansas Independent Oil & Gas Association (KIOGA). KIOGA represents the interests of independent oil and gas producers in Kansas. With over 1,400 members from across the entire state, KIOGA is the lead state and national advocate for Kansas independent oil and gas producers. Our members account for 86% of the oil and 63% of the natural gas produced in Kansas. I am responsible for public policy advocacy and interaction with external stakeholders including elected officials, regulators, governmental decision-makers, and community thought leaders. I am here this morning to comment on how pending federal energy legislation will impact Kansas oil and gas producers and refiners.

Introduction

Over the past year, the Kansas oil and gas industry has experienced a roller coaster ride with oil and natural gas prices. However, our industry is facing more complicated issues than price shifts alone. Our biggest challenges are now coming from the federal level. We are straining to adjust to a host of potentially harmful issues that raise pointed questions about our industry's future. Federal tax proposals seriously threaten independent producers by attacking virtually every tax provision that encourages investment in American oil and gas development. In addition, proposed climate change legislation discriminates against U.S. refiners creating a competitive advantage for overseas refiners which could be followed by the export of refining

capacity and jobs. These proposals put development of American oil and natural gas in jeopardy.

The White House and Congress wants to move away from oil dependence and emerging policies emphasize conservation, alternative energy sources, and new limits on the emissions of greenhouse gases they believe are contributing to climate change. Our nation needs all forms of American energy for the future, but the transition from fossil fuels to viable alternative energy sources will be much slower than is commonly assumed by the public and promoted in political advertisements.

KIOGA sees the federal oil and gas tax proposals and climate change proposals as serious and devastating threats to our industry. I have visited with the Kansas Congressional delegation and 11 other oil state Democratic Senators in three separate trips to Washington last July, August, and September. I was able to discuss the role of independent producers in the U.S., the need for tax policy that supports American oil and gas development, and the importance of small businesses that produce American oil that offsets the need for foreign oil. The meetings have been very productive and welcomed by the policymakers who indicated the perspective of the small independent producer is often missing in Washington.

Federal Oil & Gas Tax Proposals

Last May, the Obama Administration formally submitted their FY 2010 budget request that targets independent oil and gas producers with higher taxes. America's independent oil and natural gas producers produce over 80% of American oil and natural gas and drill over 90% of new American wells. In Kansas, independents produce 92% of the oil and 63% of the natural gas. The Administration's request terminates tax provisions critical for the independent oil and gas industry. Nowhere will the impacts of terminating these tax policies be more devastating than in marginal well states like Kansas. The Administration's request to repeal the current oil and gas tax provisions would have an estimated \$3.9 billion negative impact on the Kansas economy within four years of enactment. In addition, the Kansas oil and gas industry would lose 30% of its workforce and state and local governments would lose an estimated \$210 million in production taxes.

Many in Washington refer to these critical oil and gas incentives as "subsidies". The oil and gas tax provisions are not subsidies but incentives realized for the most part by small independent oil and gas producers. Historically, independent producers reinvest over 100% of their cash flow from the production of oil and natural gas back into new exploration and production ventures. In general, small independents do not tap equity markets or use other corporate measures to raise capital. The proposed tax increases would directly reduce the amount of cash available for energy exploration and would provide a disincentive for capital sources outside of the energy industry.

The assertion by the Obama Administration that tax provisions intended to help oil and gas companies recover their costs have resulted in "overproduction of oil and gas, and is detrimental to long-term energy security" runs counter to any logical national energy policy. The President's proposed action on oil and gas taxes are based on academic notions that simply

do not apply in the real world. America needs all the energy it can get and would be hurt by higher taxes that would constrict supplies, cause energy costs to increase, and kill jobs. Such policy prescriptions suggest that Americans must make an unwise and unnecessary choice between green energy and traditional oil and natural gas. Americans will need all energy sources in the future and such false choices only hurt workers, businesses, and the economy. According to the U.S. Energy Information Administration (EIA), America relies on fossil fuels for 83% of its energy and will continue to do so for many decades. With proven alternatives still years away, now is not the time to adopt tax policies that discourage the exploration and production of oil and natural gas

The U.S. Senate Finance Subcommittee on Energy & Natural Resources held a hearing on the oil and gas tax provisions of the President's FY 2010 Budget Proposal on September 10th. I submitted written testimony on behalf of KIOGA to the committee underscoring the stark reality that these proposals are anti-jobs, anti-consumer, and anti-energy. I also described how the proposals would depress investment in domestic oil and gas projects, weaken the nation's energy security, and make it more difficult to achieve economic recovery. The September 10th hearing saw Senator Jeff Bingaman (D-NM) (Subcommittee Chair) open the hearing by stating the he would be very concerned by any tax law change that impacts economies in oil and gas producing regions.

A 2009 poll found that 61% of Americans who voted in the 2008 presidential election support access to American oil and natural gas resources. At a time when other countries are providing incentives to develop their own energy resources, the U.S. is the only country actively discouraging it. The U.S. oil and natural gas industry employs over 9.2 million workers. Saddling the industry with additional taxes would likely drive these jobs overseas at a time when America needs to create jobs. There is a better way than saddling a troubled economy with new taxes that hurt consumers and workers. The oil and natural gas industry should be allowed to develop our nation's vast resources. It would improve America's energy security, create jobs, and increase federal, state, and local tax revenues.

Climate Change Proposals

Last June, the U.S. House of Representatives passed the American Clean Energy and Security Act of 2009 known as the Waxman/Markey climate bill. Waxman/Markey sets up a program forcing businesses to buy allowances for carbon emissions. Earlier this month, Senators John Kerry (D-MA) and Barbara Boxer (D-CA) introduced the Clean Energy Jobs and American Power Act or the Kerry/Boxer climate bill. The Kerry/Boxer bill looks much like the House bill. Kerry/Boxer is harsher than the Waxman/Markey bill in that it calls for a 20% reduction in emissions by 2020, instead of the 17% Waxman/Markey target. The Kerry/Boxer is incomplete in that it does not mention specific emission allowances. There are a number of place holders in the bill for emission allowances. Agriculture, manufacturing, coal, and a variety of other industries have expressed strong preferences for changes in their share of the potential handouts. If the Senate follows the same disproportionate distribution of emission allowances as the House, refiners will be allocated emission costs for fuel consumption. According to API studies, the cost to refiners would be so great that it would restrict U.S. refining capacity. EIA estimates that prices for gasoline and diesel could rise above \$5.00 a gallon.

The Kerry/Boxer bill would establish a steadily declining cap on emissions more aggressively than Waxman/Markey during the early years of its implementation, mandating an 83% reduction by 2050. As a result, the bill would force the economy to use less fossil fuel energy. Fossil fuels currently provide about 83% of America's energy needs. Strong energy demand driven by growing population will crash headlong into declining supply of emission allowances resulting in sharply rising energy costs. The EIA estimated that Waxman/Markey type legislation could force U.S. households to pay as much as \$1,870 more for energy.

Waxman/Markey style legislation could destroy jobs. EIA and others have estimated well over 2 million jobs could be eliminated as a result of Waxman/Markey style legislation, even when considering the creation of substantial numbers of green jobs.

Kerry/Boxer and Waxman/Markey bills discriminate against U.S. refiners by failing to include provisions leveling the playing field for U.S. refiners versus their foreign counterparts. As a result, competitive advantage would shift overseas, which could be followed by the export of refining capacity, jobs, and emissions. U.S. refinery production could plummet by as much as 25% and investment in U.S. refining could fall by as much as \$90 billion, a decline of 88% by 2030. Imports of refined products, such as gasoline, could double as a percentage of fuel use. For Kansas Independent oil and gas producers, the loss of Kansas refining capacity means a loss of market for Kansas crude oil.

Kerry/Boxer and Waxman/Markey bills could increase the costs of energy. They would also eliminate jobs; drive many overseas; increase our imports of gasoline and other fuels; undermine our energy security; and shift emissions abroad, reducing expected environmental benefits. The ability of the Kerry/Boxer or Waxman/Markey bills to succeed is tied to their ability to increase the cost of energy at all stages – from discovery, to production, to consumer end-use. The bottom line is that the Senate and House cap-and-trade bills would result in less energy for those who need it, and more expensive energy for those who can't afford it. And if less American energy is produced, the result will be higher prices for consumers, increased reliance on foreign oil, and many fewer jobs for hard-working, middle-class families.

Conclusion

The real showdown over energy legislation will probably occur in November. The main problem for proponents of energy proposals is that the legislation represents a great deal of additional government spending and economic hardship. While proponents claim the costs will be borne by corporations or will be compensated for by new job growth, that sentiment is not reflected in opinion polls. According to Rasmussen reports, 53% of Americans said more government spending will hurt the economy. Also, only 42% of U.S. voters believe human activity is the cause of global warming. What this means is that a sizeable number of Americans are not positively receptive to the present legislative prescription. In fact, 42% of Americans believe that Waxman/Markey type legislation will harm the economy.

Thank you for your time and consideration. I stand for questions.