

What an Independent Looks for Outside of the USA

presented by GM Yates

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Introduction

Good morning. It is an honor and pleasure to join you here in New Zealand today. The country that many are describing as a place of real opportunity, with large potential natural resources and an excellent investment climate.

I am an independent oil and natural gas producer from the state of New Mexico and the chairman of the Independent Petroleum Association of America (IPAA). This organisation represents the interests of 8,000 independent oil and natural gas explorers and producers in the United States.

I have been asked to speak about the United States independent and what the United States independent looks for in choosing an international opportunity. I am taking the license of focusing on those independents that are not yet involved in international exploration but may be candidates for doing so. This is a subject I have experience with and I am delighted, as always, to share my prejudices. In this talk I will take advantage of my experience and will, from time to time, compare our United States system to yours or to the ideal - the United States is after all, from the New Zealand perspective, the primary competition for investment, and the standard of comparison, when our focus is on United States independents.

IPAA and its Members

We drill 85% of the exploration wells in the United States. We produce half of the oil and two-thirds of the natural gas in the United States.

Our members range from small family owned companies to large public multi-nationals and lots in-between.

Since the larger companies are already international and have largely chosen areas of interest, I will focus on the traditional (small to medium size) United States independent of which I am probably representative.

IPAA's business is to help influence the development of United States policy as it affects our members which, with my international experience, gives me a perspective and basis of comparison to other systems which are necessary to attract oil and gas investment.

As I deal with policy issues in the United States, I spend a lot of time communicating a theme of competitiveness to my members and to policy makers explaining that we live in a global market - not only for oil but for capital - and that the domestic industry competes with every other country for exploration and development dollars. In order to fund domestic opportunities, we need a domestic environment that is at least as friendly to investment, relative to the risk/reward of those opportunities, as other oil producing countries. It is, of course, that competition for capital that we are talking about today.

What are the Characteristics of the United States Independent?

As a group, and independently, they have courage, spirit, and grit - this is perhaps the clearest definition of the United States independent and the reason that I am so proud to represent them.

They are independent, self reliant and resilient. They have been tested by hard times and have survived. Do a lot with a little. Watch their overheads and costs. They are opportunity driven and very entrepreneurial. They often have a regional or basin orientation.

They often have established a "niche" or "unfair advantage" which is central to their business strategy. It may be technology - 3D, directional drilling. Or a focus on a particular geologic setting

They are comfortable with and have integrated the latest practical exploration technologies into their exploration efforts. After years of hunkering down with exploitation strategies, they are ready to start exploring again. And, a large number of independents have a real interest in participating in international projects.

An IPAA survey shows 25% want to become international within five years. The reason - the United States is perceived as being less hospitable to their operations. And, a perception - an accurate one, I believe, of opportunities with upside reserves and economics which would be uncommon in the United States. Interest in international activities is so strong within our group that we have established an International Committee (with Bruce Vincent as Chairman). But, many independents are quite low on the learning curve and need to develop a better understanding of and comfort with the kinds of things we will talk about today.

What Factors Drive the Decision?

Good Geology

Good geology not only including reservoir rocks, seals, source, and traps but also geology that is familiar - that we can stretch our niche to include. Play and prospect characteristics that allow the use of any "unfair" technical advantage.

With reserve potential relative to risk that are a significant multiple of what is available at home.

Fundamentally, the only reason to become international is to grow reserves more rapidly and dramatically.

But good geology isn't something that can be controlled by a country (although geology is interpretive and ultimate evaluation is achieved by engaging the maximum number of independents in the exploration process). But aside from geology, there is a great deal that can be done to encourage the exploration process.

Country Risk

This is very important. Independents can generally accommodate geologic risk, which we are used to, but not country risk, which they have not, until recently, been subject to in the United States.

A strong case can be made that there are many countries that carry less country risk to oil and gas investment than does the United States.

Petroconsultants, Inc did a study of 99 countries and ranked them in order of political and business risk in the petroleum industry. Most of the Western European countries ranked among the top (meaning almost no political risk).

I congratulate New Zealand on having very little country risk. It ranks in the top 10% (seventh) of countries worldwide.

In contrast, my own country (amazingly) ranks 31. The United States' poor showing is primarily because of environmental activism, restrictions on drilling, and the fact that our government applies new rules retroactively from time-to-time.

Regulation in the United States and the Need for Reform

There are people and groups who want nothing less than to limit the production and use of fossil fuels. They are using and will continue to use the regulatory system to further that end.

The United States petroleum industry spends a great deal of money on complying with United States regulations. According to the American Petroleum Institute, the United States oil and gas industry spent \$10.6 billion on the environment in 1996, or nine cents for each gallon of gasoline Americans buy. That number is nearly twice the annual budget of the United States Environmental Protection Agency (EPA). Not that I want to see the EPA's budget increase but it has increased dramatically - even under our conservative congress. The Center for the Study of American Business at Washington University in St. Louis reports that federal regulatory agencies saw one of their biggest increases in fiscal 1997. The EPA's budget increased by \$1.3 billion, or 32% after inflation. The regulatory environment in the United States is getting worse!

To illustrate my point about the United States system, I present the following quote from an article on the growth of Federal Regulations which observed that the Lord's Prayer is 66 words, the Gettysburg Address is 286 words, there are 1,322 words in the Declaration of Independence, but government regulations on the sale of cabbage total 26,911 words.

Fiscal or Country Terms

Country terms include terms of licensing as well as tax systems relative to the oil and gas industry. In order to attract foreign investment, fiscal terms have to be competitive relative to perceived risk and economic return.

Fiscal or Country Terms – Van Meurs Study

You may be interested in a recent study of country fiscal terms worldwide that was conducted by a Canadian energy-consulting firm Van Meurs Associates and published by the Association of International Petroleum Negotiators.

Van Meurs and Associates' study ranks world fiscal systems in terms of their oil investment favorability. The systems in the study are rated on a star system from most favorable to least favorable.

How does New Zealand stack up relative to the United States and to the rest of the world? New Zealand has a four-star fiscal system and ranks 58th among those countries with four-star systems. That means this country's fiscal terms are top-rate.

Let's compare New Zealand's rating to state ratings in the United States. My home state of New Mexico is ranked 138th, and one of our biggest oil producing states, Texas, is ranked 180th.

One of the reasons for the poor Fiscal Terms rating is the United States tax system.

Tax Systems

Many countries with substantial resources have tax systems, which encourage the explorationist through good capital recovery programs and substantially lower tax rates at the margin than the United States. For instance, no country with which I am familiar including New Zealand has an Alternative Minimum Tax.

The United States is by no means the most hospitable place in the world for oil and gas producers and that is why a quarter of America's independent producers intend to be exploring overseas within five years.

New Zealand is in a good position overall to compete in those areas that are most within the control of New Zealand - Country Risk and Country Terms.

The recent reform of New Zealand's petroleum law when combined with its low Country Risk status means that those issues are neutralised and other real issues, such as geology and economics, will drive the decision to invest.

Markets

- Available markets for both oil and gas (especially natural gas)
- Price at the wellhead
- Time to market, particularly in the case of gas
- Data
 - Is there a good database of seismic and well log data?
 - Is this data available at a reasonable cost?

Independents are generally much more concerned than are the largest companies, about those issues that control timing - length of time to bring a play concept to a prospect status then to a drillable status, and the length of time from drilling to cash flow.

Infrastructure

Is there a drilling and service industry. If not, what are the costs of mobilisation and related services?

And finally, a very subjective criterion, is there good fly fishing?

All of the above criteria (except the last one) are part of any independent's economic and risk/reward calculation, no matter how informal or subjective.

- Where am I exploring and why?
- Onshore Europe
- Country Risk/Country Terms
- Proximity to markets - excellent gas markets
- Familiar geology (to a degree)
- Exercise of unfair advantage
- Competitive factors - onshore Europe has been dominated by national companies and to a smaller extent, major companies which means data. But significantly, giant companies weren't focused on our play areas.

Like Jack and the beanstalk, when competing directly with the giant companies, one tiptoes around the sleeping giant and then runs like hell for the beanstalk.

Although focused on Europe, my international staff has long talked about New Zealand and so, this country is definitely on the list and I can feel the opportunity.

Conclusion

Finally, let me be a little philosophical.

Our markets and prices are driven by economic growth. Economic growth also means a growing standard of living for our fellow citizens - in effect, what is good for our economy and people worldwide is good for our business and we should feel really good about that. We as oil and gas producers supply the energy for growing economies everywhere.

The trend towards economic freedom in the world and liberalisation government policy (part of the same trend) is fueling growth in our markets and presenting opportunities, world wide - right here in New Zealand, for instance - for the independent producer. New discoveries by independents will meet the growing demand for oil in the next century.

We are the innovators, the entrepreneurs and we will continue to be the leaders in this global industry. I believe that this is a tremendously exciting time to be an oil and gas producer.

Thank you for your interest and thanks especially to the organisers of this conference for including me.

Author

George Yates, Independent Petroleum Association of America's (IPAA) Chairman, was born in Artesia, New Mexico. He attended high school at the New Mexico Military Institute in Roswell, and graduated from the University of Texas at Austin with a degree in Business Administration in 1969.