

# THE AMERICAN OIL & GAS REPORTER®

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## VISION 2020

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**Kenneth White**  
Chairman KIOGA  
"Any savings from  
lower tax rates in our  
industry usually go  
back into the ground."  
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**Robert Osborne**  
Chairman  
Texas Alliance  
"The state can  
handle regulatory  
matters more  
efficiently than the  
federal government."  
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**Gary Bible**  
Chairman TOGA  
"Oil markets have  
firmed. Tennessee  
has plenty of oil, if  
we get the prices  
needed."  
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# Tennessee Operators Poised For Market Turnaround

By Dan Larson  
Special Correspondent

KNOXVILLE, TN.—While the state has seen a modest increase in drilling activity this year, most oil and natural gas companies operating in Tennessee remain on the sidelines while keeping an eye on the market, according to industry leaders.

“Our members tell us they are waiting for \$70 a barrel before they can start drilling and returning shut-in wells to service,” says Chuck Laine, president of the Tennessee Oil & Gas Association.

“We had a cold winter in New England, which should be good for natural gas prices, but there is such a massive amount of gas coming from the Marcellus that prices for Tennessee gas did not budge all winter,” reports TOGA Chairman Gary Bible, president of Cougar Dome LLC, a geological and GIS consulting firm in Helenwood, Tn.

As TOGA prepares for its annual convention faced with the “new reality” of an oil market priced just below an economic level and a gas market that rebuffs Tennessee exports, association leaders say they continue to act on important issues in the state capitol and to serve the interests of members.

TOGA’s 47th annual meeting is scheduled for May 7-8 at the Park Vista Hotel in Gatlinburg, Tn., Laine notes.

Among topics for discussion is an effort to reallocate severance tax distribution, re-energize the state’s orphan well program, and continue guiding revisions to well bonding rules for landowners through the rule-making process.

Laine says the impact of a prolonged depressed commodity market on Tennessee’s oil and gas industry will be felt for months to come.

But Bible, who is wrapping up his third year as TOGA chairman, says he remains optimistic. “We have weathered the worst of the downturn. Oil markets have firmed this year and Tennessee has plenty of oil, if we can get the prices needed to justify drilling wells,” he observes.

## TOGA Annual Meeting Gatlinburg, Tn.

### Monday, May 7

- 3 p.m. Registration Opens, Upper Level, Park Vista Hotel
- 3:30-4 p.m. TOGA Board of Directors & Membership Meeting  
Hosted Bar
- 6-9 p.m. Loco Burro Hosted Dinner

### Tuesday, May 8

- 8 a.m. Registration Opens
- 9-10 a.m. Technical Session  
Welcome Message, Chuck Laine, TOGA President  
Tennessee Legislative Update, State Representative John Ragan (Invited), R-Oak Ridge
- 10-10:15 a.m. Coffee Break
- 10:15-11:45 a.m. Technical Session  
Regulatory Update, Mike Burton, Tennessee Oil & Gas Program  
“Improving Structure Contour Maps: Regional Structural Elements of the Nashville and Jessamine Domes using Automated GIS Tools,” Kenneth Boling, University of Tennessee Knoxville
- Noon-1 p.m. Awards Luncheon  
Presentation of TOGA Godfather Award
- 1:15-2:45 p.m. Technical Session  
Tax Law Update, Kevin McCollum, Coulter & Justus PC  
Topic to be Announced
- 3 p.m. Dismiss

## Annual Report

In its annual report on the industry last year, the Tennessee Oil & Gas Program, an agency within the state’s Department of Environment and Conservation, notes that permitting activity in 2016 continued its five-year decline and showed a decrease of nearly half from 2015.

Laine says the annual Tennessee Oil and Gas Activity Report is released each year during TOGA’s annual meeting, and the 2017 report will be presented at the TOGA convention in May.

Clearly reflecting the nationwide decline, last year’s report stated, “Tennessee had its third worst year in permitting wells, fourth worst year in oil production, and the least gas production since 2006.”

“Operators were faced with the lowest price of oil since 2004 and lowest natural gas price since 1999,” observes Elaine Foust, a geologist within the Oil & Gas Program.

Permits were issued in only five counties—Overton, Scott, Pickett, Fentress and Morgan—continuing a seven-year trend away from the Cumberland Plateau and toward the Eastern Highland Rim in north-central Tennessee, Foust notes.

In its completion report, the program recorded an overall success rate of 31 percent for all wells tested during 2016, down from the 38-year average of 56 percent.

Oil production in 2016 totaled 256,664 barrels, a decline from 299,650 barrels produced in 2015, Foust reports. The average price in 2016 was \$41.20 a barrel, generating \$10.5 million in sales and \$317,000 in state severance taxes.

Natural gas production in 2016 was likewise depressed, she adds. The 3.6 billion cubic feet produced marked a 25 percent decline from the previous year. The average price was \$2.53 an Mcf, down \$0.21 from 2015. Gas production generated \$9 million in sales—down from \$13 million in 2015—and \$270,000 in severance taxes.

State records show ENREMA LLC of Knoxville was the state’s leading oil producer in 2016 and Knox Energy of Oak Ridge, Tn., was its leading gas producer.

Foust says the state oil and gas database continued to be expanded through 2016 and into 2017, and at the time the report was published held information on almost 16,100 wells. The slowdown in oil field activity allowed the Oil & Gas Program to increase field investigations and catch up on well classifications, she adds.

Foust says permitting activity showed an increase during the first half of 2017, with the state issuing 29 permits compared with 15 during the same period in 2016.

## Good Operators

Both Laine and Bible acknowledge that there continues to be little new oil and gas development in Tennessee.

“We have to become good operators to make money in a low-price environment,” asserts Bible.



"Our limestones produce a waxy crude oil that drops out of solution and plugs the well's permeability," he observes. "This has been a headache for our operators for a while. Once operators settle on a solution to this paraffin issue, there is a lot of crude oil left in our fields."

Bible adds that most Tennessee wells are shallow and less expensive to drill than deeper wells. "The trick is justifying the added cost of managing the paraffin," he says.

Laine predicts that a stronger price this year will result in more activity in Tennessee's oil patch. "Most operators say we have to get to \$70 a barrel before we will see any movement," he comments. "It is getting close and we may see some activity in the second half of the year."

"There is a company doing some work in Overton County, Tn., Laine points out. "It kept drilling right through the depressed price cycle and had success."

He is referring to privately held Hornet Corp., based in Hendersonville, Tn.

Over the past year, Hornet announced the move of its company headquarters to a building in Hendersonville and the acquisition of what it described as highly productive leases in Kentucky and Tennessee. Hornet says it acquired the Wayne Brown lease, a more than 240-acre tract in Overton County that includes the former Brown No. 3 well, which was cited as the most productive well ever drilled in Tennessee before it was plugged a decade ago.

"The Brown No. 3 did not penetrate Middle Ordovician Murfreesboro and Wells Creek formations, nor the lower Ordovician Knoxville Dolomite, which have been large producing formations for wells in the Miller Mountain Oil field," said G.A. Murrell, president of Hornet in announcing the acquisition.

"One of the reasons we acquired the Brown lease is that the producing formations in this lease are stacked, just like in the Permian Basin," Murrell added.

According to the company, the Brown lease and the Miller Mountain Oil Field lie to the south of some of the company's recent oil discoveries, including the Donnie Ray No. 1 and the T.J. Hensley Unit No. 1.

TOGA recognized Murrell with its Muddy Boots Award in 2015 for Hornet's successful drilling program in 2014, and particularly the Donnie Ray No. 1, cited as best well in the state that year by the Tennessee Department of Environment & Conservation (AOCR, July 2015, pg. 166).

## Severance Tax

One of the TOGA's top priorities for the 2018 Tennessee legislative session is reallocating severance tax revenue, Laine says. "We believe 100 percent of the sev-

erance tax money collected should go to the counties from which the production comes," he says.

Currently, one-third of severance tax revenue is returned to producing counties and the remainder goes into the state general fund, he notes.

"The amount collected—about \$450,000 a year—is not a big deal to a state with a \$38 billion budget, but it means a lot to those counties, some of which are on the lowest rung of the economic ladder," Laine observes.

While the amount of severance taxes collected may be considered a drop in the bucket, a fiscal note attached to legislation last year was enough to have it referred to a committee, where it languished, according to Roxanne Reiley, vice president at Laine Communications.

"It is an issue our members feel strongly about," she says. "That additional revenue would impact counties in a positive way and allow our members to be better community partners."

Reiley notes that this year, the bill will be revised to include a three- to four-year phase in. "We are taking a page from how Governor (Bill) Haslam was able to get his gasoline tax increase passed," Reiley remarks.

## Fuels Tax Hike

Reiley is referring to a bill Governor Haslam supported in 2017 that raised the excise tax on motor fuels with additional increases coming in 2018 and 2019. The bill was approved in March 2017.

Known as the IMPROVE Act, the tax increase will help fund a program, that according to published reports, will spend \$10 billion on a backlog of infrastructure projects in all 95 Tennessee counties.

The state's gasoline tax increased 4.0 cents a gallon to 25.4 cents in July, and is scheduled to increase by 1.0 cents in 2018 and again in 2019. The tax on diesel fuel also was increased, according to the reports. In July 2017, the diesel tax went up 4.0 cents a gallon to 22.4 cents, and is to increase by another 4.0 cents this year and next.

The IMPROVE Act allocates more than \$350 million for state, county and municipal road projects and, published reports note, is intended to provide sufficient funding so local governments do not have to use other means, such as increasing property taxes, to pay for improvements.

The act also lowers the state sales tax on food to 4.0 percent from 5.0 percent, and orders a \$5.00 increase in passenger vehicle registration fees, a \$100 increase in electric vehicle registration, and a 3.0-cent a gallon increase in the excise tax on liquefied and compressed natural gas used as motor fuel.

The act cuts the state's manufacturing excise and franchise taxes, and phases out over four years the state tax on interest and dividends, both of which are intended to boost economic activity, published reports note.

"Since Tennessee does not have a personal income tax, everything runs on sales taxes, which are some of the highest in the country," Reiley says. "Tourism is a very important source of revenue, so the governor wanted to lower the burden on citizens while still providing revenue to run the state."

## Passing Grade

Governor Haslam, a Republican, is term limited and due to leave office next year. Laine describes him as a centrist who has led Tennessee to become one of the best fiscally-managed states in the country.

"Governor Haslam is one of the most popular governors in Tennessee history," Laine declares. "He has done some unique things, such as providing free tuition for students in community colleges and technical schools. He found a way to lower taxes in every session and restored the state's AAA bond rating. He increased state services while reducing the size of state government and found a way to raise teacher salaries."

Laine concludes that although the oil and gas industry expected more from a scion of the family that owns Pilot Corp., which operates the largest chain of truck stops in the country, Governor Haslam did not hurt the industry during a period when many states were increasing regulatory burdens on operators.

On the political front, Laine says he expects 2018 to be a busy year with elections for governor, U.S. senator, and four seats in Congress up for grabs. "We will keep an eye on how things shake out, but the association does not endorse any candidate until after the primaries," he adds.

## Well Bonding

With both houses of the Tennessee Legislature under a Republican supermajority, Reiley says TOGA is able to promote an agenda that is mostly "for" rather than "against."

Following legislation to reallocate severance taxes, she says, TOGA's second priority is realigning the state's well bonding structure.

TOGA supports revising the section of Tennessee's financial assurance requirements that applies when an operator turns over ownership of a well to the landowner. Currently, the landowner is required to post a plugging bond of \$500. Reiley says TOGA supports increasing



that to \$1,500 plus \$1.00 a foot below 2,500 feet. At the same time, she adds, the landowner reclamation bond should be eliminated.

"If the well is shallower than 2,500 feet, it is a wash," Reiley observes. "We don't want to see an undue burden placed on our landowners because well plugging is a more pressing issue for them than is reclamation."

For operators, TDEC Rule Section 044-52-01 shows the well plugging bond remains at \$2,000 for a single well drilled to 2,500 feet or less. For single wells drilled from 2,501 feet to 5,000 feet, the plugging bond is \$3,000. Wells drilled deeper than 5,000 feet require an additional \$1.00 a foot plugging bond.

The state allows blanket 10-well plugging bonds on wells drilled up to 5,000 feet of \$20,000. A blanket 10-well plugging bond for wells deeper than 5,001 feet is \$30,000, according to TDEC.

### Abandoned Well Fund

Under a rules revision enacted in 1988, operators are required to post a \$1,500 reclamation bond for each well. That bond remains in effect until one year after the well has been plugged.

Of greater importance for TOGA, Laine says, is protecting the state's plugging and abandonment (P&A) well fund and ensuring it is tapped only for its intended purpose. During the recession in 2008-09, the state pulled money from its abandoned well fund to help shore up its fiscal position, Laine recalls.

"Under the previous administration, the governor's office, with the support of the legislature, raided the P&A fund," Laine attests. "There was about \$2 million in the fund at the time, and they drew it down to almost zero."

The fund was created to operate on interest earned to plug enough wells to eventually reduce the number to a reasonable level, he says.

With few dollars in the fund, the number of orphan wells grew and gave opposition groups ammunition to use against the industry, Laine comments. One published report in 2016 claimed 4,000 wells were on the state orphan well roster.

"It is important that people understand the difference between an abandoned well and one that is shut in," Bible offers. "There are a lot of wells capable of producing that are shut in because of low prices, but the opposition wants everything plugged."

A report by TDEC in 2016 says the state P&A program was liable for 253

abandoned wells covered under a \$400,000 bond held by an insurance company that went into receivership in 2003. Working with new bond revenue from operators who replaced their original bonds, the program plugged 55 wells that year.

Since 2016, the state P&A fund has held about \$700,000, TDEC reports.

Laine calls for new revenue into the fund and "an aggressive program to plug as many wells as quickly as we can."

Unfortunately, plugging orphan wells is "one of those issues that bubbles up from time to time, but does not pick up steam, especially when the economy is doing well," Laine comments.

### Tank Setbacks

The next issue TOGA is working is a regulatory revision that increased setbacks for tank batteries from roadways, Laine says.

"As a safety issue, TOGA did not object to increasing the tank battery setback to 100 feet from the road," Laine allows. "Unfortunately, it did not include a clause grandfathering existing sites that did not pose a hazard to traffic."

"None of this happens casually," Laine suggests.

Reiley explains that the regulatory process involves a review board, public notice and response, possible revision and follow-up review, then a hearing and approval by the administration. Finally, a rule change must pass muster at the legislature's Government Operations Committee, which has the authority to return the entire process to the beginning.

"Any process that lengthily gives the environmentalists plenty of opportunities to take shots at us," she comments.

### Policy Council

Bible says another item on the horizon this year is industry representation on the Tennessee Energy Policy Council, which was created by legislation approved last year.

State Representative John Ragan, R-Oak Ridge, sponsored the bill creating the council, and is a featured speaker on TOGA's convention agenda.

"We are learning more about it now, including how important an energy council is to the state's economy," Bible says. "Not having a council has cost Tennessee business in the past. This puts us in line with other states."

As passed by the legislature, the bill called for creating a council to advise the governor and the general assembly on:

- Identifying state energy resources to ensure a secure, stable, and predictable energy supply;

- Managing energy usage; and

- Increasing energy exploration, development and production within the state to promote economic growth and job creation while ensuring the protection and preservation of natural resources, cultural heritage, and quality of life.

"Our state has three distinct regions," observes Laine. "We have the mountains in the east, the Nashville Basin in the middle, and sand aquifers out west at Memphis."

Each area has access to different energy resources, from the Tennessee Valley Authority and the Oak Ridge National Laboratory, to the oil and gas in the north-central and the technology hub that Nashville has become, Laine says. The 13-member Energy Policy Council will include representatives from each region, and from utilities, the oil and gas industry, consumers and policymakers.

"The next hurdle will be finding a way to fund its operations," Laine points out.

### Annual Meeting

TOGA's annual meeting gets under way on Monday afternoon, May 7, with an open Board of Directors and membership meeting, followed by dinner at Loco Burro, a popular downtown Gatlinburg restaurant, Laine reports.

He says technical sessions on Monday morning, May 8, include legislative and regulatory updates by Representative Ragan and Oil & Gas Board Supervisor Mike Burton.

Also on tap, he mentions, is a report by Kenneth Boling, a doctoral candidate in the Department of Earth and Planetary Sciences at the University of Tennessee Knoxville on methods for automating the collection, processing and integrating of surface and subsurface oil and gas data.

Afternoon sessions include a tax law update by Kevin McCollum, tax principal for Coulter & Justus PC in Knoxville.

A highlight of every TOGA convention is presentation of its Muddy Boots Award. Laine says it is presented annually to a TOGA member who demonstrates the values, hard work and business skills that best represent the state's oil and gas industry.

This year, the honor will be temporarily renamed the Godfather Award and will recognize a long-time member who has made a great contribution to the association. It will be presented at the luncheon on Tuesday. □