KOGA Keeps Supporting Kentucky's Industry

By Dan Larson
Special Correspondent

HENDERSON, KY.–Although pandemic realities have forced them to cancel their group's annual meeting, leaders of the Kentucky Oil & Gas Association are moving ahead with plans to stay in touch with members, at least virtually, and to support their operations as the economy begins to recover.

Over the years, they say, the Bluegrass State has been fortunate to have pro-energy leaders at the capital who appreciate and understand the value of Kentucky's fossil fuel industries, especially during the global health crisis. KOGA leaders say the group continues to monitor and maintain a vigilant watch for issues and opportunities that protect the state's oil and gas industry.

In March and April, KOGA's Board of Directors held virtual meetings on several occasions to consider the coronavirus's wide-ranging industry impacts. "It always gets back to how to best serve our members, whether it's employment and small business loans, keeping track of the legislature or simply a matter of how we can help," reflects KOGA President Mark Hughes, president of Hughes Land LLC in Henderson.

Rolling With The Punches

As crude oil prices dove in early March, Kentucky's Illinois Basin oil producers found themselves looking at prices that were worse than half of February's averages, Hughes observes. On top of that, virus-related restrictions on gatherings of more than a handful of people left KOGA's Board of Directors with little choice: First, it cancelled the spring meeting set for April 8, and then it began to plan for a postponement or cancellation of the annual meeting scheduled for early June. By early May, the association decided that convention had to be cancelled too.

"It really is a perfect storm of factors," acknowledges KOGA Executive Director Ryan Watts. "We are reviewing options for what we can do for our members in the meantime."

The interests of KOGA membership will remain in the forefront, Hughes assures. An independent landman for more than four decades, Hughes notes that commodity prices always fluctuate, but it remains essential for the industry to remain united and able to count on the support of a dynamic trade association. KOGA, he says, has always "stood behind the hardworking producers and service providers operating in the Appalachian and Illinois basins' oil and gas fields."

That made the initial decision to cancel the conventions especially difficult, he says. "Our proactive measures to prevent the spread of COVID-19 shows we stand in solidarity with our commonwealth while being mindful of our members' business needs and constraints.

"Our strong-knit community has survived numerous economic setbacks and tough operating environments," Hughes continues. "It may take some time and an abundance of patience, but we will rebound with a robust, energetic spirit."

An industry rebound will be better supported by operators who plan for market swings and are ready to respond, KOGA's April newsletter points out. Strengthening a balance sheet, containing costs and identifying which operations provide the best margins can help operators weather the storm, it advises.

Similarly, it advises operators to lay the groundwork, including predrilling tasks such as geology, engineering, well design and permitting, to be ready when prices rally.

Meanwhile, Watts reports, KOGA continues to consider a number of initiatives, including a webinar series on topics of interest and the possibility of increasing its newsletters' publication frequency.

Deciding to cancel KOGA's annual convention was a tough call, Hughes admits. Complicating the decision is how the "goalposts keep moving," Watts notes, adding, "We are unsure of when some of the mass gathering restrictions will be lifted."

Kentucky Governor Andy Beshear has been recognized by the national media for his early, aggressive COVID-19 responses, Watts notes, but the absence of key rites of spring still takes an emotional toll. "When the Kentucky Derby is postponed and the NCAA tournament is cancelled, that is a stab in the heart for Kentuckians," he acknowledges.

A Flawed Formula

In the meantime, the association has been helping identify and resolve an issue with state property tax assessments, Watts reports. KOGA stepped up late last year when the state sent operators annual oil property tax bills that relied on a revised formula that significantly increased producers' obligations. For some operators, the increase was enough to negate a full year of oil income, he adds.

"When operators opened their tax bills, they were hit with exponential increases," Watts describes. "The average increase was about 24%. Any increase is difficult in these times, but this was extreme."

Once it ascertained the problem's scope, KOGA sent notices to its members advising them to protect their interests by filing protests with the state's Department of Revenue. The association then held a series of discussions with the department about the revised valuation method.

The root of the matter stretched back to meetings KOGA attended at the department's invitation in early 2018 that considered updates to the state's valuation formula and its capitalization rate, Watts recounts. The 17% capitalization rate and other variables had not changed in many years and both sides agreed on the need for updates, he says.

According to KOGA, participants recognized that the valuation formula, which had been in use for more than 20 years, was designed with the understanding that the input variables would reflect fluctuations in prices of oil and gas and operating costs. Those variables had never been modified, however, and KOGA recognized that the formula's variable needed to be updated to reflect market conditions. However, KOGA successfully convinced the department that the overall structure of the oil valuation formula did not need to be changed. "This better reflected market conditions and minimized the impact of this tax increase," recalls KOGA Treasurer John Henderson.

Unfortunately, when operators saw their oil property tax bills, they learned the department had based its valuations on a 12-year income stream, which sent their annual levies soaring over those of the previous year. "We had lobbied for a seven-year income stream which, under the updated formula, would have increased property tax assessments only slightly," Watts details. "That is why we were surprised when our members started calling us in November about big jumps in their tax bills."

After several discussions this year, KOGA has persuaded the department to reissue tax bills with a revised assessment that better reflects companies' incomes, Watts says. "We see it as an important victory for our producers," he affirms.

The issue has prompted KOGA to request follow-up meetings with the department to consider 2020 oil property tax assessments that will account for impacts associated with current market conditions, Watts says. He adds that operators who have concerns or suggestions about the current tax formula should contact the association.

Bonding Revisions

Other than skewed tax assessments, there has been little of note coming from the state Capitol this year, Watts observes. He recalls that the 2019 Kentucky Legislature revised the state's well bonding rules; now bonds for individual shallow wells are $2 a foot to total depth rather than in 500-foot increments. Deep vertical wells require a $25,000 bond while deep horizontal wells require a $40,000 bond. Blanket bonds are limited to 1,000 wells or fewer with a tiered structure for additional wells.

Midway through this year's session, more than 25 KOGA members gathered in the Capitol for the group's annual day at the legislature. Members spent time engaging legislators and staff in many productive discussions, Watts describes.

KOGA also has spent time during the past half-decade participating in an oil and gas work group that also includes representatives of landowners, regulators and environmental groups. Watts notes that a number of the work group's draft bills have attained broad, bipartisan support in the legislature.

"The group did not have a draft for the legislature this time," he reports. "This is the first time in five years we have not produced one. We would take a strawman bill and, over six months, dissect, analyze, cut and rework it until was something we could agree to send to the legislature."

For its part, the legislature agreed to a truncated budget that covered a single year so it could better assess the economic implications associated with the pandemic. According to a letter published in a Kentucky newspaper by Senate President Robert Stivers, R-Manchester, the one-year budget has been "allocated using the most pessimistic of revenue assumptions" and it "assumes that we will come in hundreds of millions of dollars short of revenue projections as a result of COVID-19's economic impact."

Rogersville Investigation

One item KOGA planned to include at its annual meeting was a session on the recently approved geological investigation into the potential for unconventional development in the Rogersville Shale and related formations.

Announced in late December, the Conasauga Shale Research Consortium project is a multistage effort with a proposed budget of $7.4 million, including $5.9 million in research grants from the U.S. Department of Energy. Led by the Kentucky Geological Survey at the University of Kentucky in collaboration from the West Virginia Geological & Economic Survey and West Virginia University, the project will examine potential oil and gas opportunities in the Cambrian-age Conasauga Group, including the Rogersville Shale, a geologic feature found at depths of 8,000-10,000 feet in what is known as the Rome Trough.

The project is intended to provide a "one-stop shop" for all existing public data and will continue to add new findings as work progresses, says KGS research geologist John Hickman, the consortium's principal investigator. The effort also will include access to completion data analytics and machine-learning techniques from previous wells, Hickman describes.

According to media reports, interest in the Rogersville Shale was re-kindled a few years ago, when a company based out of state leased acreage to drill a pair of exploratory wells in Lawrence County, Ky., near the West Virginia state line. As other

Participants in the Kentucky Oil & Gas Association's 2020 Legislative Day at the Capitol pause in between meetings. The association says more than two-dozen KOGA members spent the day engaging in productive discussions with legislators and their staffs.

operators got wind of the project, some followed suit. In all, six wells were drilled by four companies into the Conasauga Shale by mid-2015, although none proved economic. A recap of the activity in a report by the National Energy Technology Laboratory says all six encountered oil and/or gas during development, but "volumes produced were lower than expected. The play appears to be a technical success; the economics remain to be proven."

The initial interest was generated by a 2002 KGS report, says Dave Harris, head of the Energy and Minerals Section. The operators "were following up on an old report we produced 18 years ago," Harris adds. "We knew it was source rock. We had found an old core from an Exxon well drilled in West Virginia and when we identified the total organic carbon, it matched the hydrocarbons produced elsewhere in eastern Kentucky."

Funding Opportunity

According to press accounts, companies who drilled exploratory wells into the formation agreed to provide data for the new investigation. Although an initial investor lined up by the industry partner has since withdrawn, the company has expressed confidence it can find a replacement by this summer, Harris reports. Once investor funding is secure, the company plans to re-enter one of the two recently drilled wells and kick off a lateral into the formation.

"In the meantime, we are working on tasks that do not require data from new wells," Harris says, noting that in addition to mapping, the project has begun analyzing engineering data from the original wells. "We are looking at what they did and what might be improved on."

The project also draws on the well completion expertise at WVU. "That petroleum engineering department has access to a database of several thousand completions from shale plays across the country," Harris adds. "From there, we can tweak designs and try some new ideas."

Watts adds that the project had the support of U.S. Senate President Mitch McConnell, R-Ky., and Representative Hal Rogers, R-Ky. "This project is a real shot in the arm for Kentucky; the Rogersville could turn out to be our white whale," Watts considers.

Eastern Kentucky production historically has focused on natural gas, Harris notes. Development of shallow wells into the Berea tight sands and Devonian black shales dates back more than a century and the region saw an increase in drilling in the 1970s and the following two decades. Gas wells into the underpressured Ohio shale are productive but generally not as productive as those elsewhere in the Appalachians, Harris details. "Gas volumes were never huge, but they did produce for a very long time," he observes. ❐