PERCENTAGE DEPLETION

ECONOMIC IMPACT OF ITS ELIMINATION

STUDY COMPLETED: 2021

NSWA
National Stripper Well Association

www.nswa.us

INTRODUCTION

Despite the current difficulties facing the global economy, especially due to the adverse impacts of the COVID pandemic on the oil and natural gas industry specifically, the stripper well industry will likely continue to be a major source of energy production, employment, gross domestic product, and government revenues for the United States.

A critical element of that continued success is the percentage depletion allowance.

This allowance is a tax provision that allows oil and natural gas producers, limited to independent operators, to recover some of the investments associated with exploring for and producing oil and natural gas. Landowners also accrue benefits as royalty owners.

Eliminating the percentage depletion allowance would cause an economic ripple effect across the economy because the percentage depletion allowance primarily benefits the nation's smallest oil and natural gas producers and mineral owners; most of whom are farmers, ranchers, and other landowners. Elimination of the percentage depletion allowance would have an outsized impact on these small, economically vulnerable recipients of the allowance.

Energy and Industrial Advisory Partners (EIAP) was commissioned by the National Stripper Well Association (NSWA) to develop a report forecasting activity levels, spending, oil and natural gas production, supported employment, GDP, royalty payments, and government revenue changes if the percentage depletion allowance were to be eliminated.

The information that follows in this report describes who NSWA is, how stripper wells work, as well as a detailed discussion of percentage depletion and the results of the study, both nationally and across the 18 states most directly impacted.

View the 2021 EIAP study at https://bit.ly/3vYYCkc.

TABLE OF CONTENTS

WHO IS NSWA

The National Stripper Well Association (NSWA), founded in 1934, is the only national association representing the interests of the nation's smallest oil and gas operators – and their employees – before Congress and federal agencies. Learn more about NSWA at www.nswa.us.

OUR MISSION

Ensure the critical needs and concerns of producers, owners, and operators of stripper oil and gas wells are addressed regarding federal legislation and regulation.

Due to the high economic sensitivity of our members' operations – greatly exacerbated by the national COVID pandemic in 2020 – primary issues of concern include maintaining the percentage depletion allowance and related tax measures. In addition, and of keen interest, is current or proposed federal regulation of all aspects of small oil and gas operations (i.e., methane emissions).

OUR MEMBERS

With members in 30 states, from California to West Virginia, we are a viable and powerful voice for the American stripper well producer.

- Members of NSWA are the small independent business men and women who own stripper wells producing 15 barrels of oil (equal to 90 Mcf of natural gas) or less per day.
- Our members are the "family farmers" of the United States energy sector.
- The typical NSWA member company employs 11 or fewer full-time employees.

WHO WE ARE NOT:

NSWA does not represent any of the "major" oil companies (i.e., Chevron, Exxon, Shell) or offshore companies.

STRIPPER WELLS

"Stripper Wells" which make up a significant portion of America's oil and natural gas production (i.e., almost 80% of all U.S. wells are strippers) are, for tax purposes, defined as any oil or natural gas well whose maximum daily average oil production does not exceed 15 barrels of oil, or any natural gas well whose maximum daily average gas production does not exceed 90 thousand cubic feet of gas (Mcf), per day, during any 12-month consecutive time period. The term stripper well is often used interchangeably with the term "Marginal Well," although they are not the same.

MARGINAL WELL:

A marginal well's definition depends on oil prices and the cost of production. Specifically, a well is considered a marginal well when the market price of a barrel of oil exceeds the cost of extracting it.

STRIPPER WELL:

A stripper well, by contrast, is defined by its output. Stripper wells tend to be marginal wells, but a marginal well might not be a stripper well.

Despite the current difficulties facing the global economy – especially due to the adverse impacts of the recent COVID pandemic on oil and natural gas producers – stripper wells will continue to be a major source of energy production, employment, gross domestic product, and government revenues for the United States.

PRODUCTION

- The United States has an estimated 760,000 stripper wells in production – about 400,000 oil and 360,000 natural gas wells. That means, of the roughly one million active oil and natural gas wells in the United States, 76% are low production wells, typically operated by small businesses.
- Combined, these stripper wells make up over 7.8% of the total of all oil and natural gas produced domestically (7.4% oil and 8.2% natural gas).

BENEFICIAL ECONOMIC IMPACT

Over the next fifteen years, stripper wells are projected to contribute $332 billion to the overall United States economy in the form of nearly 4.4 billion barrels of oil and 37 trillion cubic feet of natural gas.

If the percentage depletion allowance were to be eliminated, between 2022-2035:

- Approximately 84,000 American jobs would be lost per year.
- Royalty owners would see reduced payments averaging $640 million per year.
- States would see an average of $200 million in reduced revenues each year.

PERCENTAGE DEPLETION

WHAT IS IT AND HOW DOES IT WORK?

Since 1954, U.S. companies that mine a range of materials, including minerals (i.e., oil and gas deposits, sand, and other nonrenewable resources from the earth) have been able to use percentage depletion. It is a tax provision that allows oil and natural gas producers to recoup some of the costs involved in exploring for and producing oil and natural gas.

- Percentage depletion supports the development of U.S. oil and natural gas, along with other mineral resources, that would otherwise be uneconomical to produce.
- For years, certain members of Congress and various groups have called for the elimination of percentage depletion, mistakenly believing it is a subsidy for "Big Oil" companies.

Those who qualify for the percentage depletion allowance must meet the following criteria:

- No more than 15% of gross oil and gas income may qualify for the provision.

The benefit is applied to the producer's first 1,000 barrels of oil [or natural gas equivalent] per day of production.

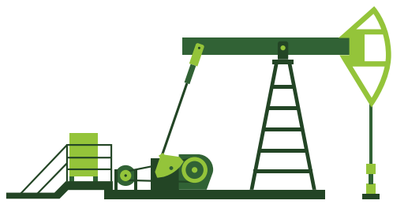
- Cannot exceed 100% of net income on a property-by-property basis.
- Amount deducted cannot exceed 65% of taxpayer's income from all sources before the deduction.

WHY IS PERCENTAGE DEPLETION IMPORTANT?

Only the smallest, family-owned oil and gas companies can use percentage depletion. Its importance, and benefit, is particularly valuable as the economy slowly recovers from the COVID pandemic when small businesses are under such economic stress.

Percentage depletion allows these operators to retain a portion of their earnings and, in turn, provides the opportunity for them to be used to reinvest cash flows – in some cases in excess of 100% – back into energy development activities. These reinvestments are directly funded from the producer's individual income and investment partners – not a bank.

Royalty owners also rely on this tax provision. The estimated 12.6 million private owners of oil and gas mineral rights in the U.S. are an integral element to the oil and gas industry, particularly to small producers that operate stripper wells. As the "landlords" of the industry, royalty owners play a critical first-step role in the development of their vital assets through an oil and gas lease that assigns the right to drill and produce to an oil and gas operator. In return, they become stakeholders in a drilling venture which provides the basis for economic benefit both for operators and royalty owners, who often receive their main source of income from royalty payments.



Percentage depletion is key to enabling independent producers (businesses with an average of 11 employees) to keep revenues that are vital to the future of their businesses.

WHY WOULD ELIMINATING THE ALLOWANCE HARM THE ECONOMY?

Stripper wells, which rely on percentage depletion, make up a significant portion of America's oil and natural gas production. These wells, which generally produce less than 15 barrels of oil a day, account for nearly 7.4% of U.S. oil production. They also produce less than 90 thousand cubic feet a day, yet account for 8.2% of U.S. natural gas production.

- Eliminating the percentage depletion allowance changes the economic profitability of production and investment for independent oil and gas producers. Independent producers typically invest 100% of their revenue into exploration and production (E&P).
- Without percentage depletion, the money available for reinvestment quickly disappears — which means no E&P and no industry growth.
- NSWA believes it is essential to protect an industry that makes such a significant contribution to the nation's economic security.

WITHOUT PERCENTAGE DEPLETION, STRIPPER PRODUCERS WILL DECREASE PRODUCTION, CLOSE WELLS SOONER, AVOID NEW PRODUCTION, OR GO OUT OF BUSINESS COMPLETELY.

THE ECONOMIC BENEFITS OF STRIPPER WELL PRODUCTION AND RELATED IMPACTS

Eliminating the percentage depletion allowance would cause a far-reaching, negative economic ripple effect across the economy because the percentage depletion allowance primarily benefits the nation's smallest oil and natural gas producers and mineral owners; most of whom are farmers, ranchers, and other landowners.

FARMERS

RANCHERS

OTHER LANDOWNERS

This study, commissioned for the NSWA by Energy and Industrial Advisory Partners, highlights the importance of the Percentage Depletion Allowance. If percentage depletion were eliminated, through the year 2035 we would see an average of:

84,000 fewer jobs per year

$200 MILLION less in state revenues per year

$640 MILLION reduced royalty payments per year

$8.7 BILLION less contributed to the GDP per year

$7.1 BILLION reduced spendings from the oil and natural gas industry per year

Over the next fifteen years, more than 11,000 wells would not be drilled and 4.4 billion barrels of oil and 37 Tcf of gas would not be produced if the depletion allowance is eliminated.

View the 2021 EIAP study at https://bit.ly/3vYYCkc.

LOST JOBS, LOST REVENUE, LOST ECONOMIC SECURITY:

If percentage depletion were eliminated, through the year 2035 we would see an average of:

- Producing stripper wells decrease by 14% per year
- Daily oil and natural gas production decrease by 12% per year
- New wells drilled decline by 9% per year
- Nearly 34,000 direct industry jobs lost, and almost 50,000 indirect industry jobs lost, per year

EXHIBIT A

ECONOMIC IMPACT: NATION

NATIONAL ECONOMIC IMPACT OF ELIMINATING PERCENTAGE DEPLETION

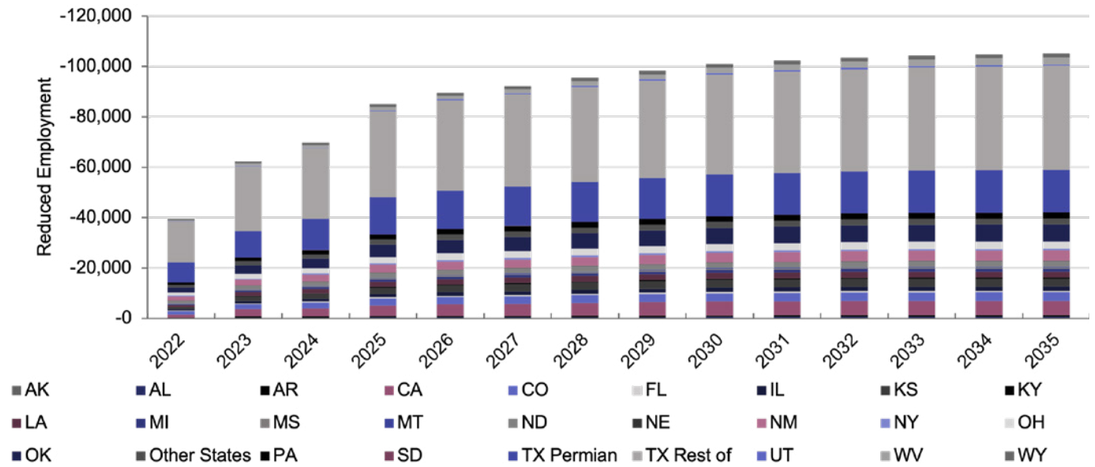
Elimination of the percentage depletion allowance would have a significant impact on hard-working men and women who work in the oil and gas industry.

Employment reductions would result from several factors, including reduced spending on operations and future activities.

Additionally, reduced royalty payments and state taxes would also impact the broader economy – by reducing or eliminating jobs in related "supply chain" manufacturing (i.e., equipment supply and manufacturing) and retail sectors (i.e., food services that supply and support workers). The loss or reduction to over 12 million royalty check recipients, who often rely on royalty checks to survive, would further impact the economy in unforeseen ways.

Projected average employment reductions are estimated at just under 84,000 each year between 2022-2035. By 2035, projected reductions in employment are estimated to reach just over 105,000 jobs each year. (Figure 5)

Figure 5: Projected Employment Reductions
Source: Energy and Industrial Advisory Partners



INDUSTRIES IMPACTED

The stripper well industry supports employment in a variety of industry sectors in addition to oil and natural gas. In fact, some of the largest projected employment reductions, if the percentage depletion allowance was eliminated, are expected in sectors such as:

REAL ESTATE
5,690 jobs per year on average

RETAIL
5,670 jobs per year on average

HEALTHCARE
5,560 jobs per year on average

FINANCE AND INSURANCE
3,520 jobs per year on average

These losses are in addition to sectors that are directly impacted, including:

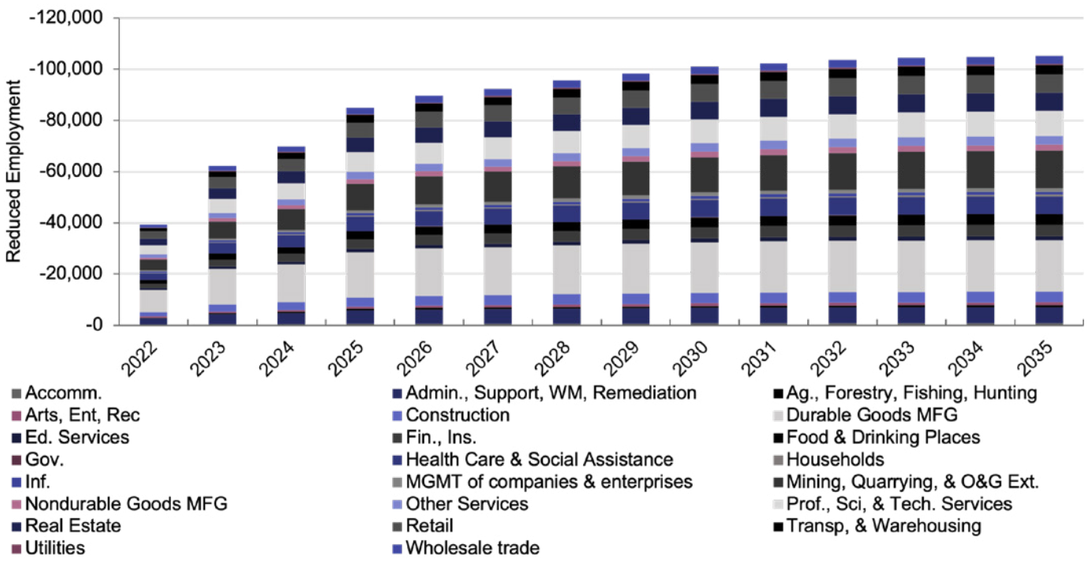
DURABLE GOODS MANUFACTURING
16,700 jobs per year on average

PROFESSIONAL SCIENTIFIC & TECHNICAL SERVICES
7,640 jobs per year on average

OIL AND GAS
10,900 jobs per year on average

CONSTRUCTION
3,450 jobs per year on average

Figure 7: Projected Oil and Gas Supported Job Losses by Industry Sector
Source: Energy and Industrial Advisory Partners



RURAL COMMUNITIES

Eliminating the percentage depletion allowance would primarily affect the nation's smallest and most vulnerable oil and natural gas producers and their employees.

Many of these producers are based, and operate, in small towns and communities in rural areas. They would see an outsized impact, beginning with companies that sell parts and equipment to the producers.

In a time where the spread of the COVID virus has already dealt a serious and painful blow to these communities, the ramifications for a host of average citizens – far from the corporate offices of "Big Oil" – could truly be devastating.

From Round Rock, Texas to Ada, Oklahoma to Bradford, Pennsylvania to Millersburg, Ohio to Mt. Vernon, Illinois – these include pumpers, clerical workers, those who repair equipment (such as machine shops and welders), and people who operate equipment. All of these people are working to earn a living and trying to make a better life for their families.

Elsewhere – from Franktown, Colorado to Bakersfield, California to Phoenix, Arizona to Bolivar, New York – important benefits are shared by farmers, ranchers, and retirees who receive royalty payments from these wells.

COST THE UNITED STATES' ECONOMY

The average economic impact of eliminating the percentage depletion allowance would cost the United States' economy from 2022-2035:

- 84,000 fewer jobs (per year)
- $8.7 billion in annual contributions to the gross domestic product (GDP)
- $7.1 billion in reduced oil and natural gas industry spendings (per year)

ECONOMIC IMPACT: ROYALTY OWNERS

WHO WE ARE

Royalty owners lease their mineral rights for drilling and, in return, receive a share of the revenue from what wells on their land produce. Many state governments and Native American tribes own mineral royalties, as does the federal government.

The National Association of Royalty Owners (NARO) represents the concerns of 12.6 million royalty owners across the country who live and vote in all 50 states. NARO defines private royalty owners as "teachers, farmers, ranchers, homemakers, accountants, firemen, plumbers, retirees, dentists, small business owners, factory workers, engineers, pet groomers, widows, roofers, lawyers, policeman, florists, carpenters, and bricklayers."

Royalty owners spend their money in their communities, give to local charities, and save for the future. Their financial benefits come solely from the mineral interests they own, and when those resources have been exhausted, the royalty income ends.

While collectively the minerals owned are of vast value, the minerals owned by a single individual are often relatively small in amount.

The average private royalty owner is over 60 years old, widowed, and receives less than $500 in monthly royalties — with many earning considerably less — as a supplement to their social security retirement income.

REVENUE AND INCOME IMPACTS

Nationwide, royalty owners pay millions of dollars in property tax, ad valorem tax, severance tax, state income tax, local tax, non-resident income tax, and federal income tax on the revenue from producing minerals.

These sources of income for the state and federal government will decline or be eliminated if royalty owners lose their ability to apply the percentage depletion allowance and if thousands of older wells are prematurely plugged because their production becomes uneconomical.

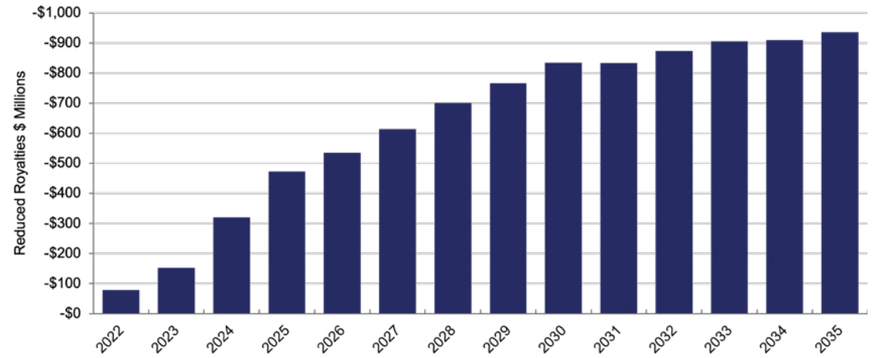
Eliminating the percentage depletion allowance would affect royalty owners in two ways:

- First, it lowers the incentive to lease their mineral rights or provide investment capital for new wells seen as riskier ventures.
- Second, the number of producing wells will decrease, thus diminishing the amount of production revenue, and lowering earnings for royalty owners.
- Third, it means owners of other types of real estate get to continue to depreciate aging assets, but mineral owners (a form of real estate ownership) would not be allowed any depreciation/depletion for a depleting asset.

Bottom line: the percentage depletion tax provision protects the most vulnerable, most likely retired, royalty owners from losing a steady – and perhaps only – source of income which, in turn, benefits federal, state, and local tax revenue.

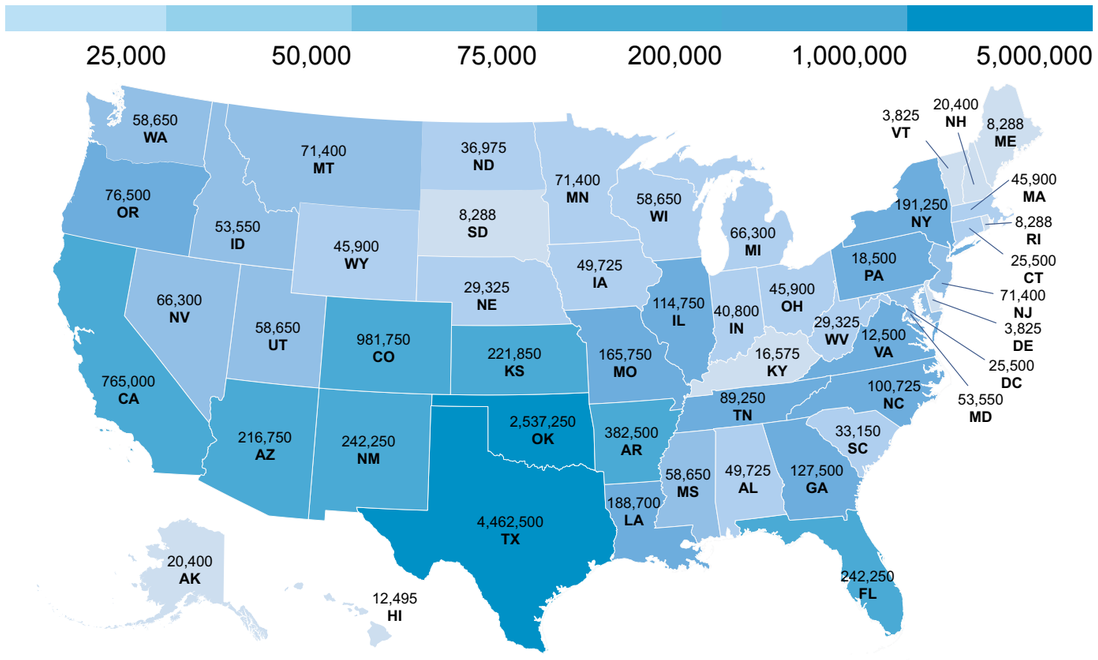
As the nation continues to recover from the devastating impacts of the COVID pandemic on the economy in general, and our most economically-disadvantaged populations in particular, now is not the time to eliminate percentage depletion.

Figure 9: Projected Percentage Depletion Elimination Case Oil and Natural Gas Royalty Reductions
Source: Energy and Industrial Advisory Partners



ROYALTY OWNERS IN THE UNITED STATES: 12.6 MILLION PEOPLE

The map below displays the estimated number of royalty owners in 2021. The total number of mineral owners is much greater, as vast areas are unproductive or have not yet been explored and developed.
Source: National Association of Royalty Owners

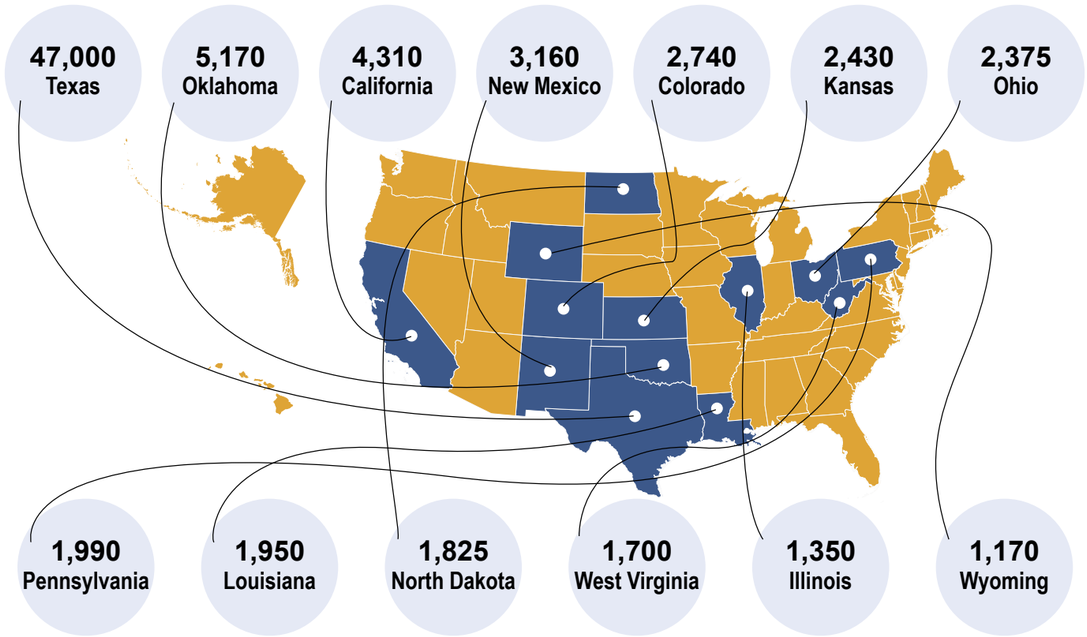


ECONOMIC IMPACT: STATES

STATES ECONOMIC IMPACT OF ELIMINATING PERCENTAGE DEPLETION

The overall economic costs for the U.S. are large, but they are not equally distributed across all states. Of the 38 oil-and-gas-producing states in the nation, the top-producing states would be hardest-hit by elimination of percentage depletion.

There are 13 states projected to see average reduced employment of over 1,000 jobs per year from 2021-2035:



AVERAGE DIRECT & INDIRECT JOBS LOST PER YEAR (2021-2035)

1	Texas	47,000	7	Ohio	2,375	13	Wyoming	1,170
2	Oklahoma	5,170	8	Pennsylvania	1,990	14	Michigan	905
3	California	4,310	9	Louisiana	1,950	15	New York	580
4	New Mexico	3,160	10	North Dakota	1,825	16	Arkansas	515
5	Colorado	2,740	11	West Virginia	1,700	17	Alabama	405
6	Kansas	2,430	12	Illinois	1,350	18	Utah	400

EXHIBIT A

ALABAMA

Over the decade projected (2021-2035), if percentage depletion is eliminated...

JOBS LOST

404 AVERAGE JOBS LOST EACH YEAR over fifteen years

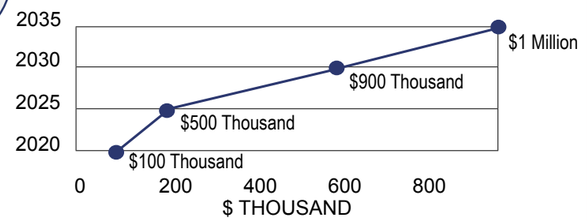
ACTUAL JOBS LOST

2022	2025	2030	2035
155	402	494	516

*includes direct & indirect employment totals

STATE REVENUE LOST

$600 THOUSAND
AVERAGE LOSS EACH YEAR

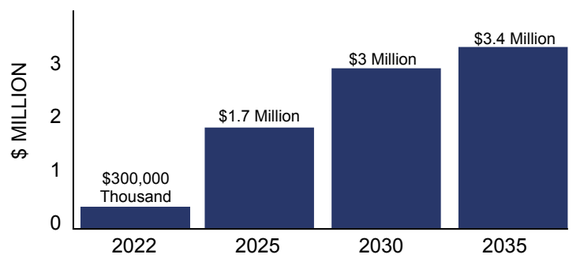


ROYALTY OWNERS

49,725
ROYALTY OWNERS IN ALABAMA

$2.2 MILLION LOST
ON AVERAGE EACH YEAR IN ROYALTY PAYMENTS

ROYALTY PAYMENTS LOST



#17
largest state impacted from the elimination of the percentage depletion allowance due to the state's large base of stripper wells

PRODUCTION

2,630
barrels of oil equivalent reduction per day over 15-year forecast period

STRIPPER WELLS

1,020
producing stripper wells lost each year for the 15-year forecast period

ARKANSAS

Over the decade projected (2021-2035), if percentage depletion is eliminated...

JOBS LOST

514 AVERAGE JOBS LOST EACH YEAR over fifteen years

ACTUAL JOBS LOST

2022	2025	2030	2035
189	497	630	694

*includes direct & indirect employment totals

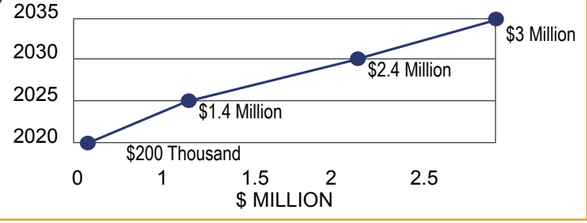
#16
largest state impacted from the elimination of the percentage depletion allowance due to the state's large base of stripper wells

PRODUCTION

2,445
barrels of oil equivalent reduction per day over 15-year forecast period

STATE REVENUE LOST

$1.8 MILLION
AVERAGE LOSS EACH YEAR



STRIPPER WELLS

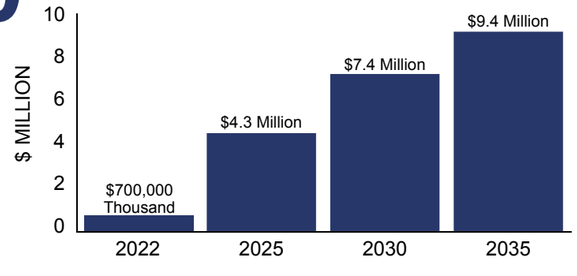
3,820
producing stripper wells lost each year for the 15-year forecast period

ROYALTY OWNERS

382,500
ROYALTY OWNERS IN ARKANSAS

$5.4 MILLION LOST
ON AVERAGE EACH YEAR IN ROYALTY PAYMENTS

ROYALTY PAYMENTS LOST



CALIFORNIA

Over the decade projected (2021-2035), if percentage depletion is eliminated...

JOBS LOST

4,311 AVERAGE JOBS LOST EACH YEAR over fifteen years

ACTUAL JOBS LOST

2022	2025	2030	2035
1,124	4,137	5,521	5,590

*includes direct & indirect employment totals

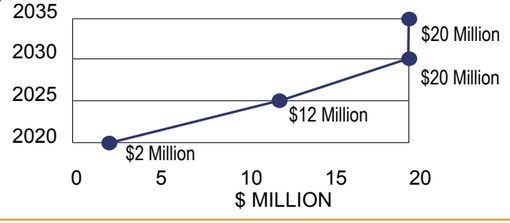
#3
largest state impacted from the elimination of the percentage depletion allowance due to the state's large base of stripper wells

PRODUCTION

25,320
barrels of oil equivalent reduction per day over 15-year forecast period

STATE REVENUE LOST

$14 MILLION
AVERAGE LOSS EACH YEAR



STRIPPER WELLS

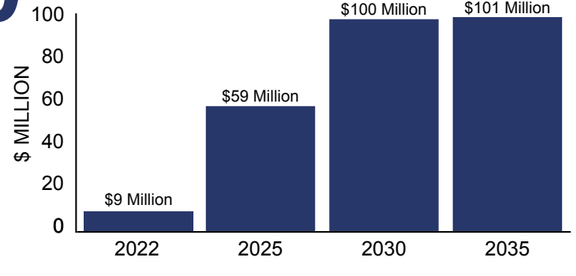
4,745
producing stripper wells lost each year for the 15-year forecast period

ROYALTY OWNERS

765,000
ROYALTY OWNERS IN CALIFORNIA

$70 MILLION LOST
ON AVERAGE EACH YEAR IN ROYALTY PAYMENTS

ROYALTY PAYMENTS LOST



COLORADO

Over the decade projected (2021-2035), if percentage depletion is eliminated...

JOBS LOST

2,739 AVERAGE JOBS LOST EACH YEAR over fifteen years

ACTUAL JOBS LOST

2022	2025	2030	2035
1,367	2,775	3,297	3,517

*includes direct & indirect employment totals

#5

largest state impacted from the elimination of the percentage depletion allowance due to the state's large base of stripper wells

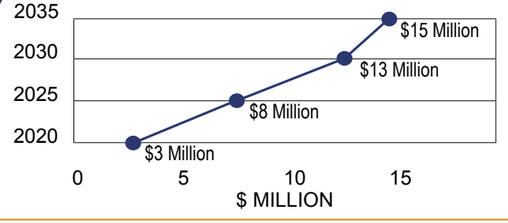
PRODUCTION

22,800

barrels of oil equivalent reduction per day over 15-year forecast period

STATE REVENUE LOST

$10 MILLION
AVERAGE LOSS EACH YEAR



STRIPPER WELLS

3,200

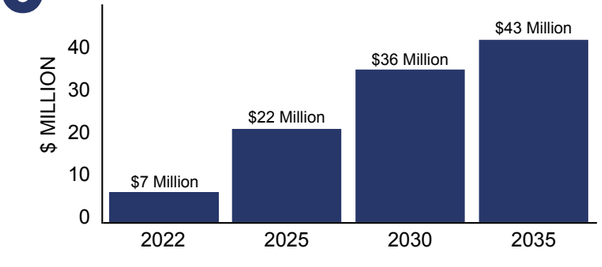
producing stripper wells lost each year for the 15-year forecast period

ROYALTY OWNERS

981,750
ROYALTY OWNERS IN COLORADO

$27 MILLION LOST
ON AVERAGE EACH YEAR IN ROYALTY PAYMENTS

ROYALTY PAYMENTS LOST



ILLINOIS

Over the decade projected (2021-2035), if percentage depletion is eliminated...

JOBS LOST

1,351 AVERAGE JOBS LOST EACH YEAR over fifteen years

ACTUAL JOBS LOST

2022	2025	2030	2035
497	1,335	1,668	1,722

*includes direct & indirect employment totals

#12

largest state impacted from the elimination of the percentage depletion allowance due to the state's large base of stripper wells

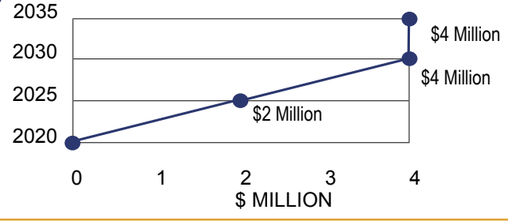
PRODUCTION

3,640

barrels of oil equivalent reduction per day over 15-year forecast period

STATE REVENUE LOST

$3 MILLION
AVERAGE LOSS EACH YEAR



STRIPPER WELLS

5,320

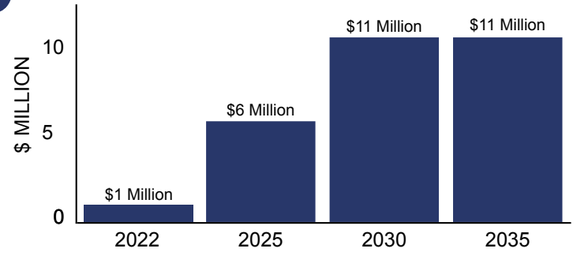
producing stripper wells lost each year for the 15-year forecast period

ROYALTY OWNERS

114,750
ROYALTY OWNERS IN ILLINOIS

$7 MILLION LOST
ON AVERAGE EACH YEAR IN ROYALTY PAYMENTS

ROYALTY PAYMENTS LOST



KANSAS

Over the decade projected (2021-2035), if percentage depletion is eliminated...

JOBS LOST

2,432 AVERAGE JOBS LOST EACH YEAR over fifteen years

ACTUAL JOBS LOST

2022	2025	2030	2035
641	2,465	3,086	3,071

*includes direct & indirect employment totals

#6

largest state impacted from the elimination of the percentage depletion allowance due to the state's large base of stripper wells

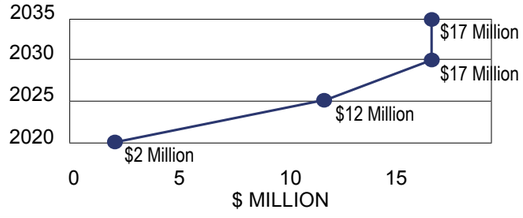
PRODUCTION

15,470

barrels of oil equivalent reduction per day over 15-year forecast period

STATE REVENUE LOST

$13 MILLION
AVERAGE LOSS EACH YEAR



STRIPPER WELLS

12,085

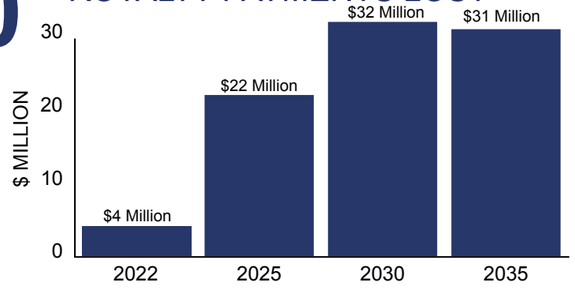
producing stripper wells lost each year for the 15-year forecast period

ROYALTY OWNERS

221,850
ROYALTY OWNERS IN KANSAS

$23 MILLION LOST
ON AVERAGE EACH YEAR IN ROYALTY PAYMENTS

ROYALTY PAYMENTS LOST



LOUISIANA

Over the decade projected (2021-2035), if percentage depletion is eliminated...

JOBS LOST

1,951 AVERAGE JOBS LOST EACH YEAR over fifteen years

ACTUAL JOBS LOST

2022	2025	2030	2035
950	2,024	2,333	2,429

*includes direct & indirect employment totals

#9

largest state impacted from the elimination of the percentage depletion allowance due to the state's large base of stripper wells

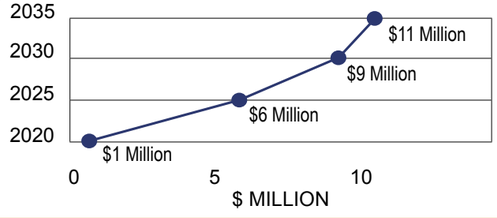
PRODUCTION

7,140

barrels of oil equivalent reduction per day over 15-year forecast period

STATE REVENUE LOST

$7 MILLION
AVERAGE LOSS EACH YEAR



STRIPPER WELLS

2,785

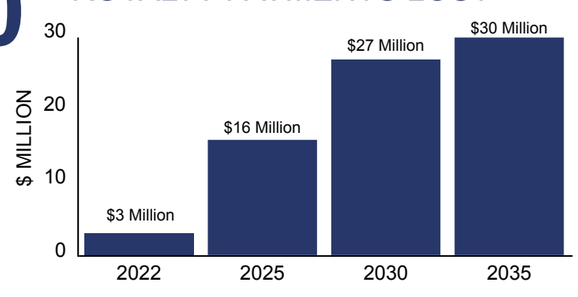
producing stripper wells lost each year for the 15-year forecast period

ROYALTY OWNERS

188,700
ROYALTY OWNERS IN LOUISIANA

$19 MILLION LOST
ON AVERAGE EACH YEAR IN ROYALTY PAYMENTS

ROYALTY PAYMENTS LOST



MICHIGAN

Over the decade projected (2021-2035), if percentage depletion is eliminated...

JOBS LOST

905 AVERAGE JOBS LOST EACH YEAR over fifteen years

ACTUAL JOBS LOST

2022	2025	2030	2035
315	903	1,119	1,150

*includes direct & indirect employment totals

#14

largest state impacted from the elimination of the percentage depletion allowance due to the state's large base of stripper wells

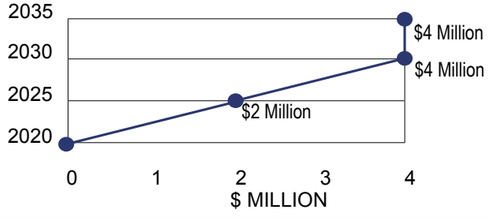
PRODUCTION

5,535

barrels of oil equivalent reduction per day over 15-year forecast period

STATE REVENUE LOST

$3 MILLION
AVERAGE LOSS EACH YEAR



STRIPPER WELLS

2,235

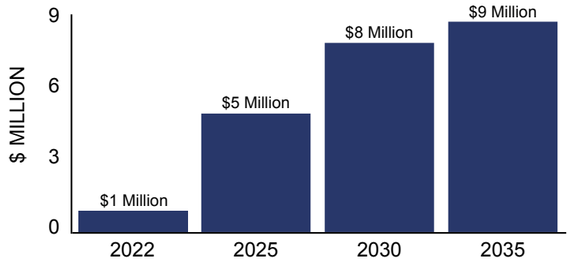
producing stripper wells lost each year for the 15-year forecast period

ROYALTY OWNERS

66,300
ROYALTY OWNERS IN MICHIGAN

$6 MILLION LOST
ON AVERAGE EACH YEAR IN ROYALTY PAYMENTS

ROYALTY PAYMENTS LOST



NEW MEXICO

Over the decade projected (2021-2035), if percentage depletion is eliminated...

JOBS LOST

3,160 AVERAGE JOBS LOST EACH YEAR over fifteen years

ACTUAL JOBS LOST

2022	2025	2030	2035
1,703	3,179	3,787	4,126

*includes direct & indirect employment totals

#4

largest state impacted from the elimination of the percentage depletion allowance due to the state's large base of stripper wells

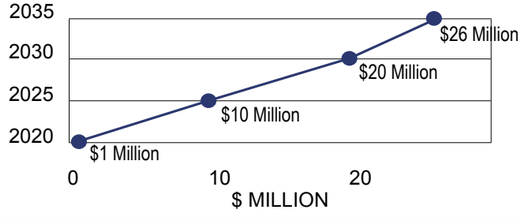
PRODUCTION

25,725

barrels of oil equivalent reduction per day over 15-year forecast period

STATE REVENUE LOST

$14 MILLION
AVERAGE LOSS EACH YEAR



STRIPPER WELLS

2,660

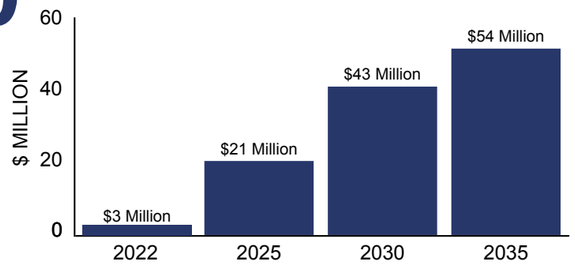
producing stripper wells lost each year for the 15-year forecast period

ROYALTY OWNERS

242,250
ROYALTY OWNERS IN NEW MEXICO

$30 MILLION LOST
ON AVERAGE EACH YEAR IN ROYALTY PAYMENTS

ROYALTY PAYMENTS LOST



NEW YORK

Over the decade projected (2021-2035), if percentage depletion is eliminated...

JOBS LOST

580 AVERAGE JOBS LOST EACH YEAR over fifteen years

ACTUAL JOBS LOST

2022	2025	2030	2035
303	618	684	697

*includes direct & indirect employment totals

#15

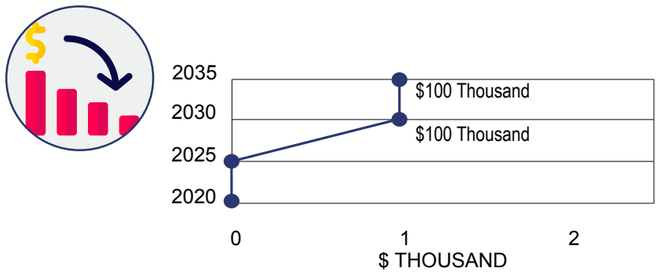
largest state impacted from the elimination of the percentage depletion allowance due to the state's large base of stripper wells

PRODUCTION

390

barrels of oil equivalent reduction per day over 15-year forecast period

STATE REVENUE LOST



STRIPPER WELLS

635

producing stripper wells lost each year for the 15-year forecast period

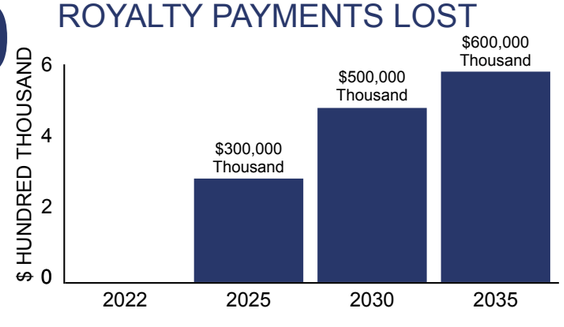
ROYALTY OWNERS

191,250

ROYALTY OWNERS IN NEW YORK

$400 THOUSAND LOST
ON AVERAGE EACH YEAR IN ROYALTY PAYMENTS

ROYALTY PAYMENTS LOST



NORTH DAKOTA

Over the decade projected (2021-2035), if percentage depletion is eliminated...

JOBS LOST

1,824 AVERAGE JOBS LOST EACH YEAR over fifteen years

ACTUAL JOBS LOST

2022	2025	2030	2035
1,117	1,988	2,114	2,146

*includes direct & indirect employment totals

#10

largest state impacted from the elimination of the percentage depletion allowance due to the state's large base of stripper wells

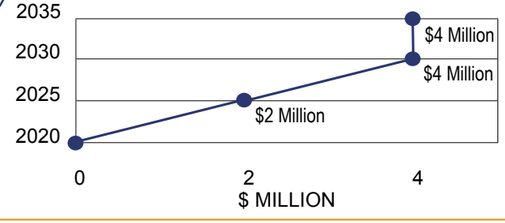
PRODUCTION

3,160

barrels of oil equivalent reduction per day over 15-year forecast period

STATE REVENUE LOST

$3 MILLION
AVERAGE LOSS EACH YEAR



STRIPPER WELLS

485

producing stripper wells lost each year for the 15-year forecast period

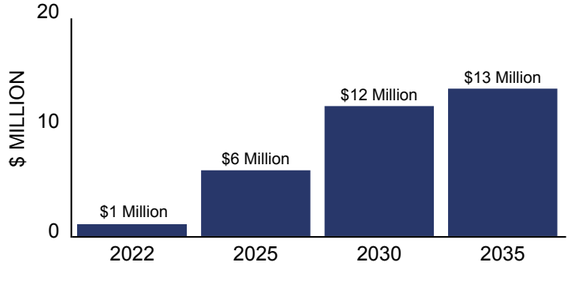
ROYALTY OWNERS

36,975

ROYALTY OWNERS IN NORTH DAKOTA

$8 MILLION LOST
ON AVERAGE EACH YEAR IN ROYALTY PAYMENTS

ROYALTY PAYMENTS LOST



OHIO

Over the decade projected (2021-2035), if percentage depletion is eliminated...

JOBS LOST

2,377 AVERAGE JOBS LOST EACH YEAR over fifteen years

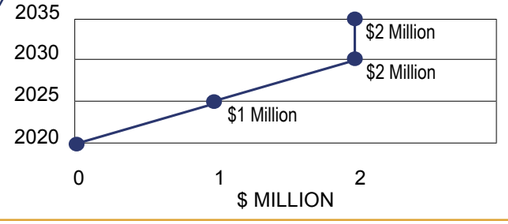
ACTUAL JOBS LOST

2022	2025	2030	2035
1,160	2,478	2,835	2,915

*includes direct & indirect employment totals

STATE REVENUE LOST

$1 MILLION
AVERAGE LOSS EACH YEAR



#7

largest state impacted from the elimination of the percentage depletion allowance due to the state's large base of stripper wells

PRODUCTION

4,765

barrels of oil equivalent reduction per day over 15-year forecast period

STRIPPER WELLS

4,430

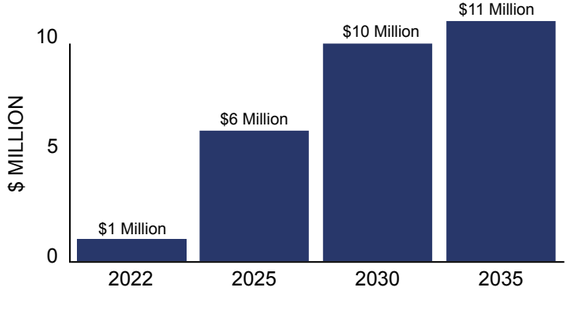
producing stripper wells lost each year for the 15-year forecast period

ROYALTY OWNERS

45,900
ROYALTY OWNERS IN OHIO

$7 MILLION LOST
ON AVERAGE EACH YEAR IN ROYALTY PAYMENTS

ROYALTY PAYMENTS LOST



OKLAHOMA

Over the decade projected (2021-2035), if percentage depletion is eliminated...

JOBS LOST

5,170 AVERAGE JOBS LOST EACH YEAR over fifteen years

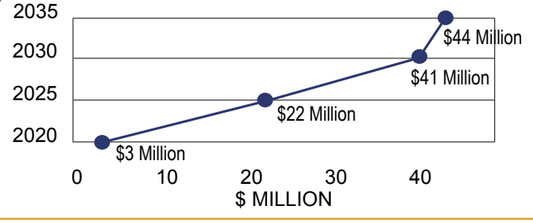
ACTUAL JOBS LOST

2022	2025	2030	2035
2,018	4,870	6,478	6,769

*includes direct & indirect employment totals

STATE REVENUE LOST

$29 MILLION
AVERAGE LOSS EACH YEAR



#2

largest state impacted from the elimination of the percentage depletion allowance due to the state's large base of stripper wells

PRODUCTION

37,305

barrels of oil equivalent reduction per day over 15-year forecast period

STRIPPER WELLS

10,405

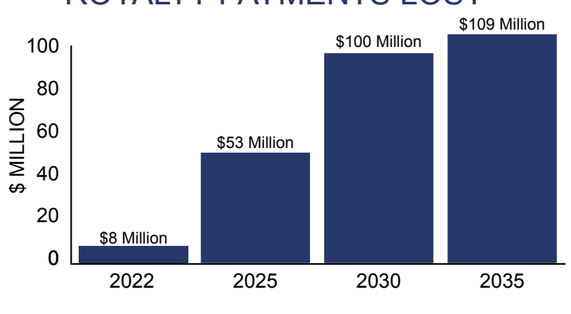
producing stripper wells lost each year for the 15-year forecast period

ROYALTY OWNERS

2,537,250
ROYALTY OWNERS IN OKLAHOMA

$71 MILLION LOST
ON AVERAGE EACH YEAR IN ROYALTY PAYMENTS

ROYALTY PAYMENTS LOST



Over the decade projected (2021-2035), if percentage depletion is eliminated...

PENNSYLVANIA

#8

largest state impacted from the elimination of the percentage depletion allowance due to the state's large base of stripper wells

JOBS LOST

1,993 AVERAGE JOBS LOST EACH YEAR over fifteen years

ACTUAL JOBS LOST

2022	2025	2030	2035
1,003	2,013	2,391	2,476

*includes direct & indirect employment totals

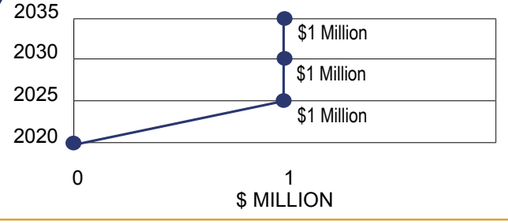
PRODUCTION

7,430

barrels of oil equivalent reduction per day over 15-year forecast period

STATE REVENUE LOST

$1 MILLION
AVERAGE LOSS EACH YEAR



STRIPPER WELLS

8,789

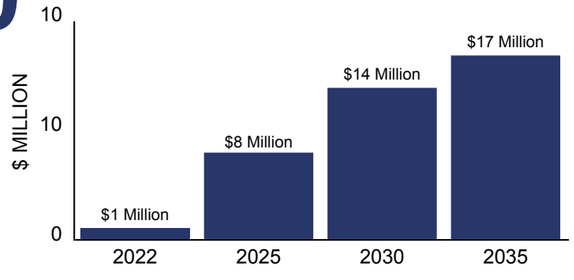
producing stripper wells lost each year for the 15-year forecast period

ROYALTY OWNERS

178,500
ROYALTY OWNERS IN PENNSYLVANIA

$10 MILLION LOST
ON AVERAGE EACH YEAR IN ROYALTY PAYMENTS

ROYALTY PAYMENTS LOST



Over the decade projected (2021-2035), if percentage depletion is eliminated...

TEXAS

#1

largest state impacted from the elimination of the percentage depletion allowance due to the state's large base of stripper wells

JOBS LOST

47,060 AVERAGE JOBS LOST EACH YEAR over fifteen years

ACTUAL JOBS LOST

2022	2025	2030	2035
24,260	48,894	56,145	58,228

*includes direct & indirect employment totals

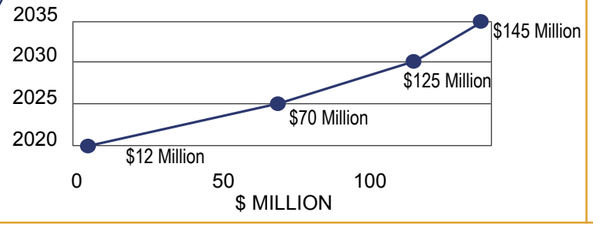
PRODUCTION

109,215

barrels of oil equivalent reduction per day over 15-year forecast period

STATE REVENUE LOST

$90 MILLION
AVERAGE LOSS EACH YEAR



STRIPPER WELLS

26,195

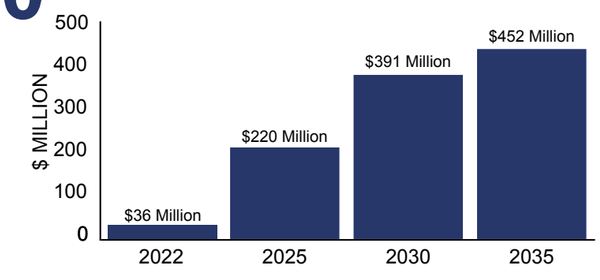
producing stripper wells lost each year for the 15-year forecast period

ROYALTY OWNERS

4,462,500
ROYALTY OWNERS IN TEXAS

$281 MILLION LOST
ON AVERAGE EACH YEAR IN ROYALTY PAYMENTS

ROYALTY PAYMENTS LOST



UTAH

Over the decade projected (2021-2035), if percentage depletion is eliminated...

JOBS LOST

398 AVERAGE JOBS LOST EACH YEAR over fifteen years

ACTUAL JOBS LOST

2022	2025	2030	2035
87	361	557	510

*includes direct & indirect employment totals

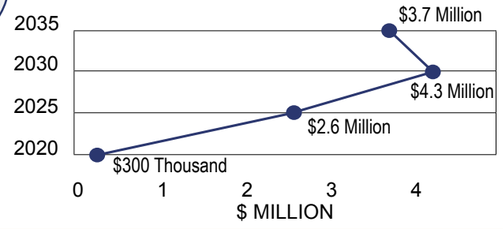
#18
largest state impacted from the elimination of the percentage depletion allowance due to the state's large base of stripper wells

PRODUCTION

5,820
barrels of oil equivalent reduction per day over 15-year forecast period

STATE REVENUE LOST

$2.8 MILLION
AVERAGE LOSS EACH YEAR



STRIPPER WELLS

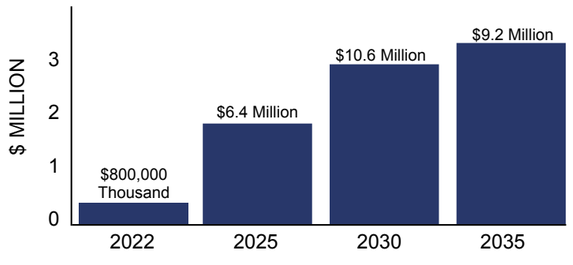
1,610
producing stripper wells lost each year for the 15-year forecast period

ROYALTY OWNERS

58,650
ROYALTY OWNERS IN UTAH

$7.1 MILLION LOST
ON AVERAGE EACH YEAR IN ROYALTY PAYMENTS

ROYALTY PAYMENTS LOST



WEST VIRGINIA

Over the decade projected (2021-2035), if percentage depletion is eliminated...

JOBS LOST

1,697 AVERAGE JOBS LOST EACH YEAR over fifteen years

ACTUAL JOBS LOST

2022	2025	2030	2035
361	1,294	2,144	2,803

*includes direct & indirect employment totals

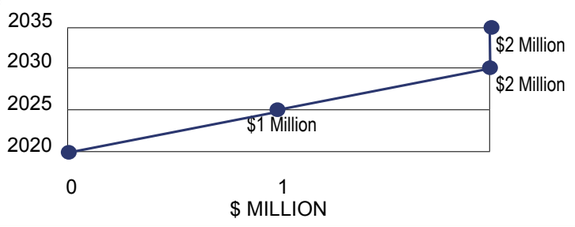
#11
largest state impacted from the elimination of the percentage depletion allowance due to the state's large base of stripper wells

PRODUCTION

2,970
barrels of oil equivalent reduction per day over 15-year forecast period

STATE REVENUE LOST

$1 MILLION
AVERAGE LOSS EACH YEAR



STRIPPER WELLS

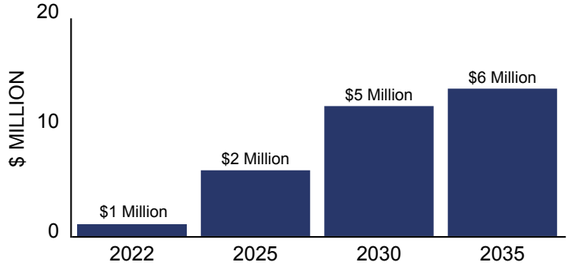
4,220
producing stripper wells lost each year for the 15-year forecast period

ROYALTY OWNERS

29,325
ROYALTY OWNERS IN WEST VIRGINIA

$4 MILLION LOST
ON AVERAGE EACH YEAR IN ROYALTY PAYMENTS

ROYALTY PAYMENTS LOST



WYOMING

Over the decade projected (2021-2035), if percentage depletion is eliminated...

JOBS LOST

1,169 AVERAGE JOBS LOST EACH YEAR over fifteen years

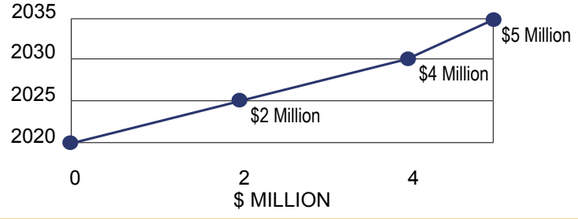
ACTUAL JOBS LOST

2022	2025	2030	2035
419	1,115	1,491	1,442

*includes direct & indirect employment totals

STATE REVENUE LOST

$3 MILLION
AVERAGE LOSS EACH YEAR

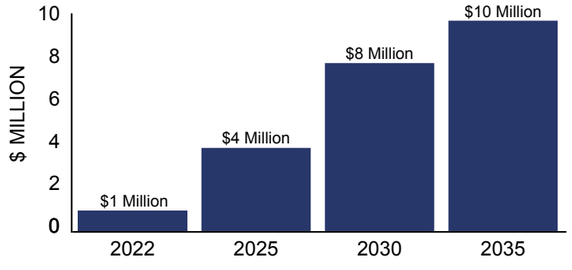


ROYALTY OWNERS

45,900
ROYALTY OWNERS IN WYOMING

$6 MILLION LOST
ON AVERAGE EACH YEAR IN ROYALTY PAYMENTS

ROYALTY PAYMENTS LOST



#13

largest state impacted from the elimination of the percentage depletion allowance due to the state's large base of stripper wells

PRODUCTION

5,070

barrels of oil equivalent reduction per day over 15-year forecast period

STRIPPER WELLS

1,750

producing stripper wells lost each year for the 15-year forecast period

THANK YOU TO OUR PARTNER ASSOCIATIONS

PLATINUM

ILLINOIS OIL & GAS ASSOCIATION

INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

THE PETROLEUM ALLIANCE OF OKLAHOMA

TEXAS Alliance of Energy Producers

GOLD

National Association Royalty Owners NARO

PIPP Pennsylvania Independent Petroleum Producers Inc.

PETROLEUM ASSOCIATION of WYOMING

SILVER

CIPA California Independent Petroleum Association

INOGA

Indiana Oil & Gas Association

IPA NM INDEPENDENT PETROLEUM ASSOCIATION OF NEW MEXICO

OEPA Oklahoma Energy Producers Alliance

PPRA PANHANDLE PRODUCERS & ROYALTY OWNERS ASSOCIATION

BRONZE

AIPRO ARKANSAS INDEPENDENT PRODUCERS & ROYALTY OWNERS

DEPA DOMESTIC ENERGY PRODUCERS ALLIANCE

GWV GAS & OIL ASSOCIATION OF WEST VIRGINIA

KIOGA Voice of the Kansas Independent Petroleum Industry

TIPRO

as of 5.25.21

THANK YOU TO OUR INDIVIDUAL SUPPORTERS OF THIS STUDY

Steve Baize
Charter Energy

Dewey Bartlett
Keener Oil & Gas Company

Madelon L. Bradshaw

Pete Brown
Brown & Borelli, Inc. &
Cimarron Production Company

David Burns
Burns Energy, LLC

Paul Burton
Paul Burton, LLC

Lee Caldwell

Mike Cantrell
Postwood Energy, LLC

Jimmy Chatham
Jimmy R. Chatham Oil & Gas

David Clark
Pennsylvania Grade Crude Oil Coalition

Jeff Cooper
Cooper & Brain, Inc.

David Corley
Corley Trust, LLC

Wiley Cox
Falcon Oil Properties, LLP

Helen Davis

Leo Dorzweiler
Cattlemans Oil, LLC

Tom Dunlap
Tripledee Drilling Company

William Dutcher
Dutcher & Company, Inc.

Ann Felton Gilliland

Carol Gasser
CAG Oil Properties, LLC

Jon Geyerman
Western Energy Corporation

Scott Gruns
BRG Energy, Inc.

Alfred Guinn
Guinn Petroleum Company, Inc.

Robert D. Gunn
Gunn Oil Company

Jerry Hess
Jerry Hess Operating Company

Ken Hunter
Vaquero Energy, Inc.

Donald Hupp
Gunn Oil Company

Jerry James
Artex Oil

Dorothy Ann Jenkins

Steven Johnson
ONEOK

Roger Kent
RJ Energy, LLC

George T. Kimbell, II
Burk Royalty Company, Ltd.

Aaron Kincaid
Kincaid Oil Producers, Inc.

King Kirchner
Kirchner Investments, LLC

David Knapp
Knapp Oil Corporation

David Loger
Lario Oil & Gas Company

John McCool
Edward Oil Company

Jesse Middagh
Herman L. Loeb, LLC

Victor Mitchell
Mitchell Minerals, LLC

Patrick Montalban
Montalban Oil and Gas Operations, Inc.

Don Montgomery, Jr.
Fairfax Oil Company

Melvin Moran
Moran Oil Enterprises

Dave Murfin
Murfin Drilling Company, Inc.

John Nichols
The Grayrock Corporation

Tim Nordell
Matador, Inc.

Pat O'Neal
O'Neal Oil & Gas Company

Tim Pivonka
Timka Resources Ltd.

Nick Powell
Colt Energy, Inc.

Margaret Redwine
EagleEye Royalty Management

Michael Schott
Helis Oil & Gas Company, LLC

Dick Schremmer
Bear Petroleum, LLC

Mark Shreve
Mull Drilling Company, Inc.

Bob Sullivan, Jr.
Sullivan and Company, LLC

Sarah Tipka
A.W. Tipka Oil & Gas, Inc.

Bob Von Rhee
The Weston Company

Darlene Wallace
Wallace Holdings, LLC

Bill Warnock

Frank Weber
Great Southwest Oil & Gas Corporation

Eric Weiss
Muslow Oil and Gas

J. Nelson Wood
Wood Energy, Inc.

David Yost
Yost Energy, Inc.

Transcontinental Company

as of 5.25.21

DEWEY BARTLETT, JR.

Bartlett shares how his family got into the oil business and how the percentage depletion allowance helps his small business.

WHAT TO KNOW

Location: 10 counties in Oklahoma

Number of Wells: 15 operating

Employees: 5 individuals + contractors

About Keener Oil and Gas Company.
We are a family-owned company. My grandfather, DA Bartlett, started the company in the very early 1900s in Titusville, Pennsylvania which is where oil was first found by drilling in the U.S. My grandfather was a clerk in a general store, and, as the story goes, he ended up taking the store over when the owner went out of business. He would advance credit to some of the operators and, for collateral, he would take their lease. Apparently, somebody didn't pay the bill so he ended up in the oil business all of a sudden. He then came to Tulsa, Oklahoma in 1910, and was able to buy a few leases on the outskirts of the Cushing Field, and we've been here ever since.

We've had our ups and downs but, generally, our approach has been successful. Like most small companies, we've had to be pretty versatile and look for alternative ways to not only make money but to stay in business.

When did you get involved in oil & gas?
About the time that my father and uncle both died, that's when I got involved with running the company. I worked out in the oil fields with Halliburton for several years and learned the operational side, which was a very, very good experience for me.

How many employees does Keener Oil and Gas have?
Now we have a total of five employees, including me. We contract out a lot of things. All of our field operations are contracted out and we probably have 10 to 15 pumpers that are contracted out at any one time. We contract out our engineering and geological activities, for example.

Where does Keener operate?
We are in a couple of different areas. Seminole County in the southeast of Oklahoma City is one area that a lot of our production is located. Another area is in Creek County, south of a small town called Bristow, which is southwest of Tulsa. We're also concentrated in an area west of Stillwater, Oklahoma around a community called Orlando. We have operated leases in about 10 different counties. It's a very rural, very small town where the oil and gas industry has been a significant player for decades. When the oil and gas industry is doing well, the towns are very prosperous. When things slow down, you can really tell. It has a negative effect on those towns. It's very similar to how the industry goes, so goes Oklahoma, Texas, New Mexico, Kansas, etc.

How would eliminating the percentage depletion allowance impact Keener Oil and Gas Company?
The big oil companies have a variety of sources of revenue other than selling crude oil or natural gas. Besides refining crude and processing natural gas, many own plants that produce plastics, chemicals, and fertilizer - all using crude oil or natural gas as feed stock. An advantage of owning those businesses is they usually become more profitable when their cost of feed stock is low, thereby subsidizing their lost revenue from selling crude and natural gas in a declining price market. Lower prices can be very beneficial to the major oil companies.

That's terrific for them. But it's not good for us because, we, the independent oil companies, mostly have only one or two major sources of revenue, and that's selling oil and/or natural gas. Our future really depends upon a reasonable, stable, good price of both of those commodities. The percentage depletion allowance is a tax benefit that helps the small companies only, it's really identified and restricted only to small companies, and it does help to a small degree.

When things get a little tight for us financially, it at least gives us a little bit of relief, and it's not a big amount, but it is enough to help keep a person or a few people employed, to have a little bit of extra money left on the side to do some geological research or have some engineering done. It gives us an ability to do a few things that, when prices do recover, then we could take advantage of the research or the work and possibly drill a few more wells or do some workovers. Since we have a finite source of product it is much different than a manufacturing company. Oil is a very finite resource, generally speaking, it does deplete. Percentage depletion makes the economic situation between say, a manufacturing company and an oil company, a little fairer. The percentage depletion allowance recognizes the fact that we do have a depleting asset that will eventually go away.

How would reduced activity impact the communities where you operate?
Most of the additional income from percentage depletion is used for keeping employees. The percentage depletion allowance may be enough to keep somebody employed. If that depletion allowance goes away, so goes that employee. If that employee is laid off, or the spending doesn't happen, it impacts the community where he or she lives and works. In small towns in Oklahoma that are in or around oil and gas production, their economic activity is directly related to oil and gas. Everything from privately-owned companies to public utilities, and the electric co-ops, for example. Some of the co-ops in Western Oklahoma have major clients that are oil and gas companies. When a well is shut-in that electric motor doesn't run, and the $300 or $500 a month of electricity that it had been using stops immediately. That has a real immediate impact upon that particular co-op that's supplying electricity to a multi-county area of Oklahoma, and they employ a lot of people. If the percentage depletion allowance was taken away, it would affect everybody in these communities.

> When things get a little tight for us financially, percentage depletion at least gives us a little bit of relief, and it's not a big amount, but it is enough to help keep a person or a few people employed.

PRODUCER PROFILE - CALIFORNIA

SETH HUNTER

Hunter shares how he is the fourth generation to manage their family business, which has survived due to the percentage depletion allowance.

WHAT TO KNOW

Location: 3 counties in California

Number of Wells: 400 operating

Employees: 60 individuals + 10 contractors

About Vaquero Energy

Vaquero Energy is a fourth-generation business that began with my great-grandfather here in California. Obviously, over the course of time, we've evolved in terms of size and have grown through drilling and acquisitions over the course of time. We currently operate in three counties in California and have approximately 1,800 barrels a day of production.

How many people does Vaquero Energy employ?

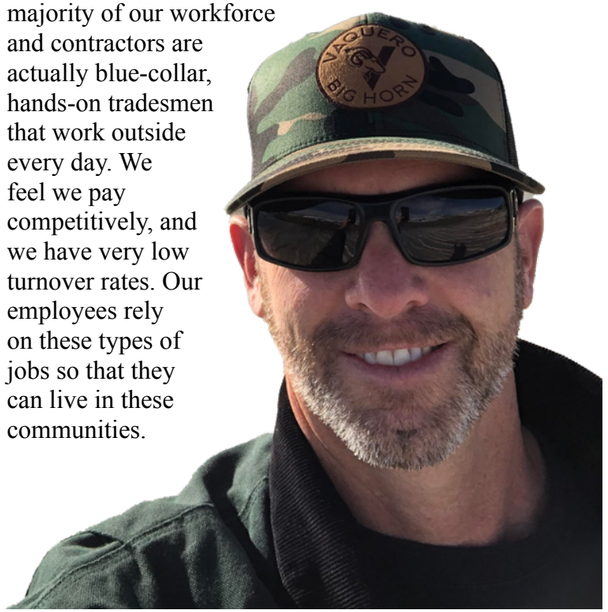
We employ about 60 employees and about 10 full-time contractors.

Where does Vaquero operate?

We are based in Bakersfield, California, and have offices on the central coast in Santa Maria, California. There's a community here that half of our operations are based out of, next to the town of Garey, a very small town, with about 80 people who live in it. We feel that we're very important to the areas we operate in, for example, there's a small store called the Garey Store, a sole proprietorship, and a lot of her business comes from not only my company but also our contractors and neighboring oil and gas companies that eat lunch and buy snacks. There are no majors here in Santa Barbara County or in Kern County in the fields we operate in. Stripper well operators support the oil field supply houses, restaurants, hospitality industry, and other businesses in these areas.

What kind of employees does Vaquero hire?

The majority of our employees are on the operations side, who operate oil wells, associated facilities, and equipment. We also employ welders and various tradesmen who make an oil field function on a day-to-day basis. We also have engineers, geologists, and accountants but the majority of our workforce and contractors are actually blue-collar, hands-on tradesmen that work outside every day. We feel we pay competitively, and we have very low turnover rates. Our employees rely on these types of jobs so that they can live in these communities.



Without companies like ours, they might be forced to work in another industry for lower pay. We're definitely in the upper tier in terms of compensation relative to other industries in the areas that we operate. We offer benefits packages, health care, vision, dental, as well as retirement that a lot of other industries just can't offer.

How have market conditions impacted you in the last year?

Greatly. Everybody else in every other industry has been very affected but we're directly affected because of the reduction in demand for crude oil by refineries. That trickled down to our level and the economics of producing a barrel of oil. As a stripper well operator, two-thirds of our wells produce about a barrel of oil per day, and for every barrel of oil, they make nine of water (average well is 90% water and 10% oil). It's costly to produce that small amount of oil and keep a stable workforce when the price is impacted by the economy in general. We have struggled over the last year but we haven't laid anybody off in hopes that the industry will recover in 2021.

How would the elimination of percentage depletion impact your company?

It would trickle down and leave us with less ability to access capital or operating cash. The percentage depletion directly affects the bottom line, and if that bottom line sees a change for the worst, that affects everything, not only our production but the number of employees or contractors that we can employ. We redeploy 100% of that cash from percentage depletion back into our business and the local community. We are a family-owned, privately held company that utilizes percentage depletion to keep our people working during the challenging economic times that have plagued the industry since 2015. It's a commitment to reinvesting into our business to make it last so that I can teach my children the art that is the energy creation business. Beyond that, it affects the community because we support the communities that we operate in, whether that's through our employees spending money or donating time and money for programs in our communities.

How important is the stripper well industry to Kern County and Bakersfield?

It's extremely critical. Kern County, where Bakersfield is located, is the largest in terms of oil production per county in the U.S. That's a fact that gets lost, most people don't think of California as a large energy producer outside of renewables, but it is. The county and the community rely very heavily on the industry because there really isn't anything else other than agriculture in Kern County, which can only support so much employment. If oil and gas were to dry up, then obviously people will have to move on to other places, whether it's in or outside of the state, but there would definitely be an exodus. It's very critical to the community and the county that oil and gas stays a part of the economy.

> We redeploy 100% of that cash from percentage depletion back into our business and the local community.

PRODUCER PROFILE - OHIO

JERRY JAMES

James explains how a past employer convinced him to join the oil industry and how the percentage depletion allowance helps to grow his small business.

WHAT TO KNOW

Location: Ohio & New Mexico

Number of Wells: 250 operating

Employees: 15 individuals + field crews

About Artex Oil Company.
Artex actually goes back to the 1950s. Mr. Rupe, who is 103 years old, started Artex Oil Company back in the 1950s. Thirty years ago, my business partner Gene Huck and I were engineering consultants and we did a lot of work for Mr. Rupe. He convinced us that we could be good at this and to go into business with him full-time. Right now, we're concentrated mainly in Ohio doing conventional and unconventional work. We previously had operations out West, but as prices over the last decade have trended down, we've sold most of our western operations, but still have a bit in New Mexico.

How many employees does Artex currently have?
We have 15 full-time employees, most of them are engineers and accountants. We do have some field people, too, that are foremen.

What kind of vendors does the company use?
Our list of vendors is 75 companies. It's everything. Oil and gas service companies of course, but everything - the local copier shop, the local computer support company, the local office supply company, cleaning services for the office.

How important is the oil and natural gas industry to Eastern Ohio?
In Eastern Ohio, the oil and gas industry is one of the stalwart industries in the area. What most people don't realize is that the modern oil and gas industry really starts in Ohio. Not taking away anything from our brethren in Pennsylvania. The first well was drilled in Pennsylvania, but within a month, they were drilling wells in Ohio and by the late 1800s, Ohio was the leading producer of oil and gas in the world. That's how Ohio became such a large industrial manufacturing state. We have a lot of manufacturers because we had the energy to run the businesses and we had molecules to make things. Most people forget that there are over 6,000 products made from oil and gas. A lot of those products are made here in Ohio. There are over a thousand businesses in Ohio that make products from plastics. When you have both energy and a market, it's a great place to manufacture things. The oil and gas industry has always been important, and the shale industry has really increased that importance.

We did a study with one of the groups I volunteer with and found that if Ohio, West Virginia, and Pennsylvania were our own country, we would be the third-largest natural gas producer in the world, behind only Russia and the rest of the United States. If you look at the energy that comes out of the Appalachian Basin, the energy equivalence is comparable to the Permian Basin. Natural gas is not only cleaner but if you look at the increase in natural gas production, and the savings to Americans, conservatively, over the last 10 years, it saved consumers $1.2 trillion.

How would the elimination of percentage depletion impact Artex Oil and Gas?
We're a good example of percentage depletion because the majority of the money that we've used to drill is our own company money. We're not a publicly held company. We can't go out and issue stock. Bankers just won't, for a small company, lend you money to drill oil and gas wells. They just won't. We have to drill out of cash flow. Because wells deplete, we have to continually replace our production every year. Hence, we need to redeploy as much capital as we can which is why you have percentage depletion in mineral industries. It's because your asset depletes and you've got to continually replace it.

If you had to pay higher taxes, you just wouldn't be able to drill as many wells, and therefore production would decrease. Then the whole American economy will suffer from higher prices. The lack of spending will hurt our communities. We're locals, we're much more engaged with companies that are in the community. The fracturing company we use is a small fracturing company located in Ohio. It's employee-owned. Whereas a lot of big companies may be reluctant to use a local company, we've used them for years. Millions of dollars aren't flowing somewhere else, it's flowing right back to the employees in the company right here. We're very open-minded about using the small companies that are embedded in our communities.

What other regulatory changes are you concerned about?
We're extremely concerned about methane emissions. When you look at stripper wells, they're not very large sources of methane at all. Eliminating methane emissions from them wouldn't make any difference to the climate whatsoever but it would destroy our economics. The new wells that we're drilling, we can afford to put on the methane emission reduction equipment, but our wells that have been out there 20 or 30 years we can't and don't need to.

Another thing people don't realize is that a lot of these wells are supplying income for a farmer and gas at their house. In the East, for a lot of people, their primary source of energy is from the well itself. They don't have utilities and the well is their source of heat. You'd not only destroy the economics and we'd have to plug the well, but you would eliminate heat for a lot of people.

What else do you think is important for readers of this report to understand?
What most people don't realize is prior to COVID, every recession for the last 50 years was preceded by a spike in energy prices. All energy prices are set on the margin and when you start having public policies that discourage energy production, you're going to send prices up. These recessions can have really negative impacts on the average person. That's what happens when you start banning stripper well production on the margins because it's 10% or 15% of U.S. production.

Let's say you've got a husband and wife, they're struggling, raising a couple of kids, and all of a sudden, you double the price of energy. It may be an extra $5,000 a year. Where's the average couple who's struggling going to get $5,000 more a year to pay these bills? All the prices set on the margin, most experts say when you look at the economic equations for every 1% that you adjust supply, the price will move about 10%. You may not be able to travel when you want to travel and you may not be able to work when you want to work because there won't be enough energy to have the lights on at the place you work.

> Bankers just won't, for a small company, lend you money to drill oil and gas wells. They just won't. We have to drill out of cash flow...which is why you have percentage depletion.

PRODUCER PROFILE - WEST VIRGINIA

SAM MCKOWN

McKown shares how his company supports his community and how the percentage depletion allowance is helping keep his business afloat.

WHAT TO KNOW

Location: 12 counties in West Virginia

Number of Wells: 400 operating

Employees: 20 individuals

About C.I. McKown and Son, Inc.
My parents and I started the company. Nine months later, my dad got sick, and I took it over far too young at the age of 22. Early on we bought wells from larger companies that were exiting West Virginia, such as Pennzoil and Ashland. Then later we started drilling our own wells. We currently have less than 400 wells in central West Virginia, in 12 counties, right in the middle of the state, which are all stripper wells.

How many people does C.I. McKown and Son employ?
We employ just over 20 people directly but also buy equipment and services from other companies. We buy oil and gas-specific items from primarily three suppliers. One is a medium-size regional company. The other two are small, locally owned suppliers that have been around forever. One of them is actually a producer like ourselves who started his own supply house. We buy a lot of auto parts from locally owned suppliers, as well as the larger national chains. We buy a lot of fuel; we buy a lot of electricity. One of our suppliers is in a small town near our office, it used to be a booming oil and gas town, of course, it's not now. He owns an oilfield supply store. He runs it himself and he has one employee. Of his business, I would guess three-quarters of it is from small independents. That's his livelihood, if there were no independent producers, his entire income stream would be gone, and there really aren't that many of us that he caters to, probably 20.

How important is your company and the stripper well industry to West Virginia?
Well, I'm biased, but I think it's very important. While my company is small, small producers on aggregate are very significant. We pay pretty fair. For West Virginia, it's well above the median income and we try to do the right thing. We provide health insurance and a retirement plan so they're good jobs for Central West Virginia. Another thing we've done is, and I've loved to say this for years, I like to be stable. A lot of people in our business tend to ramp up employees, especially when there's a lot of drilling going on. Ramp up employees in the summer and then lay them off in the winter, and that's just something we've never done. When we hire someone, it is full-time, and if they work out, it's for as long as we're in business, and we make that clear. It creates stability for the employees. I just never thought it was good for an employee to always think they may get laid off come November. That's just been my thing.

What would be the impact on C.I. McKown and Son of eliminating percentage depletion?
Percentage depletion is very important for us. Things are still bad in the industry, but they've improved a little bit. Percentage depletion is one shining spot in our industry right now. Even though right now most entities are posting operating losses, especially given what gas prices were last year, so depletion doesn't come into play. But one of the reasons we hang around is because hopefully it will be used in the future. I would be lying to you if I told you I was taking full advantage of it right now, just because the industry is so bad. I have always viewed it as just a little bit of relief for the fact that we're in a, by it's very name, depletable industry. By its nature, the value of my business is worth less every year, and that's different than most industries. I've always thought depletion was a little bit of an offset of that to encourage people to stay in business in a depletable industry.

Other than the ability to utilize percentage depletion how else does the stripper well industry differ from larger producers?
The percentage depletion cutoff is 1,000 barrels, that takes out all of the majors and big independents. They have to use cost depletion. We are just a completely different animal than the bigger companies, I won't even use Exxon and BP as examples, but large independents, or the unconventional gas that we have in the Appalachian basin right now. Our capital is raised completely differently. We sell our own labor. The economics are different. In the early days I bought wells from companies that would not qualify for percentage depletion, the economics of those just didn't work for them anymore. That's why they got rid of them. Without us those wells would hopefully end up plugged and not end up being as I would call it, wards of the state. We have continued to produce wells that otherwise would not have been. One of the reasons we're able to do that is percentage depletion.

How important is the natural gas industry to West Virginia?
We supply local utilities, even more so now because the local utility just bought a big gathering system. A lot of our royalty owners, the checks go out, and they're West Virginia addresses. There is also free gas for most of these surface owners. I would say we supply around 200 homes with free gas. Where we supply the utilities, it keeps their cost of gas down, because they don't have to store it. A lot of the utilities have to buy storage, and we're just a direct supply. Their cost of gas is much lower than it would be otherwise, which they can pass on to consumers.

> We have continued to produce wells that otherwise would not have been. One of the reasons we're able to do that is percentage depletion.

Are there any other regulatory concerns facing the industry in West Virginia?
Probably one of my biggest concerns about the new administration is where they may go with methane emissions on existing low-volume-producing wells. A vapor recovery unit is a small cost on a well flowing a few hundred barrels a day of condensate, and 5 million cubic feet a day in gas, versus a well that's only flowing five thousand cubic feet of gas a day. The economics just don't work at the smaller levels. Having said that, I love the environment. Nobody wants dirty air and dirty water. The emissions from the unconventional wells producing large volumes could really be significant. But the emissions off of an oil tank that we have on a well, that makes half a barrel a day, pale in comparison to that. I live in Charleston, West Virginia, and I remember as a kid, the air quality used to be so bad it would be nauseating. We've done so much to clean that all up.

PRODUCER PROFILE - MONTANA

PATRICK MONTALBAN

Montalban talks about his generational business and how the percentage depletion allowance keeps smaller oil producers in business.

WHAT TO KNOW

Location: Montana & North Dakota

Number of Wells: 410+ operating

Employees: 11 individuals + 2 contract pumpers

About Montalban Oil & Gas Operations
Montalban Oil & Gas Operations (MOGO) has been in business since the late '50s. My father started the company and I took it over from him. My son is the third generation to continue building the company. We currently operate over 410 stripper oil and natural gas wells. However, throughout our career in the industry, we have been involved with every sector of the oil and gas business.

How important are MOGO and the industry to employment in the areas where you operate?
We work hard as operators to treat our employees very well with a good benefits package. Many of our employees have worked for us for over 20 years. Oil and gas companies traditionally pay a much higher wage. It is like a few other local industries; such as the rural electric or railroad companies. We've been in the business for a long time and we understand that to have a good operation, you need to have loyal employees.

How important is the industry to the region, especially in rural areas?
You will find that stripper properties that are operated in rural communities are critical to the area because they provide high-paying jobs. Most of the people in the oil and gas business have an average income of between $50 and $80 thousand per year. Some of the jobs associated with the industry are rig operators, water haulers, truck drivers, roustabout crews, etc. These service entities would not exist if not for the local stripper well operators.

The stripper well industry is extremely important to rural communities, as it provides high paying jobs. The money stays in the rural communities and adds to the local tax base, providing support for schools, hospitals, and other small businesses, restaurants, bars, grocery stores, etc. It takes a company the same amount of time, effort, and cost to produce a three-barrel-a-day well as it takes to produce a 300-barrel-a-day well. The bottom line is that stripper wells still create jobs.

What role does the stripper well industry play in producing older fields that may have been developed by larger companies?
The way it works, in our business, is that a lot of these fields were discovered back in the 1930s and 1940s. The Cut Bank field was discovered in the 1920s. It was developed by independents until the 1940s and 1950s. Then, major oil companies moved in. We had Exxon, Phillips, Conoco, Unocal, just about every major oil corporation here at one time, until they sold out. The latest acquisition that we made, almost a year and a half ago, was a property originally developed by Unocal in the 1940s to 1970s. They sold it to a larger independent in the early 2000s. This company had it for 18 years, and then we, as a small independent stripper producer, bought it. These stripper properties are always going to return to the local small independents.

How damaging would it be for the industry if percentage depletion were eliminated?
The depletion allowance is extremely important to the oil and gas industry because for stripper businesses these wells are not making 20 to 100 barrels a day. These wells are only making 1/2 a barrel to two barrels a day. When you take away 15% of your income by eliminating the expenses that we are allowed to take on these wells, it is very drastic because of the very low volumes and very low income at low prices for the commodity. It is also very critical to our mineral owners who also take advantage of the depletion allowance.

> If we did not receive the depletion allowance, you would see several wells shut down. If we plug these wells, that income is no longer generated, jobs are lost that created taxes paid by employees, and no money flows back into the local communities.

Many of the incentives that larger companies receive are not available to stripper well producers. For example, the foreign tax credit is an incentive for the major oil companies to develop natural resources around the world. This is not an incentive that benefits the stripper operator. Intangible drilling costs can be a benefit to stripper operators when the price of oil allows for development with internally generated cash flow. Thus, one of the only tax incentives that benefits small stripper producers is the depletion allowance. The important thing about the depletion allowance is that it enables us to produce half, one, or two-barrel-a-day wells for a longer period-of-time and delays the need to plug and abandon the wells. It allows us to keep our costs down when the price of the commodity is down. If we did not receive the depletion allowance, you would see several wells shut down. If we plug these wells, that income is no longer generated, jobs are lost that created taxes paid by employees, and no money flows back into the local communities.

How important is the depletion allowance when oil prices are low?
Most people do not realize that when the price of oil goes down, our service costs do not go down. One of the largest costs of producing a stripper oil well is electricity. If our price goes from $50 a barrel to $20 a barrel, we still have the same cost for electricity and the same cost for chemicals. That is why the depletion allowance is so important to us. We do not see the cost of hauling water, service rigs, backhoes, and other services for these wells decrease. In these rural communities, there are only one or two different service companies from whom you can get a competitive bid. The depletion allowance allows us to operate stripper wells economically at low crude prices.

Can you speak to the pricing differentials companies in areas like Montana receive?
Yes, I think that it is a very critical part of the oil and gas business. When you watch Bloomberg, CNBC, or Fox and see the price of oil, it is based on WTI (West Texas Intermediary). We are currently receiving a $9.50 differential from that posting. Essentially, our price at the wellhead is $9.50 less than the posting price people see in the news. In Billings, Montana, where there is local refining, they can pick all the barrels that they want from Alberta and ship them via pipeline. That is what we compete within our area, the Alberta barrel. The important part is to look at the net value of what we receive for our barrels. We are producing in a very rural area and far away from the Cushing area of Oklahoma where prices are set.

NICK POWELL

Powell explains how he got started in the oil business and how the percentage depletion allowance supports micro businesses and small communities.

WHAT TO KNOW

Location: Eastern Kansas

Number of Wells: 800 operating

Employees: 32+ individuals

How was Colt Energy founded?
The Colt family started this business back in the 1920s. It's an almost 100-year-old company that has always operated in Eastern Kansas. Our headquarters for operations is Iola, Kansas in Allen County and we produce across Eastern Kansas.

How did you get involved in the oil industry?
I got started in the business working for a trucking company back in the 1970s. The trucking company was consuming about a quarter of a million gallons a day of diesel fuel, and I was doing the purchasing of the fuel. They decided to get into the oil and gas E&P business like many other utilities and transportation companies were doing as a result of the oil embargo. We were being allocated 80% of last year's sales by suppliers of diesel. They started a company called Overland Energy as a subsidiary and got into investing with other E&P companies and I managed that.

In 1981, the trucking industry was deregulated. When they got out of the energy business, I decided to stay in the oil business in Kansas and then I made an acquisition of the Mack P Colt Energy company in 1986. That was really my move into the industry and we then changed the name to Colt Energy. We grew from about 125 barrels a day up to 800 barrels a day by 1998. In 1998, the price of oil then dropped drastically again from the mid-30s back down to 12. We currently do about 400 barrels a day of crude oil production and just under 2,000 cubic feet a day in gas production.

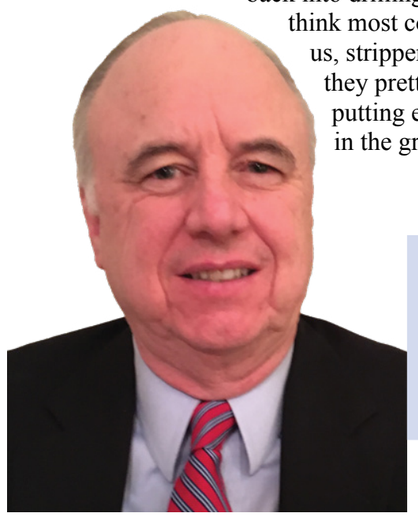
How many people does Colt Energy employ?
We've got 32 full-time employees currently and a few part-time people on top of that. Of those, about six of them are based in Kansas City and most of the rest are based in Allen County, but we also have some down in the south. So, for the most part, they are in smaller towns.

Most of our employees are field employees who are not college-educated. We have our pumpers to manage our leases. We have crews to do our own small scale well workovers like repairing downhole problems. Then we have a team that repairs and installs tank batteries and production lines. We do all those things in-house, and outsource all of our drilling and completion work.

How many new wells did Colt Energy drill in the last year?
We drilled four this year so far, including some in December and some in January that were more exploratory. If pricing stays where it currently is for another few months, we'll probably be looking at starting a drilling program in the spring or summer. We operate in an old field and we're just drilling to see what's left behind. Our wells are generally less than 1,200 feet in depth. Typically, 500 to 1,300 feet in depth for oil, and for gas a little deeper. Our average well makes a barrel a day or less.

That's what separates us from larger companies, and it's why we're the type of people who can take advantage of percentage depletion because it only covers the first thousand barrels a day. The majors have single wells that produce a thousand barrels a day. We're on the lower end of wells in Kansas that produce on average 5 barrels or less per day with an average production of a barrel a day or less per well.

What would be the impact on Colt Energy of eliminating percentage depletion?
When you look at percentage depletion for these stripper wells, most of these old wells have already used up all their cost depletion and so the only way to be able to reduce the tax burden is through percentage depletion. These are also low-margin wells because it costs a lot more in terms of man-hours to manage so many wells to get so little oil, so we've got higher operating costs per barrel, high lifting costs, whereas the majors might be $10 a barrel, we've got thinner margins, no cost depletion, and so that percentage depletion of 15% of gross income on a well that may only have 30% operating margin when oil and gas prices are good, it's a big impact on your taxable income and then dollars that can be put back into drilling and hiring. I think most companies like us, stripper oil producers, they pretty much end up putting everything back in the ground that they are earning in order to maintain their production. So, if you eliminate percentage depletion then you just take that off our cash flow and we drill less, see slower to no growth rates, and fewer, if any, people hired.



> I think most companies like us, stripper oil producers, they pretty much end up putting everything back in the ground that they are earning in order to maintain their production.

How would eliminating percentage depletion impact Kansas and the communities where you operate?
Kansas, in particular, is almost exclusively a stripper well state. We have a lot of old wells where if you eliminated percentage depletion, you'd take a big chunk of wells and they'll just knock-off into the uneconomic category. We're people-intensive, when we're putting dollars into new wells, the ratio of that money going to people instead of steel and drilling rigs is much more people-intensive. A bigger share of our investment goes back into jobs instead of steel that is imported from overseas, it drives right back into local hiring.

That hiring helps small communities that are struggling. In states like Kansas, we've become a pretty good employer in the areas we operate in. We have good jobs in the industry. We pay an average of over $20 an hour. Our field employees average 45 hours a week based on nine-hour days, and we provide health insurance, 401(k) matching, and vacations. Many of the people we hire were making less than $15 an hour or making $15 an hour with no benefits. If you lose those jobs, that's a loss for the communities as well. In a town of 6,000 including the surrounding community, these jobs are important. In these communities, there are not very many employers who offer jobs that pay $55,000-60,000 a year or better plus full benefits.

DICK SCHREMMER

Schremmer shares when he started his first oil and gas business and how the percentage depletion allowance has allowed him to succeed.

WHAT TO KNOW

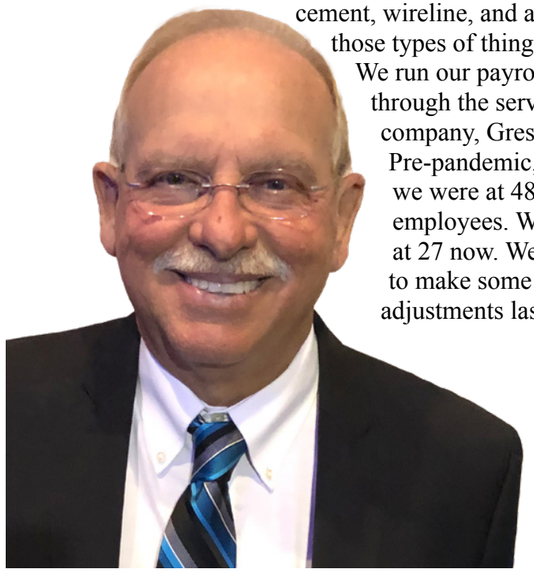
Location: 25 counties in Kansas

Number of Rigs: 13 well service rigs

Employees: 27 individuals

About Bear Petroleum.
I started Bear Petroleum in 1985. I had previously been with Gulf Oil where I was a production supervisor for 12 years. I went out on my own in 1985 and put some money together to drill a few wells, and then I've just grown the company from there. We operate in 24 counties in Kansas, and one county in Oklahoma. We're scattered from the Colorado line belt to Eastern Kansas, all the way north to Nebraska.

How many people does Bear Petroleum employ?
Bear Petroleum doesn't have any employees. I also own a service company named Gressel Oil Field Service. We use that company for most of our services and supplies such as acid, cement, wireline, and all those types of things. We run our payroll through the service company, Gressel. Pre-pandemic, we were at 48 employees. We're at 27 now. We had to make some major adjustments last spring when the low prices hit because we didn't know how long it was going to last. We shut down two wells servicing crews and a tank truck, plus a couple of other things. We're pretty self-sustaining. We do electrical service work, we have acid, cement, a wireline company as well as field supply stores. We also have downhole pump shops, and a packer, plug, and tool rental business. We've got 13 well service rigs, though we're down to just two crews. We're trying to get more started up, as we've been working four or five contract crews lately. We use a few different tank trucks and pulling units from outside the company.



You mentioned Bear Petroleum operates in 25 counties, what are those counties like?
They are all rural counties except for Sedgwick County, which would be the county that Wichita, Kansas is in. Other than that, most of them are really rural. When you get up to areas around Western Kansas, Morton County, and up North in Decatur County by the Nebraska line, it gets pretty rural.

How do the jobs you offer compare to others available in the communities where you operate?
Oh, there's no doubt they're good jobs. Our minimum wage, we start people out as $13 per hour on the well-servicing rig. If they're around very long at all, they're making $18 or $20. Other jobs like wireline, propane, acid, are all Department of Transportation certified and pay even more. I have to have more experienced and qualified drivers for those jobs, with Hazmat licensing. We've got good-paying jobs for the industry, and we have full health insurance and 401ks we fund, as well as safety programs. In these communities, the people that work for us are doing very well.

What would be the impact on these communities if oil and gas jobs were to go away?
Well, it would be huge because these people wouldn't have the money to go to restaurants and they wouldn't have health insurance to go to the doctor. It'd make a big difference. There's just lots of money being spent that comes from the industry. In Kansas, for many years, oil and gas has been the second biggest moneymaker for the state. It creates a lot of jobs and creates a lot of tax dollars for roads, schools, etc. It would be a huge impact to lose those jobs.

What has been the impact on Bear Petroleum of recent low oil prices?

Our biggest cost in producing stripper wells in Kansas is our electrical rates. We've got wells that lift a lot of water to get a barrel of oil and, due to those high lifting costs, we just couldn't afford to produce those back through June. We didn't have any choice but to shut them down.

Then once you're shut down, there's always an expense to starting back up. You have to have your cash flow up to where you can afford to turn these wells back on. As we've come into the end of the year, we still have wells down that we shut down last March. We're trying to get them back on now, but want to make sure we've got the money to pay our bills at the end of the month.

What is your biggest regulatory concern right now?
Methane emissions regulations are one of our biggest concerns. The initial study on methane emissions looked at wells around the Dallas–Fort Worth airport, and those wells were leaking pretty badly. They just took those numbers and ran them across the board for the rest of the United States.

"In Kansas, for many years, oil and gas has been the second biggest moneymaker for the state. It creates a lot of jobs and creates a lot of tax dollars for roads, schools, etc. It would be a huge impact to lose those jobs.

I'm part of the Kansas Independent Oil and Gas Association and we funded a study to see what kind of methane we were leaking. They came up with hardly anything. As a matter of fact, they sent their meters in for repair because they didn't think they were working because they weren't coming up with any methane gas. That tells us that the stripper wells are not the big problem with methane gas.

When they come out with a one-size-fits-all regulation, "it has to be the same for each installation," then the small producers will be forced out of business and all our jobs will be lost. Our economics just don't work. We're independent and we own the wells. We're putting our own money in it, it's not investor money, it's not Wall Street money, it's not stock money. It's money that we've gone out and raised ourselves and we put it back into our business.

Is there anything else you think readers should know about the industry?

In the Midwest, and Kansas again, we're actually the oil reserve for the country. When we need it, when the price goes up, that's when we can afford to produce it. When the nation has too much oil and the price goes down, we don't produce as much oil because we can't afford to do it with our lifting costs. You give us $60, $70, we'll go out there and start producing the oil and drilling wells and getting things done. Without that, when you go to a gas pump, the price of gasoline will be higher, people may not be able to afford to heat and cool their house.

DARLENE WALLACE

Wallace shares about her experience in the oil industry and the impact of the potential elimination of the percentage depletion allowance.

WHAT TO KNOW

Location: Seminole County, Oklahoma

Number of Wells: 20 operating

Employees: 2 individuals

Tell us about Columbus Oil Company.
Columbus Oil Company was established by my husband in 1971 in Seminole County, Oklahoma, and is still based in the city of Seminole. He started it in '71, we married in '79, he died in 2004, and I've been running it ever since. Seminole is still pretty active in the oil and gas business. Back in the '20s, it was the largest oil field at the time. Now, almost everything is stripper wells. It's a very small operation and has always been somewhat of a mom and pop organization.

How many employees do you have?
Right now, it's just me and my field manager. We source everything else out. My field manager has been with me now for 27 years.

How many wells do you operate?
We operate 20 wells in Seminole and Pottawatomie County, which are side by side. We can drive to all of our wells in one day, even though it's a rural area.

What kind of services does Columbus Oil contract for to support your operations?
For paperwork and administration. I contract things out to our accountants, and my five pumpers are contracted. The people that do work on the wells themselves, pumping units, roustabouts, hot oil treatments, trucks that haul water, are all contracted. We also buy supplies here in town. We have electricians, welders, chemical companies. Whatever goes on in the oil business, we use.

How important is the stripper well business for the communities where Columbus Oil is located?
Oil is a good business for rural areas. You have the opportunity not to live in a crowded urban area and you get that small-town atmosphere. Everybody knows everybody. That includes in the business. We know all the service companies and they know us. We do business with everybody and we support each other.

Tell us about your wells.
All of our wells are vertical stripper wells. Most of the oil companies in this area are small stripper well producers employing eight or nine people, many even smaller. The husband takes care of the field, the wife takes care of the books, and they have one person that helps them do everything else. For everything in this town, including the schools, the oil business is probably 80% of the tax revenue. It trickles down to the grocery stores, the restaurants, and the churches.

How does oil support other organizations in your community?
We're a member of the Chamber of Commerce for the town. All those things that our community has the oil and gas industry helps keep alive. When times are good, we give money to all these organizations. We also have a junior college where we give out two scholarships every year. Most of the producers in this area are like that. We're just a small community of people helping each other make a living.

How important is percentage depletion to companies like Columbus Oil?
I am truly one of the smaller producers. I've got some wells that I haven't switched back on since April 2020, when we had to shut down all of the wells for two months until prices got back up. Percentage depletion has allowed me to keep my wells in really top-notch running condition. If a well goes down, I have the money in my reserve to fix it or to do an acid job or change a pump. Percentage depletion helps small producers keep wells viable. If you don't take care of your wells, they can't produce. If I can't change my pumps every year or so, they wear out just like everything else and wells start declining. When you change a pump out, you've got to buy the pumps, you've got to have the crew, you've got tank trucks out there to flush it out. All these things cost money, and percentage depletion helps us do them. Without percentage depletion we would see a decline in the industry, and the areas we live in can't afford that.

How could Seminole be affected if percentage depletion was eliminated?
Seminole is pretty small, about 6,800 people, but we are the largest city in the county. It would be devastating if the oil and gas business really gets any worse for this town.

Oil companies do things like buying the equipment for the football, basketball, track, and cheerleading teams.

How do you help people who are affected?
I was born and raised in the DFW area and then lived in New York City for two years when I left home after high school. In big cities like New York or Dallas, you do not see how these things affect people because there's so much industry in large towns. We have a huge low-income housing development because getting those people to move to rural areas helps them get housing, health care, and jobs. You see people who can't get a job in the city come down here without an education, without a lot of skills, and they can get a pretty decent job when the oil field is going well. We know our neighbors from the churches and community centers, and if you know your neighbor hasn't worked for six months you see if you can't help him get a job. That's how small rural towns do things. We work with what we've got and to make it good for everybody.

> Percentage depletion helps small producers keep wells viable. If you don't take care of your wells, they can't produce. Without percentage depletion we would see a decline in the industry, and the areas we live in can't afford that.

PRODUCER PROFILE - ILLINOIS

J. NELSON WOOD

Wood explains how the oil price downturn hit his company and how the percentage depletion allowance impacts his community.

WHAT TO KNOW

Location: Illinois Basin

Number of Wells: 160 operating

Employees: 13 individuals

About Wood Energy

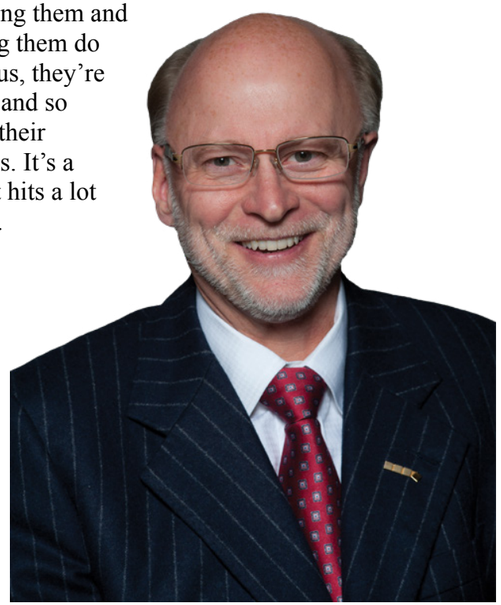
Our company had its beginning in 1952 in Illinois. It was formed by my mother and father. My mother got into the oil business in 1938, my dad in 1948. They eventually formed a partnership and created our company in 1952. They are both deceased, and I've taken over. We started as, and remain, a small independent company drilling and operating oil wells in the Illinois Basin. We operate around 160 wells, the average production two barrels a day.

How many people does Wood Energy employ?

We presently are at 13 full time employees due to the downturn and the pandemic. Historically, we have had around 25 employees. My three supervisory personnel have high school educations, but they command six-figure wages because of their abilities and their leadership. Southern Illinois, particularly, is an economically depressed area and there are not a lot of jobs with those types of salaries. All of our jobs, our laborers, rig hands, and roustabouts all make more than minimum wage. I have several long-term employees that have been with me in excess of 10 years.

What types of goods and services does Wood Energy purchase?

Wood Energy purchases casing, tubing, rods, and other products to operate and drill wells from supply stores, hardware stores, and plumbing supply stores. We outsource a lot of our well repairs, infrastructure repairs, pipe repairs, that sort of thing to third parties. There are several companies that have existed here since the 1950s or 1960s, they're still in business and our spending hits them directly because if I'm not buying supplies from them, hiring them and not having them do work for us, they're impacted and so are all of their employees. It's a chain that hits a lot of people.



How has the oil price downturn impacted you?

In April, we did not sell a barrel of oil. That's the first time our company has not sold any oil in a month since 1952. We were hanging on trying to survive, but it's been very difficult. Due to the layoffs we are all taking on more responsibility and duties to keep the doors open. As is the case with any business of commodities, we are governed by that commodity price. Because of the slight recovery in oil prices, we're starting to see a little activity, not near as much as there needs to be, but I do see things improving a bit slowly because we can't turn things right back on, particularly the wells that were shut in as the pandemic raged. For many of those, you can't just flip the switch and turn them back on. We're having to go back in and do repairs. We're in the process of that, and I think many other companies are. We're certainly not back up to optimum levels. As far as drilling, I have projected that I'm going to try to drill two new wells this year, that's what I hope to do, which is down from my normal average of five to six wells a year, so it's about half or less than half of what I normally would have done.

How would eliminating the percentage depletion allowance impact the industry in Southern Illinois and the communities where it operates?

Eliminating the depletion allowance would be devastating because the wells we have are stripper wells, therefore we have to go back out and replace barrels that deplete every year. Every company in Illinois has a minimum of around 5% a year of loss in production due to natural declines in the reservoirs. If you're not replacing those barrels, either by drilling or acquiring new production you are withering away. If you have a 20-year life cycle, then you're completely without anything. If you're not going back and drilling and finding new production, you go away and your employees go away. The depletion allowance allows us to take that money to drill and acquire more wells to keep our company viable. When that resource has been depleted, we can't go back and tap it anymore. We're not like a factory that can keep producing widgets. We have to have incentives to go back out. They're not subsidies, we're not handed a check by the government for this. This is just a deduction, just like any normal business does under normal business activity.

Eliminating the depletion allowance would impact everyone that touches our company and most importantly our employees' lives. In Illinois, we have over 4,000 direct employees in the oil and gas industry. That exceeds coal or any other natural resource in Illinois and those jobs would be at risk.

> "Eliminating the depletion allowance would impact everyone that touches our company and most importantly our employees' lives. In Illinois, we have over 4,000 direct employees in the oil and gas industry.

How does the stripper well industry differ from the rest of the oil and natural gas sector?

We are typically lumped in with major integrated companies, with all of the oil and gas industry, but are a separate and distinct part of the industry. We are small business people who risk capital and explore to find new oil in the U.S. not overseas. Independents find almost all the new oil and gas in the continental United States and develop it. If we're gone, then we have to go to unstable sources overseas such as Saudi Arabia and other OPEC countries. It helps shape our foreign policy; it does many things. The stripper well industry is the small independents, but collectively we amount to a lot. Most areas where stripper well companies operate are also in economically depressed areas. We are in areas that need jobs and need the stable jobs that we provide.

PRODUCER PROFILE - NEW MEXICO

JOHN YATES, JR.

Yates shares how his family company evolved and how the percentage depletion allowance is for the small producer.

WHAT TO KNOW

Location: Eddy & Lea Counties, New Mexico

Number of Wells: 5 operating

Employees: 20 individuals

About Abo Empire.
The company started when my sister and I merged our old family companies. A lot is owed to our ancestors including grandparents, whom we never met, and our parents, who laid the groundwork for the businesses that we participate in. It's all because of their foresight and risk-taking acumen. We had some remnant of leaseholds, leftover properties that were mostly marginal, some undrilled federal acreage in New Mexico, and we had working interests in other people's operated properties.

My sister and I decided that our family would continue on in the industry in a smaller way. We called our new company Abo Empire. Most of our production now is from stripper wells and as a small producer, we are challenged here in New Mexico with all the regulatory issues. Most of our wells don't make enough production, especially at low oil prices, or low gas prices, to be very economic, even in good times, and they are especially uneconomic in bad times. Our bread and butter is just trying to make these marginal wells pay.

Where do you operate?
We operate in Eddy County and Lea County here in New Mexico. Those are the two prominent counties in New Mexico, then in the Delaware Basin.

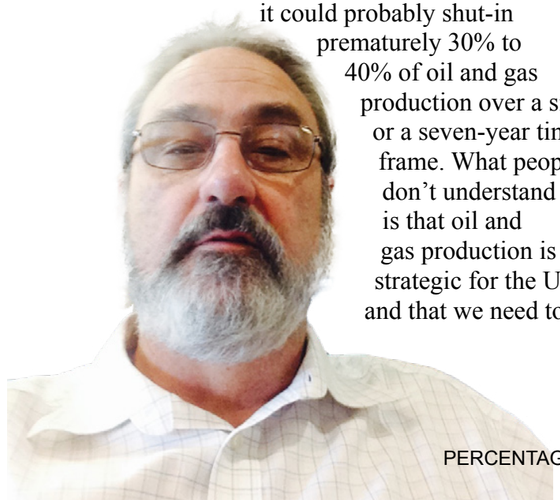
How many employees does Abo Empire have?
We have about 20 employees. Whenever there are low oil prices, people don't appreciate the fact that we're continuing to produce, and we still have to pay our employees. Our costs don't come down with the price of oil. Our employees mostly have been fine during COVID, and we didn't have to lay anybody off. Lots of people around us did, and a lot of businesses went under. A lot of the employees here have been with us for a long time. Some of these people have worked for us as many as 40 years, and others 30, and some 20. Most of our employees are long-time employees.

What types of services do you buy to support your operations?
Most people that are in the field, that are pumping wells and working on wells. Mainly because our production that we operate is mostly really marginal so we use outside contractors to pump the wells. We hire pulling and workover units. Occasionally, we ourselves drill, but mainly our partners do and they hire drilling rigs and fracturing crews. It's sometimes the kind of thing where a guy lives up by a well and checks on it every day. It can be like a mom-and-pop type thing.

How do these jobs compare to others available in the communities where you operate?
For sure, these are good jobs. I would say most of our bookkeeping folks have just learned the job by doing, for example, but don't have advanced education. But there are some people that have degrees or have parts of degrees. A lot of what our people do is just by experience. I think that for every job that's in the office, the 15 to 20 employees that we have, there's probably a multiplying factor of two and a half to four times, of other jobs that are created in the community that would be lost if these jobs went away. The state of New Mexico receives a third of the state budget from our industry as well so, anything that impacts the industry will impact that also.

How would the elimination of the percentage depletion allowance impact companies like Abo Empire in New Mexico?
I think it would really hurt the small independent operators if percentage depletion were eliminated. To me, percentage depletion is for the small producers. It may not be good for the majors of the world who make different decisions because they have upstream and downstream operations. It's helpful to build capital so that we can reinvest. It would get a lot harder to operate marginal wells as the economics just wouldn't make sense.

If we lost percentage depletion in New Mexico, it could probably shut-in prematurely 30% to 40% of oil and gas production over a six or a seven-year time frame. What people don't understand is that oil and gas production is strategic for the U.S., and that we need to support plenty of reliable cost-effective energy. Cost-effective strategies where we don't pay high prices for electricity and saddle people with costs that they just can't afford.



> If we lost percentage depletion in New Mexico, it could probably shut-in prematurely 30% to 40% of oil and gas production over a six or seven-year time frame.

Is there anything else you think readers should understand about the oil and gas industry?
Many of the countries where oil is produced have terrible environmental records. In the U.S., the industry is far better at doing things right. We're much better stewards of the land here in the U.S. We're also innovators that have brought a lot of new things to the fore in the last 60 years including fracking which started basically after World War II.

My dad was at the forefront of trying it over here, he was probably the first operator in the Permian to frack a well and it worked. Of course, he had to learn about it. He was an avid reader, he found out about it and he took a big risk, but it worked. We are always trying to uncover new technologies that are coming to the fore to make production more efficient, and also potentially even be more benign to the environment. These technologies may really take off, but it takes a lot of money upfront and we don't know what the results could be. The domestic industry is good at promoting novel technologies and startups. Finally, when state and federal governments provide encouragement by making terms reasonable to justify taking risks, by having risk profiles commensurate with the potential of suitable rewards, that is the key to encouraging entrepreneurship and stewardship.

GLOSSARY OF TERMS

COST DEPLETION

One of two accounting methods used to allocate the costs of extracting natural resources, such as oil and natural gas, and to record those costs as operating expenses to reduce pretax income.

EXPLORATION & PRODUCTION (E&P)

The early stage of energy production, which includes searching for and extracting oil and gas.

GROSS DOMESTIC PRODUCT (GDP)

The total value of goods produced and services provided in a country, state, or another area during one year.

GROSS INCOME

For a business, also known as gross profit or gross margin, includes the gross revenue of the firm less the cost of goods sold, but it does not include all of the other costs involved in running the business.

IDLE WELL

A well that is not producing or injecting and has received state approval to remain idle.

INTANGIBLE DRILLING COSTS (IDC)

Costs related to drilling and necessary for the preparation of wells for production, but have no salvageable value. These include costs for wages, fuel, supplies, repairs, survey work, and ground clearing. They compose roughly 60 to 80 percent of total drilling costs, and are 100 percent deductible in the year incurred.

INVESTMENT CAPITAL

The money used to acquire plants, equipment, and other items needed to build products or offer services. Investment capital is also referred to as financial capital. In the context of the oil and natural gas industry, it typically refers to outside investment capital.

MAJOR OIL & GAS COMPANIES

Typically the largest of all oil and gas companies that are vertically integrated and directly involved in exploration, production, refining, transportation, and marketing.

MARGINAL WELL

A marginal well definition is about economic viability, whether the extraction of oil and gas is profitable. To define a particular well as a marginal well depends on oil prices, and the cost of production, unlike a stripper well that has a definite output attached. Stripper wells tend to be marginal wells, but a marginal well might not be a stripper well.

NET INCOME

Calculated as sales minus cost of goods sold, selling, general and administrative expenses, operating expenses, depreciation, interest, taxes, and other expenses.

PERCENTAGE DEPLETION

A tax provision that allows oil and natural gas producers to recoup some of the costs involved in exploring for and producing oil and natural gas. Percentage depletion is calculated by applying a 15% reduction to the taxable gross income of a productive well's property. The reduction is determined on a property-by-property basis and is limited to the taxpayer's first 1,000 barrels of oil (or 6,000 Mcf of natural gas) of production per day. It is also capped at the net income of a well and limited to 65 percent of the taxpayer's net income.

PLUGGED AND ABANDONED

Wells that have had plugging operations during the calendar year. It does not include wells that have been plugged back up-hole to kick the well, etc. This category does not necessarily exclude those with site restoration remaining to be completed.

ROYALTY OWNERS

Ownership of a portion of a resource or the revenue it produces. A company or person that owns a royalty interest does not bear any operational costs needed to produce the resource, yet they still own a portion of the resource or revenue it produces.

STRIPPER WELL

For tax purposes, a stripper well is defined as any oil or natural gas well whose maximum daily average oil production does not exceed 15 barrels of oil, or any natural gas well whose maximum daily average gas production does not exceed 90 Mcf, per day, during any 12-month consecutive time period.

TEMPORARY ABANDONMENT

Cessation of work on a well pending determination of whether it should be completed as a producer or permanently abandoned. A temporary abandoned well can include wells that were formerly producing but are temporarily abandoned, waiting on a decision to restart or plug.

SOURCES

Energy & Industrial Advisory Partners [2021, February]. The Economic Impacts of Eliminating the Percentage Depletion Allowance

Flaticon.com. Clipart in this booklet has been designed using resources from Flaticon.com

National Association of Royalty Owners, U.S. Senate Committee on Energy and Natural Resources Hearing (February 4, 2010)

EXHIBIT A

2313 N. Broadway, Ada, Oklahoma 74820

(405) 228-4112

admin@nswa.us

www.nswa.us

National Stripper Well Association