Testimony of

Mr. Michael D. Watford

On Behalf Of The

Independent Petroleum Association of America

Before the

Natural Gas Caucus

July 25, 2012

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Mr. Watford was appointed Chairman, President and Chief Executive Officer, of Ultra Petroleum Corp. in 1999. In his thirteen year tenure with Ultra Petroleum, he has led a successful restructuring of the Company and has subsequently grown its proved reserve asset base from 0.5 Tcfe to approximately 5.0 Tcfe while the market value of the enterprise has increased from $50.0 million to $5.5 billion with consistent growth in profits.

Mr. Watford has enjoyed a full range of industry experiences while working over his 37 year career for a number of energy companies including Shell Oil, Superior Oil, Meridian Oil (Burlington Resources), Torch Energy, and Nuevo Energy. Prior to joining Ultra Petroleum, Mr. Watford was Chief Executive Officer of Nuevo Energy Company for three and one-half years where he led the company's growth in market value from $200.0 million to over $1.0 billion.

Mr. Watford attended the University of Florida where he earned his undergraduate degree in Finance in 1975. While working for Shell Oil, he attended night school at the University of New Orleans where he earned his MBA in 1978.

Previously, Mr. Watford served as a Director on the Boards of Southern Minerals, Nuevo Energy, and Bellwether Exploration. He has exploration and production experience domestically and internationally and was briefly involved in coal-mining. He has worked in the downstream refinery and chemicals business and managed product marketing, processing, and pipeline businesses.

Currently, he serves as Vice-Chairman of the Independent Petroleum Association of America; on the Boards of Valerus and America's Natural Gas Alliance; in addition, he is a member of the National Petroleum Council, an oil and natural gas advisory committee to the Secretary of Energy.

Representative Murphy, Representative Boren, and all the members of the Natural Gas Caucus, thank you for providing the opportunity for me to speak with you today. My name is Michael Watford. I am the Chairman, President and Chief Executive Officer, of Ultra Petroleum Corp. Ultra, is among the Top 20 U.S. natural gas producers ranked by production. In Wyoming, where our primary operations are located, we are the second largest producer, behind EnCana, and larger than Exxon Mobil.

Additionally, I currently serve as Vice-Chairman of the Independent Petroleum Association of America. Independent producers develop 95 percent of American oil and gas wells, produce 68 percent of US oil and produce 82 percent of US natural gas. These companies operate principally as explorers and producers of oil and natural gas – selling their product to others who transport, process and distribute final products. Independents range in size from small mom-and-pop operations to large, publicly traded corporations. According a recent study by IHS Global Insight, onshore independents supported 2.1 million jobs in 2010, and contributed over $320 billion of U.S. GDP in 2010, a figure that will rise to over $466 billion by 2020.

Clearly, independents play a major role in the development of America's oil and natural gas industry. Equally clearly, natural gas can be a linchpin to a more secure energy future and a strong economy. Natural gas production has been a bright spot in what has otherwise been a dismal business economy in our nation for the past several years. However, future American natural gas production can be enhanced or prevented based on actions by the federal government. For independent producers federal government decisions can determine our access to capital, our access to resources and the scope of the nation's regulatory system.

Because independent producers derive their revenues from selling produced natural gas and oil, federal government actions that reduce our investment capital will result in significant reduction in American energy production and the economic machine it fuels.

Arguably, the most significant current risk to this industry are the various proposals floated by the Obama Administration and some in Congress to single out the oil and natural gas industry and punitively repeal our ability to deduct ordinary and necessary business expenses. Like any business, the oil and natural gas industry pays taxes on income, which are earnings after the costs of doing business are deducted. One of the primary reasons the U.S. Tax Code is structured this way for businesses across all sectors was so that capital could be recovered for reinvestment thereby spurring further growth and a healthy business economy. This should not be confused with "subsidies," which are targeted tax reductions or direct payments from the government for a narrowly defined purpose. Unlike a subsidy, producers must first make an investment in order to be able to deduct it for tax purposes.

One particularly threatening tax proposal by the Administration would eliminate the current treatment of drilling costs. Under current tax policy, companies can deduct the costs of drilling that have no salvage value. Singularly this one change would on average reduce independents' capital expenditure budgets by about 20 to 25 percent. For producers, our capital budget is our drilling budget. What this means for a company like Ultra is that we would pay an additional $189 million in cash taxes for 2011. This amount reduces Ultra's cash flow by 20 percent, meaning less available capital to invest in drilling wells. The ability to deduct expenses for those costs that have no salvage value is not unique to oil and natural gas producers; there are comparable provisions elsewhere in the tax code. Research and experimental expenditures as well as expenditures by farmers for fertilizer are two examples. Moreover, the ability to deduct the costs associated with drilling a well also applies to geothermal wells. Despite these facts, the Obama Administration has only proposed repealing the intangible drilling cost provision for the oil and natural gas industry.

A second punitive tax provision that has been proposed is the availability for oil and natural gas producers and royalty owners to take percentage depletion deduction for mineral assets. All mineral resources from sand to gold are allowed a deduction for percentage depletion. However, only the oil and natural gas percentage depletion has been targeted for repeal. Without detailing the issue now, it is essential to understand that this repeal would primarily affect small business producers and royalty owners.

Most small independent producers are operators of America's marginal wells – wells that produce about twenty percent of U.S. oil and about twelve percent of U.S. natural gas. Percentage depletion can be essential to keep these wells economic and operating. If they are shut in because they become uneconomic, they are lost forever as is that U.S. production.

In addition to direct hits on capital budgets through the tax code, another threat to the economics of drilling can be a death by a thousand cuts through an uncertain and overly burdensome regulatory regime. Currently, there are approximately a dozen federal agencies working through multiple approaches in pursuit of an apparent agenda to federalize the regulation of oil and natural gas activities, as though no regulatory structure currently exists.

Even studies by the federal government have showed an almost blatant disregard for the success that robust state regulatory regimes have already achieved.

State programs have effectively and aggressively policed this industry for over half a century, managing the environmental risks associated with resource development as well as balancing local interests and local concerns in the areas nearest the activity. States are uniquely qualified based on a long history of developed expertise and because of their inherent flexibility, which allows them to adapt to ever changing and evolving technology and circumstances. Contrarily, federal proposals that have come out so far have lacked any true justification, often times are based on highly questioned assumptions and utilizing economic analysis that varies widely from reality. One example would be EPA's excessive estimation of methane release it used as a basis for its recent air emissions regulations; an estimation that has been characterized as being off by a factor of 14. Taken in tandem, these efforts are likely to have a much greater negative impact than represented, making it increasingly difficult to grow and create jobs in the United States.

Nowhere is this more apparent than in the west, offshore, and Alaska where the federal government has predominant control and significant resources are going underdeveloped to the detriment of the American taxpayer who owns them. In contrast, in places like Ohio, Pennsylvania and North Dakota, economies are growing because of increased American oil and natural gas production led by independents operating on private and state lands. Other supporting industries – like restaurants, hotels, trucking companies, the steel industry - are realizing growth and renewed economic activity because of their proximity to these American oil and natural gas plays.

By any estimation, this growth, these jobs, and the added American energy security should be touted as an astounding success. Instead, the administration has been systematically making it more difficult or expensive to operate, making federal lands less competitive through layers upon layers of unnecessarily burdensome regulations, or taking resources off the table for development. Even more troubling, many of the current actions by the Administration have serious flaws in their underlying data and economic analysis. For example, the economic analysis accompanying BLM's proposed drilling regulations for federal lands identified a compliance cost of roughly $40 million industry-wide. By comparison, one of our IPAA member companies estimated its costs alone would easily equal that number. More accurate analysis reveals that many federal proposals are solutions to non-existent problems and fall short of generating tangible benefits that would justify the excessive costs.

The sad reality is that resultant uncertainty in the business environment means many independents cannot meet their full job-creating potential. 500,000 workers are employed in American natural gas and oil exploration and production. These workers earn wages more than 50 percent higher than the average of all American manufacturing jobs. With unemployment over 8 percent, we need these jobs.

As a nation, we must embrace conservation, efficiency and all forms of American energy for the future. However, for the foreseeable future oil and natural gas will be our main energy sources. If the nation's tax, financial, resource access and environmental regulatory policies are set to encourage development, we can unleash the full power of this American industry, create millions of new jobs for hard-working Americans, and make our country more energy independent and secure.