Kansas Independent
Oil & Gas Association

800 SW Jackson Street - Suite 1400
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Oil & Gas
Drilling & Promotions

Costs and Risks

A public service announcement for investors in oil and gas drilling and lease prospects in Kansas

Kansas Independent
Oil & Gas Association

Voice of the
Kansas Independent Petroleum Industry

References

Always check creditable references

A potential investor in oil and gas leasing and drilling prospects should not overlook the opportunity of reviewing public records available at the Kansas Corporation Commission and the Kansas Geological Survey. These organizations maintain valuable historical records that include plugging, abandonment, and production history. Inquiries concerning misleading statements or questionable practices may be referred to the Office of the Kansas Securities Commissioner.

Professional geologists, engineers, and landmen are available as references. In addition, practicing attorneys and accountants as well as normal business references such as banks and supply companies can assist in furnishing credible references.

Most well-established independent oil and gas producers in Kansas would be happy to discuss any questions the public might have about investing in oil and gas leasing and drilling activities. In addition, the Kansas Independent Oil & Gas Association is available to assist you in answering questions about oil and gas activity in Kansas.

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Costs & Risks Associated with Oil and Gas Drilling Promotions

History

The first oil well in Kansas was drilled in 1860. Today, oil & gas are produced in 89 of Kansas' 105 counties.

Generally, 1,000-3,000 permits to drill are issued in Kansas each year. The average well depth is about 3,500 feet.

Over 80,000 wells are actively producing oil and natural gas in Kansas today with about 75% of the wells producing oil and 25% producing natural gas. The average daily oil well production is 2 barrels (bbls) and the average daily natural gas production is 23 thousand cubic feet (Mcf). Over 2,100 oil and gas producers operate in Kansas.

The Kansas oil and gas industry supports over 100,000 jobs and $3 billion in family income. The oil and gas industry is a dependable and stable element of the Kansas economy today and will be a critical part of the economy going forward.

Crude Oil and Natural Gas Prices and Income

Crude oil prices received by Kansas oil producers are a result of several factors. The New York Mercantile Exchange (NYMEX) price is set daily by an open auction. The price is based on global supply/demand factors. West Texas Intermediate (WTI) is the benchmark price for crude oil produced in the U.S. WTI crude oil produces more gasoline per barrel of oil than any other crude oil, not only in the U.S., but in comparison to almost any other crude oil produced in the world. WTI prices are less than NYMEX reflecting distribution and administrative costs to get the crude oil to market. Kansas common crude oil contains more contaminants and produces less gasoline per barrel than WTI and , as a result, is priced slightly lower than WTI. Natural gas prices are determined by individual contracts between the producer and purchaser.

Kansas Oil & Gas
Energy for the Future

The lease owners, which include investors, pay all of the cost and receive only part of the income from wells developed on a leasehold. Landowner and overriding royalty will be subtracted from the total income. Landowner royalty interest is usually 1/8 (12.5%) but can be greater. Additional overriding royalty interests can be added to the lease by lease brokers, geologists, and others causing net income to vary. Generally, revenue interest to investors should be about 75-82% of the total income.

Costs

The cost of drilling and equipping a producing well varies from location to location throughout Kansas. Wells drilled in western Kansas may be as deep as 8,000 feet while wells drilled in eastern Kansas are normally less than 1,000 feet. Oil and gas production per well is normally greater in western Kansas than eastern Kansas.

The cost of drilling and equipping an average 3,500-4,500 foot well can be approximately $500,000. At approximately $200,000, the cost of a 3,500-4,500 foot dry hole is considerably less than a fully equipped producing well. An investor should inquire into the expected variances of costs between a dry hole and a fully equipped producing well. All costs can vary considerably depending upon many circumstances. A potential investor should attempt to determine if the asking price for the prospect is reasonable.

Acreage or leasehold costs vary considerably. The purchase costs of leases, commonly referred to as "bonuses" paid to landowners, are added to the cost of the first well. If the prospect acreage is large, the initial cost can be extensive. Other initial costs added to the cost of the prospect include seismic tests, core holes, and other evaluation technologies and processes.

Prospective investors should inquire into field and administrative overhead charges. In addition, a review of any operating agreements may disclose unusual stipulations affecting the investor. Investors should determine if contiguous leases are included in the prospect and whether participation is allowed and on what terms. The policy of the operator regarding the investors participation concerning additional wells on the prospect should be determined.

Other Considerations

An inexperienced potential investor should:

- Inquire what the proposed cost of participation relative to the actual cost of leasehold, drilling, and testing costs. If in doubt, the investor should inquire of an outside party if the difference is reasonable compensation to the offeror or an over promotion.
- Request from the offeror of the prospect a record of their past oil and gas investor offerings and list of references in those offerings as a basis for establishing their reputation.
- Inquire what extra charges, such as operating overhead, addon or handling, services, and/or supervision and expense charges can be expected.
- Negotiate a credit to be given for the value of salvageable equipment if the well is equipped but is non-commercial.
- Require an operating agreement or at least an outline of lease operating procedures and future changes.

WARNING

Do not invest savings, borrowed money, or any funds you cannot afford to lose regardless of how glowing the prospect looks. Lose you might!