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UT System pumped millions into its oil institute, then pulled the plug

By Ralph K.M. Haurwitz - American-Statesman Staff

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Ralph Drilling site on UT System lands east of Fort Stockton in West Texas. Ralph K.M. Haurwitz/AMERICAN-STATESMAN 10/14

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Highlights

UT regents established an energy institute with ambitious goals and an industry leader, then dropped the plan.

The UT System paid $7.1 million in compensation to the head of its oil unit for 28 months of work.

When a blue-ribbon task force recommended that the University of Texas System establish an energy institute with research and academic chops reminiscent of Sematech, the computer chip consortium that helped spark Austin's high-tech expansion, the system's Board of Regents rose to the challenge.

"This is a great initiative, without question, and one critical to the state and the university system," then-Chairman Paul Foster said in August 2014 as the regents voted unanimously to establish the institute. Francisco Cigarroa, who was chancellor at the time, said it was "at least a 10-year plan," adding: "We will get the very best person in the United States or the world to lead this effort."

The UT System hired Jeffrey Spath, whose credentials include a doctorate in engineering, a stint as president of the Society of Petroleum Engineers and a 32-year career with oilfield services giant Schlumberger Ltd. that saw him take on assignments around the world and rise to vice president.

But the system's sunny ambitions for what came to be known as the Texas Oil and Gas Institute soon wilted like a flower in a hailstorm, an American-Statesman investigation has found.

Not long after Spath was hired in September 2015 as chief executive director, system officials began scaling back his mission. And by November 2017, they quietly decided to shutter the Houston-based institute, telling him in a letter that it no longer reflected "current strategic priorities" but praising his "excellent and productive service."

Spath was terminated Dec. 31. Because he had a three-year contract, he received $7.1 million in base salary, retention pay, bonuses and deferred compensation for the full three years, although his employment lasted two years and four months, according to documents obtained by the Statesman through an open-records request. The figure includes $1.3 million that he would have received from Jan. 1 through August of this year.+

Jeffrey Spath, former chief executive director of the UT System's Texas Oil and Gas Institute, will become professor and head of ... read more

The oil institute, which had just six employees other than Spath, has been in wind-down mode for several weeks and officially closes at the end of this month. All told, the UT System has spent $12.8 million from endowment proceeds on the institute, including Spath's compensation.

"When they hired me, there was a lot of support from the board," Spath said in an interview. "That diminished over a two-year period. I fought uphill battles from Day One on staffing and performing research. It just kept getting smaller and smaller in scope."

Spath will become a professor and department head at Texas A&M University next month, making a fraction of what the UT System paid him.

Big investments, and second thoughts

This is not the first time in recent years that the UT System, which oversees 14 academic and health campuses, including the Austin flagship, has pulled back abruptly on an initiative launched with fanfare and millions of dollars in funding from the Permanent University Fund, a higher education endowment controlled by the Board of Regents.

Last month, the system closed its Institute for Transformational Learning, which worked to expand online classes and competency-based education, after spending $75 million on the project since 2012. A year ago, Chancellor Bill McRaven, facing pushback from lawmakers and even some regents, scuttled plans for a data science institute in Houston after the system spent more than $200 million to acquire about 300 acres.

As in those cases, the closing of the Texas Oil and Gas Institute reflects a political calculation, a shift in spending and strategic priorities, and perhaps a failure to think through what it would take to achieve the goals in the first place. It comes as the Board of Regents, responding in part to critics in the state Legislature, has been working to trim the headcount and budget of the system's various administrative offices.

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For Spath, a telltale sign that the reality of the institute might not live up to its original promise came soon after he started work in September 2015 when system officials told him that it would not be permitted to conduct research. That came as a surprise considering that research had been listed as an "essential function" in the job description posted for his position.

The Texas Constitution does not permit the UT System to use proceeds from the permanent fund for research, but its staff members can get faculty appointments and collaborate with campuses to conduct research, said Karen Adler, a spokeswoman for the system.

Spath had such an appointment, as an unpaid adjunct professor in the department of petroleum and geosystems engineering at UT-Austin, for the first nine months of his time at the UT System. A UT-Austin spokesman said it's not unusual for adjunct appointments to be short-term.

"I was told we would be competing with the campuses" if the institute conducted research, Spath said. "I wasn't informed until I was on board that there was a constitutional restriction on research by a system-created institute" funded with permanent fund proceeds. "Plus, there was no capacity to perform research with our limited staff."

System officials soon stopped referring to the institute by the name it was originally given by the regents — the Energy Research, Engineering, and Education Institute — and began calling it the Texas Oil and Gas Institute, or TOGI for short.

Scott Kelley, the system's executive vice chancellor for business affairs, acknowledged that research aspirations for the institute were sharply curtailed. "At one time it was even thought maybe they would create their own research facilities," he said. "That expense just didn't seem to make sense" because of research taking place at various departments and units at UT-Austin, including the Bureau of Economic Geology, and at Texas A&M University.

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It's not clear why these issues weren't sorted out before the institute was created. After all, it had a long gestation period, beginning in November 2012 when Cigarroa and Gene Powell, then chairman of the regents, announced the formation of the "Task Force on Engineering Education for Texas in the 21st Century."

The panel, whose members included engineering deans, industry officials and regents, delivered a report in December 2013 that recommended stepped-up efforts to graduate more engineers and computer scientists, as well as creation of an oil and gas institute in Houston for research and education.

An implementation committee of the task force spent months fine-tuning those concepts before the regents' August 2014 meeting, at which $2 million in endowment proceeds was allocated to create the Energy Research, Engineering, and Education Institute.

The UT System declined the Statesman's request to interview one or more current regents for this story, including former Chairman Foster and Jeffery Hildebrand, an oilman who was also a regent when the institute was established.

Another "essential function" in Spath's job description that didn't pan out was to develop a business model featuring energy firms, especially those in the oil and gas industry, as "member companies" paying for technical analysis of engineering and geological data.

Kelley said a sharp decline in oil and gas prices left companies with less capital to invest in such analysis. And Spath said his efforts to raise donations from industry players were thwarted.

"I said I'd go talk to energy ministers and CEOs around the world," Spath said. "I got pushback from the system on allowing me to travel and meet with these clients. I made one trip to Bogota and it was really frowned on."

Also undermining the institute's prospects was the decision to cancel plans for the data science institute in Houston, said Alex Cranberg, a former UT regent who chairs the system's University Lands Advisory Board. Energy data would have been a major focus, and officials had intended for the oil institute to play a significant role in developing the data unit.

Analysis revealed richness of UT oil lands

The institute wound up focusing on two other charges: conducting technical analysis to help increase production and revenue from 2.1 million acres of system-owned lands in West Texas that are rich in oil and natural gas, and providing internships for students. The system leases to oil and gas companies and receives royalties and other payments that are deposited in the permanent fund, whose proceeds benefit campuses in the UT and A&M systems.

Kelley and Mark Houser, CEO of the system's University Lands unit, said that in its short life the institute more than paid for itself.+


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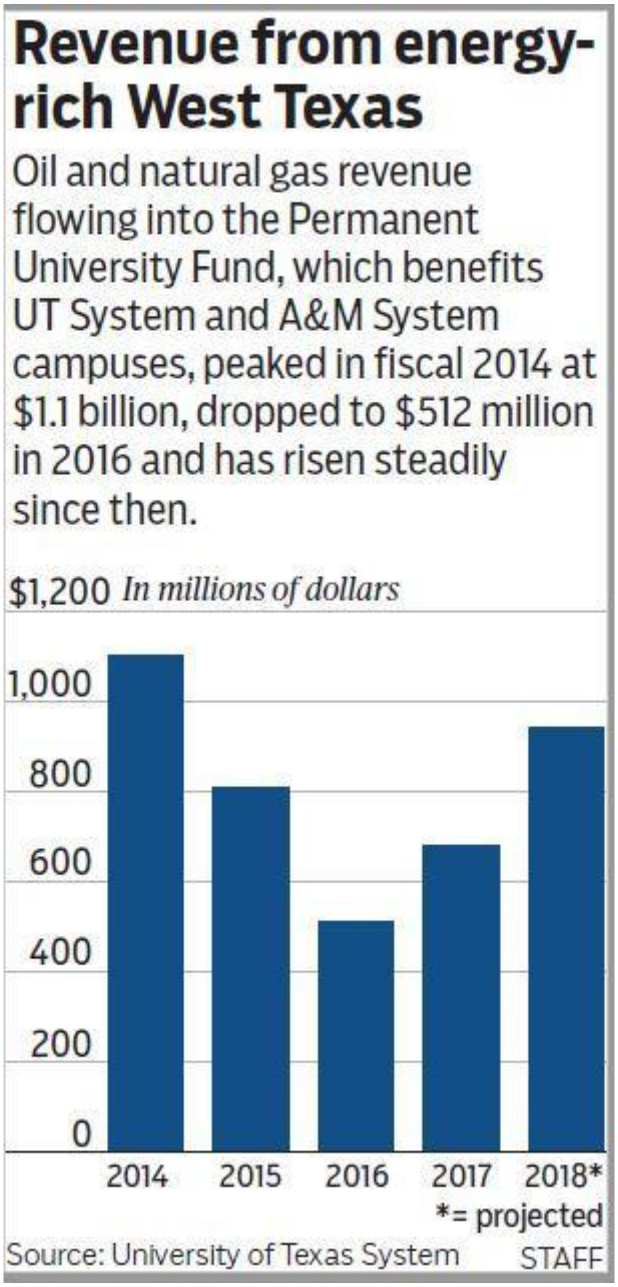
Drilling site on UT System lands in Reagan County, southeast of Midland. Courtesy photo, University of Texas System, 2014.

Its geologists and engineers conducted a comprehensive analysis of geological, engineering, production and other data that had been collected over the years by University Lands but never studied, Kelley and Houser said. That work pointed the way to increased efficiencies in drilling, such as a better understanding of how far apart to space wells. The institute's analysis also showed that reserves were greater than previously thought.

"The combined work of the technical staffs of TOGI and University Lands has significantly enhanced the current and future performance of development activity from the (oil and gas) lands through increased understanding of reservoir performance and through the increased ability to leverage operators into more creative development programs," the system's Adler said. The resulting increases in production, along with the drilling of additional wells, boosts revenue for the permanent fund.

The system's oil and gas lands are a massive operation, with 9,000 operating wells, including many drilled in recent years into shale formations that are especially productive. Oil and gas revenues peaked at $1.1 billion in the 2014 budget year, dipped to $512 million by 2016 and have risen steadily since then and are projected to reach $942 million in the current budget year.



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Houser said Spath also saved the UT System millions of dollars in licensing fees by using his contacts to acquire sophisticated software for managing oil and gas resources. Spath said he obtained the software from Schlumberger, his former employer, for free.

The University Lands staff didn't have the level of expertise needed to conduct the sort of analysis that the institute undertook, Houser said, adding that a few of the institute's employees might well be absorbed by his department.

"A significant benefit of the TOGI initiative, in addition to their assistance in our technical evaluation, is that we are now positioned to manage our data with a smaller staff," Houser said.

UT System officials and Spath say that his compensation package was warranted given the broad goals initially envisioned for the institute. But as time went on, it became evident that "I just wasn't needed," Spath said.

System officials no doubt were also concerned about the optics, inasmuch as Spath's compensation was similar to that of Houser, whose University Lands unit has 50 employees. Houser, who also came from the industry, has received a total of $4.2 million in base salary, retention pay and bonuses in the past three years, and he becomes eligible for $1.1 million in deferred compensation later this month, according to records.

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Spath will become a professor and head of the petroleum engineering department at A&M in April. Under his agreement with the UT System, he is obligated to pay back whatever he earns this year through August, but no more than the $1.3 million the system paid him to cover those eight months. His total annual compensation at A&M will be $351,550, according to engineering Dean M. Katherine Banks' letter offering him the job.

The Oil and Gas Institute had a robust internship program, averaging 18 students for each of five semesters, with a total of 48 students involved, many working more than one semester. The students hailed mainly from UT-Austin, with smaller numbers from UT-Permian Basin and A&M. Some were placed with companies that operate on the system's West Texas lands to help boost production, benefiting the permanent fund.

Internships will continue at University Lands, Houser said. "Frankly, that's value," he said. "We can educate these young people and they can help us solve problems."