April 14, 2020 Meeting on Oil Market Demand and Possible Responses
By the
Texas Railroad Commission

Via email to RRCconference@rrc.texas.gov

Chairman Wayne Christian
Commissioner Christy Craddick
Commissioner Ryan Sitton

Given the demand destruction caused by COVID-19 mitigation measures and the battle for market share initiated by the Kingdom of Saudi Arabia in response to Russia's refusal to extend OPEC+ production cuts, oil sales prices have declined to approximately $20 per barrel and are indicating sub-$10 per barrel for May deliveries assuming you are able to sell oil at all. The demand destruction is estimated to be 18.5 million barrels per day (MMBopd) by Commissioner Sitton and Goldman Sachs estimates 20 MMBopd of oversupply in a roughly 100 MMBopd global market for oil. Estimates call for available global storage of an estimated 1.3 billion barrels of oil to fill in mid to late May unless massive reductions in oil production take place immediately. Saudi Arabia, following its abrupt decision to discount its crude sales price by $7-8 per barrel to take market share away from Russia and the U.S. producers, has since contracted and loaded VLCC tankers with over 80 MMBO looking for a home on foreign shores, including the U.S.

As an oil and gas producer, employer and taxpayer trying to survive through this difficult commodity price environment (gas and NGL prices are negative at the wellhead) and tight credit, we have proactively taken the following actions:

1) Indefinitely deferred drilling new wells and paid an early termination penalty on our rig contract, thus laying off over 150 contract employees involved in constructing a well.
2) Deferred completing two wells drilled recently for $8 million excluding completion costs.
3) Shut-in 12 of our 22 Devonian horizontal wells at our Block 1 property in Andrews County, which account for 5% of our oil production and do not make a profit with sub-$20 oil prices and negative gas and NGL prices after processing and transportation fees paid to third parties.
4) Reduced G&A expense by 25% through layoffs, pay cuts, and reducing our office space. These are actions many of our peers are taking to survive, and will permanently impact Elevation Resources' ability to restart drilling and restoring growth in the future.

The Texas Railroad Commission's implementing allowables on an operator level starting in May is essential to stem the freefall in oil, gas and NGL prices. Once implemented, requiring operators to reduce production from a first quarter 2020 baseline will do the following:

1) Take credit for the actions being taken by U.S. oil and gas producers even before COVID-19 related demand destruction and the Saudi-induced oil price war to reduce capital spending to generate free cash flow. The steep decline of our unconventional wells will soon become evident in U.S. oil and gas production data and inventory levels.
2) Additional action around shutting in marginal production will help reduce oversupply and help meet the State's proration goals. In each of the oil price declines of 1986-87 and 1998-99, approximately 1 MMBopd of marginal production was shut-in, for the most part permanently.
3) Purchaser curtailments and cancellation of oil purchase agreements caused by weak petroleum products demand, reduced refinery runs and full oil storage will further reduce U.S. oil supply.

While the effects of these industry responses to low oil prices is inevitable and does not require action by the RRC, taking credit for our actions and creating a more equitable, orderly approach to curtailment will avoid decimating the small to mid-size independent operators who do not have access to or ownership of pipelines and storage. Secondly, it will provide President Trump's negotiators leverage with OPEC+ to obtain commitments to curtail their production and end their predatory pricing behavior.

Waiting until the U.S. independent oil producers and service companies fail and for foreign economies and regimes to fail creates permanent damage to our global oil production infrastructure, leading to oil price spikes in the future like we suffered in the early 80's and again in 2008 that were damaging to the U.S. and global economy. Each of you recognizes the economic driver that cheap oil, natural gas and natural gas liquids has provided global consumers and enabled global competitiveness of U.S. exports, many of which are produced in Texas. That affordable energy has been delivered by the unconventional development of oil and gas resources in the U.S., 5 MMBopd of which is produced in Texas, along with the 12 Bcfd of dry natural gas and associated natural gas liquids.

Regarding fears that other states won't follow Texas' lead, North Dakota is enforcing flaring rules that have shut-in oil production, Oklahoma has proration laws in place, and conversations the Permian Basin Petroleum Association has had with New Mexico's leaders show willingness to consider implementing curtailment through various means including its state-owned lands as well as the large amount of federal land administered by the BLM. Oil producers including the majors and large independents express concern over their marketing and delivery contracts. These large oil producers do not have 100% of their production committed, and they are subject to the same force majeure provisions that the rest of the industry faces. With refineries running at 50-70% of capacity, the largest producers will have no place to go with their produced crude when oil storage fills in May.

I applaud you for conducting an open meeting on April 14 followed by a rule-making hearing on April 21. Thank you for considering the position of a smaller operator in West Texas who has sent over $85 million of royalty and fees to the University of Texas System and tens of millions of severance and ad valorem taxes to the State and counties over the past seven years of our history. Our investments and operations have provided numerous direct and indirect jobs as well. We pray with your action and leadership, Elevation Resources will be able to remain active in the oil and gas production and development business in Texas for years to come.

Yours very truly,

Steven H. Pruett

Steven H. Pruett
President & CEO
Elevation Resources LLC