Texas Pipeline Association

Thure Cannon
President

April 8, 2020

VIA EMAIL: RRCconference@rrc.texas.gov
The Honorable Wayne Christian
The Honorable Christi Craddick
The Honorable Ryan Sitton
Railroad Commission of Texas
1701 North Congress Avenue
Austin, Texas 78711

RE: DOCKET NO. OG-20-00003167; IN RE: MOTION FOR COMMISSION CALLED HEARING ON THE VERIFIED COMPLAINT OF PIONEER NATURAL RESOURCES U.S.A. INC. AND PARSLEY ENERGY INC. TO DETERMINE REASONABLE MARKET DEMAND FOR OIL IN THE STATE OF TEXAS

Dear Chairman Christian and Commissioners Craddick and Sitton,

The Texas Pipeline Association appreciates the opportunity to participate in the meeting to determine whether the Commission should "prorate" or restrict the production of oil in Texas.

As one of the integral parts of the oil and gas industry, the members of the Texas Pipeline Association understand how hard the recent international demand destruction has been on the energy industry. It is understandable that some members of the industry have sought governmental intervention in the crude oil market to try to influence the supply part of the global demand/supply imbalance.

However, the Texas Pipeline Association and, we believe the majority of the industry, oppose the request to suddenly begin restricting the crude oil supply in Texas instead of allowing the market to correct the supply imbalance, as it will do. Decades of experience shows us that market forces will work faster and reach a sustainable solution much better than regulatory intervention.

Texas, or even the United States, acting alone cannot solve the global problems created by the recent demand destruction. Attempting to restrict crude oil production in Texas does nothing but replace sales from Texas wells with sales from other producing states and/or other nations.

<u>The Economic and Commercial Considerations for the Entire Industry Has to Be Considered</u>

Crude oil production restrictions impact more than just the oil supply. All other segments

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of the industry will be affected by an oil proration order. The Pipeline Association wants to stress that the following issues have to be successfully resolved to make any proration policy work without further damaging the economy of Texas:

Restriction of Gas Supply

1. When the Commission restricts oil production, it necessarily restricts gas production because oil and gas come out of the same well bore. Much of the gas in the Permian Basin, for example, comes from wells classified as "oil wells" which historically provide gas to the Metroplex and the Gulf Coast. There is also a large volume of oil that is produced from wells classified as "gas wells." If <u>all</u> oil production is to be prorated, that would require the proration of both types of wells which reduces the gas supply even further. Pipelines, suppliers, customers and third parties all have contractual arrangements at both ends of the pipeline which may be impacted by a gas production restriction. The result of such impacts is neither known nor knowable until it happens.

   We know that we cannot reduce the gas supply for electric generation, homes and hospitals without injury to the public. In particular, the gas distribution systems must be kept pressured up or they will shut down and it will take months to get them back up. We should not restrict the gas supply for commercial and industrial users that are necessary to support the economy.

Restriction of Natural Gas Liquids

2. When the gas supply is restricted, the flow of natural gas liquids is also restricted. Wells which produce large amounts of oil also produce a gas stream rich in liquids. Oil production restrictions will result in reduced volumes of liquids going to places like Mt. Belvieu and reduced volumes of natural gas products like propane and ethane being available to the chemical industry and other types of industrial customers.

   In the event of a products shortage due to production restrictions, do customers get supplied based on contractual commitments or some other basis determined by the Commission?

3. Clearly no gas or liquids restrictions make sense once the pandemic recedes and the economy is trying to recover. We should be trying to get all the gas and gas products delivered that industry needs to support the economic recovery.

   If we take all the gas consumers need, that will necessarily increase the amount of oil produced as it all comes up the same well bore. Is the Commission going to make up the difference by restricting other wells even more?

4. All proration regulation in the past has required purchasers and pipelines to be part of the regulatory process to make it work. There are in fact statutory duties placed on purchasers and pipelines which might apply when oil or gas is prorated.

What would the Railroad Commission of Texas expect pipelines and purchasers to do if it prorates oil production? For example, do we take the allowable crude based on contractual commitments or some other basis established by the Commission? Is the Commission going to abrogate contractual rights and obligations in favor of a regulatory scheme?

Operational Issues

Reduced flows, or erratic flows created by turning wells on and off, will create operational difficulties and inefficiencies for numerous facilities. Gathering systems and gas plants will be adversely impacted by reduced flows which reduce the ability of those facilities to efficiently treat and process raw gas from the wells. Erratic production from wells can overpower the ability of gathering systems or plants to adjust if conditions change from day to day. Sections of gathering systems may have to be shut in when pressures are too low and may not be able to react timely when wells are turned back on and pressures climb. Plants can face insufficient pressure to operate as configured on some days and too much pressure on other days. Any production restriction program will need to include provisions for exceptions for well, pipelines, plants and other facilities that will have their ability to operate negatively impacted by reduced or erratic production.

Credit Impact

Energy companies' ability to obtain financing for wells and necessary infrastructure will be severely impacted if lenders and investors react negatively to a sudden change in Texas regulatory policy. The energy industry is dependent on the ability to finance billions of dollars of equipment and infrastructure each year. Are lenders and investors going to shy away from Texas because the Railroad Commission of Texas policy no longer provides a predictable regulatory environment compared to other producing states?

The Texas Pipeline Association believes that neither the industry nor the Commission can be certain that all the moving pieces that have to be considered in order to make proration work without damaging an already fragile economy have been addressed. There are going to be unintended consequences that are not discovered until after the fact. However, the few, but important issues that have been identified make it clear that a regulatory intervention will not work as well as allowing free market forces to correct the demand/supply imbalance in the short term. Moreover, experience teaches us that regulatory intervention will not provide a sustainable market balance over the long term.

<u>Legal Considerations</u>

The Pipeline Association will not at this time attempt to address all of the difficult legal issues regarding proration. However, it does want to point out that a number of legal requirements have to be met by any production restriction order.

Sec. 85.054 Tex. Nat. Res. Code, for example, provides for the Commission to allocate the market demand among all the various "pools" of oil in the state on a reasonable basis that does not discriminate against any pool in favor of another and for the Commission to consider the specific market demand for oil from each pool. If the Commission restricts production from any field, the Commission also has to allocate a share of the field production to each operator as provided by §85.053 so that each producer has a chance to protect its correlative rights.

Moreover, there are certain types of wells and fields which cannot be restricted, see for example the exception for "new" fields which do not produce at least 10,000 bbls/d (§85.048) and "marginal wells" (§§85.122, 85.123). The Commission has to have the data and systems in place to make those distinctions in order for any proration system to comply with the law.

Is the Commission, for example, prepared to conduct hearings for a large number of applications to set a "special allowable" for fields and wells that need to be produced at a higher rate (maximum efficient ratio) than the prorated allowable in order to prevent waste because of potential wellbore or reservoir damage.

Inability to Meet Either the Statutory or Practical Requirements

Oil has not been prorated in Texas since 1972. Fifty years ago, the Commission received the extensive data from industry necessary to allocate the expected market demand for oil to every field and every well in the state. Its data on gathering systems and analytical systems addressed both the statutory requirements and practical requirements, e.g. safeguards to prevent the allocation of demand to fields or wells which could not produce the allowed amount. Both the industry and the Commission had trained staffs to implement the proration system. The people and systems are not here anymore.

We do not believe the systems necessary to comply with the statutory scheme can be put in place in time to lawfully prorate oil by May. It is more reasonable to believe that it would take months to recreate systems which have not been used in almost 50 years. The 90-year-old statutes and rules from decades past require a process that no longer exists either within the industry or the Commission. The resulting litigation, involving both any proration process and disputes among individual companies, will no doubt outlast the crisis.

The Market Place is Reacting to Curb US Production

Texas and the US are already taking steps to curb production as evidenced by the reduced rig count. According to data published by Baker Hughes for the week of April 3, 2020, the US oil rig count is down 62 rigs from the previous week with Texas accounting for almost half of that decline with 30 of those dropped rigs. The Texas Rig Count is currently at 338, down from 491 one year ago. These numbers represent a drop of 8.15% from last week and 31.6% from a year ago. Finally, and most telling, the Texas rig count is down 17% (70 rigs) from March 13, 2020, the approximate date that Russia and Saudi Arabia chose to flood the market with their oil.

These same percentage declines are reflected in national rig counts, underscoring the role of the market in already driving U.S. production declines without the need for government intervention. To the extent that proponents of prorationing might contend such intervention is necessary to demonstrate U.S. commitment to any global supply agreement, TPA respectfully suggests that the U.S. is already far ahead of any OPEC+ or G-20 nation in taking steps that will result in sharp domestic production declines.

The members of the Texas Pipeline Association stand ready to assist the Commission in any way possible during this difficult time both for the industry and the nation.

Respectfully Submitted,

TEXAS PIPELINE ASSOCIATION

By: ______________________
Thure B. Cannon
President