PERMIAN BASIN
PETROLEUM ASSOCIATION

April 8, 2020

Chairman Wayne Christian
Commissioner Christi Craddick
Commissioner Ryan Sitton

VIA EMAIL: RRCconference@rrc.texas.gov

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

Per the Commission's Notice: Ben Shepperd; President; Permian Basin Petroleum Association; 601 North Marienfeld, Suite 200; Midland, TX 79701; 512.297.2693

Dear Chairman Christian and Commissioners Craddick and Sitton:

The Permian Basin Petroleum Association appreciates the Commission holding this Reasonable Market Demand Hearing and appreciates the opportunity to comment.

**Comment Summary.** The Permian Basin Petroleum Association (PBPA) is providing this written testimony to offer the range of comments our members have on this important issue. Our members, like the Commission, believe it best to hear the arguments and facts of the April 14 Hearing, and weigh the insight provided by the Commission, members in the industry, and other interested parties before rushing to judgement.

We support regulatory action based on facts and science and believe the same needs to be taken into consideration here.

Given the importance of this hearing, PBPA submits this testimony to provide the Commission with the thoughts and discourse of its members that operate in the Permian Basin. This testimony addresses the policy questions of the law, oil supply, storage, oil demand, and other policy questions our members have, and which we believe the Commission faces.

We find ourselves in unprecedented times facing dual black swan events. The Permian Basin, Texas, and our nation are all fortunate to have leaders willing to debate and ultimately decide whether it is time for the petitioned action. We appreciate the Commission giving careful consideration to each and every available option there is in order to respond to these times and ensure that the operating framework remains best suited to allow the continued safe and responsible development of natural resources in the Permian Basin and other operating basins in the state and country.

America, because of the advent of horizontal drilling and improved well completion techniques, has seen an unparalleled expansion of production in the modern world. This expansion has come at the cost of institutional foreign producers who have all seen their market share decrease. That market space is larger than the growth in global demand. That coupled with recent global pandemic has further clamped down on demand and has only heightened what has already been an existential threat to American production. This has led many to ask the question, what do we want for the American energy industry?

The foreign state actors, primarily Russian and Saudi producers, know what they want to do. They have made it publicly known they would like a 10 million barrel per day cut in worldwide oil production.[1] Further they want the United States to participate in that cut of worldwide production.[2]

Texas produces approximately 43% of the United States' production. With growing calls for reduction in production and the ongoing reduction of capital expenditures by producers in the region, the question for all operators is how to lessen the negative impact and how best to work in this new global market. The hope for Permian Basin producers is that whatever will be lost over the next 30 days, 60 days or longer under depressed economic conditions, does not lessen the opportunity for future growth.

There is no question in our mind that the Commission's answer to those questions will draw focused attention from not just Midland and Houston, but also from our nation's capital in Washington D.C., and from others around the world including those in Vienna, Moscow, and Riyadh.

In the longer term, without action, this fundamental challenge continues unabated. Maybe not at the size of today's problem, but it continues. Regardless of which market analysis is used, there is an increasing oversupply of oil in the world market that has only been accelerated by the Russia-Saudi Price War. Regardless of whose numbers we use, there is a decreasing demand for oil[3] that the coronavirus only accelerated.

Assume that tomorrow the Russia-Saudi Price War is resolved, and that the coronavirus is cured. For the foreseeable future, Permian Producers will face an over-supply of oil and decreasing demand for oil as the world economy recovers.[4] It is possible, if not probable, this issue continues even after the world economy has recovered. The oil and gas industry and global demand for hydrocarbons had already been under attack, especially in developed countries. It is not just the CAFÉ Standards shrinking demand, but aggressive attitudes toward climate change, the Green New Deal, electric cars, renewable energy and investor activism are each additional challenges facing industry growth. The imbalance of supply and demand could very well continue for all of these reasons.

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[1] Vladimir Putin said a cut to global oil production of about 10m barrels a day is possible, but only if all major crude producers including the US join in the reduction pact. Financial Times 040320 Putin oil supply cuts possible if all major producers take part

[2] Riyadh and Moscow have privately made it clear they won't cut output unless U.S. producers do so as well. Wall Street Journal Saudi-Arabia-Russia-to-debate-oil-cuts ; Wall Street Journal opec-allies-to-debate-oil-cuts-as-Saudis-delay-pricing-move

[3] The U.S. Corporate Average Fuel Economy (CAFE) Standards is an ongoing example of decreased demand for oil. The CAFE Standards have for years been decreasing demand for oil because they require increasing miles-per-gallon ratings for cars as the fleet turns over. These standards are not going away.

[4] See, Demand Graphs of Goldman Sachs and JBC Energy. Bloomberg 2020-03-29/the-coronavirus-means-a-truly-free-market-for-oil

U.S. producers cannot do much about international demand. Right now, without action taken by entities like the Commission, producers are left to hope that positive developments on the demand side come sooner rather than later. However, it could be possible for changes, self-imposed or mandated, on the supply side which some believe will make an impact in the short-term.

As reports show, there is an immediate and pressing problem. However, it is joined by a longer-term challenge as well.

The next wave in the short-term problem is storage. As the Commission knows, pipelines have been sending letters to Permian Producers stating that pipelines can no longer take Permian Producers' crude due to a shortage of storage. While in the meantime the Commission, for safety purposes, could determine if these letters are accurate, it represents another example of an imbalance in supply versus demand. Once again, the solution proposed for Permian Producers that are not fully-integrated is to take the brunt of this imbalance.

**Does the Commission have the authority to act?** Our members have no questions in this regard. The Commission has the authority to act. The Texas Legislature has answered the policy questions[5] and has given the Commission the authority to address: production of oil in excess of "reasonable market demand" (Tex. Nat. Res. Code § 85.046(10); when production of oil is in excess of "reasonable market demand" (Tex. Nat. Res. Code § 85.058), and (i) to limit oil production, (ii) to order production allowables and (iii) to create rules, regulations and orders to enforce these provisions. In contrast, the Commission "shall not restrict the production of oil from any new field brought into production by exploration until the total production from that field is 10,000 barrels of oil a day in the aggregate." (Tex. Nat. Res. Code § 85.048). Additionally, the courts have upheld the Commission's authority.[6]

Many of our members were surprised to learn that the Commission has been setting monthly production schedules as recently as March 2020.[7]

As to storage, some PBPA members have questions as to the volume of physical storage. We believe the Commission has the authority under §85.058 to make an inquiry as to whether the actual volume of physical storage available has been reached or when it will be reached, in contrast to storage that has been contracted, but does not contain physical oil. It is essential information to know and understand for the Commission to make a fair and reasonable decision.

**Questions and Concerns**. Below are some questions and concerns that PBPA members have been raising and that the Commission may want to consider in making its determination.

On the demand side of the issue, it is suggested the Commission may want to consider the demand for oil over the next 12 months globally, nationally and in Texas. Our members understand that over the next 12 months that the coronavirus will have some impact on that demand.

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[5] For "Those who cannot remember the past are condemned to repeat it." George Santayana, we recommend reading "The Oil Wars" at https://www.tsl.texas.gov/exhibits/railroad/oil/page6.html. Many of the policy arguments made during "The Oil Wars" are the same policy arguments the Commission is hearing today. Right or wrong, the legislature has decided these policy arguments. The history is interesting and insightful. We specifically call your attention to the attempts by the federal government to regulate production during "The Oil Wars".

[6] Though there are a number of other cases, Champlin Refining Co. v. Corporation Commission, 286 U.S. 210 (1932), is the dispositive case as to the constitutionality of the Commission's authority.

[7] For examples of proration schedules for operators in Texas for March 2020 click this link: proration schedules listed by operator for the month of March 2020

On the supply side of the issue, it is suggested the Commission may want to consider what amount of Texas oil supply will be lost/destroyed if no action is taken versus whatever proposal they might make. In that consideration, the Commission may want to consider the volume of Texas production that has been voluntarily taken offline due to current economic conditions and the volume of Texas production estimated to be voluntarily shut-in as a result of the Russian-Saudi Price War.

As to worldwide oil supply, the Commission may want to consider what oil supply might be if the Russia-Saudi Price War is settled and what that supply level might be if the Russian-Saudi Price War is not settled. In both of these areas, our members are concerned it may take months to balance the current oversupply of oil due to the volume of the oversupply and the impacts of the coronavirus demand decline.

If the United States decides to participate in the OPEC+ agreement, our members asked will other producing states make a similar decision; and will the federal government make a similar decision as to its production from offshore and federal lands?

PBPA and its members understand that low gasoline prices are the only bright spot in our current economy. We also understand if the United States goes from the number one producer in the world, to an economy once again based on foreign oil, then the return of foreign control and actions like the 1973 Arab Embargo could reverse this decades efforts back on the table along with long lines for gasoline and high prices.

At the end of the day, we worry about the cost of inaction in the global market, and look to the leaders in our industry, including Commissioners, to chart the long-term future of domestic oil and gas producers.

We encourage the Commission to carefully evaluate the data and utilize all of the resources at its disposal to help prevent the waste of our precious natural resources and industry and help us ensure a healthy and robust industry for generations to come.

Thank you for this opportunity to comment.

Sincerely,

Ben Shepperd

Ben Shepperd
President