

## **Comments to Railroad Commission of Texas**

### **Regarding April 14, 2020 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**

**by A. Scott Anderson, on behalf of Environmental Defense Fund**

**April 8, 2020**

When the Railroad Commission first began to prorate oil, the initial results were disastrous – though not because it was a bad idea. On May 1, 1931, an allowable was set for the East Texas Field of 70,000 barrels per day. Production instead increased to 150,000 barrels per day. When the allowable was raised to 90,000, production hit 300,000. The next allowable of 160,000 barrels yielded 400,000 barrels a day of production. See LAWRENCE GOODWYN, TEXAS OIL, AMERICAN DREAMS 38 (Texas State Historical Association 1996).

The Commission, the courts and the Legislature soon developed a system that was enforceable, generally considered fair, and upheld by both state and federal courts. It is called market demand proration. A new statute, adopted in 1932 in a special session called by Governor Ross Sterling, gave the Railroad Commission the power and duty to prorate oil to market demand.

It is important to keep in mind what market demand proration is and what it is not. It is not an effort to prop up prices by restricting production until prices reach a desired level. That has never been held to be within the Commission's authority. Market demand proration is more sophisticated. Done properly, this form of proration protects correlative rights and prevents waste while supporting the efficient functioning of a competitive market. Simply put, the Commission determines the reasonable market demand on a monthly basis, assuring that the state's production does not exceed this market demand (which under the statutes would constitute waste), and allocates the total allowed production to individual wells in a manner that prevents the waste of resources and protects private property rights.

The Commission learned to operate this system in accordance with the 1932 statute, adjusting the total state allowable up and down in response to market fluctuations, and carefully allocating allowables in a way that prevented waste and protected correlative rights. Supply and demand came into balance and industry developed and prospered.

Market demand oil proration made sense when the industry had surplus producing capacity. When surplus capacity disappeared, market demand proration stopped making sense.

The end of surplus producing capacity became apparent in 1970. Former Railroad Commissioner Bill Murray, serving as President of TIPRO, stated publicly that "there is essentially no net spare efficient producing capacity in this entire nation." GOODWYN at 111.

After running some experiments to test the system, the Commission became convinced that the state had little spare capacity, as opposed to the two million barrels a day of shut-in capacity long assumed. In March 1972 it set allowables at 100%. Total daily production went up by only a few thousand barrels. Market demand proration came to an end. See GOODWYN at 112.

Now things have changed again, and the situation today is more like the 1930s than the 1970s. Texas can produce as much as 13 million barrels of oil per day. Some countries are intentionally

flooding the world market with oil to destabilize the competition and gain market share. Demand has collapsed with unprecedented speed and on an unprecedented scale. Transport capacity struggles to keep up. Storage capacity is said to be running out.

It is reasonable for the Commission to consider whether to reinstitute market demand proration to operate in conjunction with a modified allowable allocation process.

If the Commissioners decide the answer is yes, Environmental Defense Fund has three recommendations:

- (1) Set total allowables at market demand – neither above nor below, but at the amount of oil Texas producers would produce in an economically efficient market.
- (2) Allocate allowables among wells in a way that prevents waste and protects correlative rights. The Commission's legal authority rests on this bedrock oil and gas jurisdiction.
- (3) Consider the multiple ways in which allocation can either do a good job of preventing waste and protecting correlative rights or a bad job.
  - For some fields, and perhaps wells, allowables will need to be adjusted to maximum efficient rates in order to assure full ultimate recovery.
  - Consideration must be given to assuring marginal wells are not unduly impacted and to providing capacity allowables as appropriate to EOR fields.
  - Oil proration must be designed to help reduce natural gas flaring. It is the most obvious waste occurring in Texas today. It damages correlative rights, especially the rights of royalty owners and mineral owners. It is terrible for the environment. Tolerating it is not good for the Commission's reputation. The Commission has the legal power to and should use allocation to create incentives to reduce flaring.

The present moment is every bit as historic as those the Commission faced in 1931 – 1932, when proration began, and in 1972, when it for good reason discontinued the practice.

EDF appreciates the Commission's interest in these issues. We respectfully make two requests. First, the opportunity to sit down with the Commission's technical staff and examine the available data on flaring. Second, an invitation to speak at the April 14 webcast meeting.

Respectfully,



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