April 8, 2020

Submitted electronically to: RRCconference@rrc.texas.gov.

To: Chairman Wayne Christian
Commissioner Christi Craddick
Commissioner 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 Alliance of Energy Producers appreciates the opportunity to comment on the above-titled cause before the Commission. With over 2,600 members, the Texas Alliance of Energy Producers is the largest state oil and gas association in the US. Our members hail from nearly 30 states and 300 cities. We represent the upstream (exploration and production) segment of the oil and gas industry; our members are oil and gas operators/producers, service and drilling companies, royalty owners, and a host of affiliated companies and industries in Texas and beyond.

While we are fortunate to count among our members a number of large publicly traded integrated oil and gas companies as well as publicly traded independent energy companies, our membership profile consists primarily of smaller, privately held independent oil and gas companies. The vast majority of our member companies employ 20 people or less. But they are great, sophisticated companies and operators as evidenced by the fact that they have seen and survived the brutal cycles by which the industry is characterized, and they remain in business today.

The TAEP has a number of concerns about the implementation of proration in Texas. First and foremost, we believe proration is at best unnecessary, and at worst, more harmful to the Texas upstream industry than a market-driven response will be. The US economic system of free markets and prices is based on the long-held belief that the judgment of individual firms acting in their own economic interest is preferable to the substitution of government dictates, and results in the best overall market outcome for both producers and consumers.

Additionally, there is great concern about Texas acting alone in terms of state-mandated lower levels of production. Prorating production in Texas when other states have not done so creates a competitive disadvantage for Texas operators, cedes national market share to other states, and at least to some degree negates the need for other states to follow suit and lower production as well. And if Texas should go down this path alone, the likely mandated decline in production would be insufficient to provide any significant upside price support. Absent the unilateral move to prorate Texas production, individual producers in all US states, subject to the same price and marketing conditions, will be forced to make adjustments at the company level and we will all be on the same footing. And any notion of Texas entering into proration as part of a grand bargain to bring other states, the US government, and/or other producing nations alongside is met with great skepticism by our members.

The current circumstances in the US and the global economy are unprecedented. As a result of the spread of the coronavirus and the resulting economic shutdown, energy demand has fallen rapidly, sharply, and deeply. Current crude oil demand relative to still-high levels of production can only have one result – crude oil price declines that are also rapid, sharp, and deep. In a market economy, price movements are paramount, and there simply is no substitute for the response of companies to price signals provided by current and evolving market conditions.

The call for an assessment of market demand and the implementation of proration assumes that these events will not happen absent the intervention of government. This could not be farther from the truth, however. As we speak, oil and gas companies in Texas, small and large, private and public, independent and major, are conducting market assessments at the firm level, and adjusting their operations accordingly. They are doing so well ahead of government, and doing so more effectively and efficiently.

If the goal of proration is to regulate Texas statewide production downward to more closely align production with demand under current market conditions, the Commission should rest assured that this is going to happen organically, and indeed already is. Anecdotal information from various Alliance member operators suggests that companies either have, or are in the process of shutting in production by anywhere from 20% to 50%. Larger companies have announced deep cuts in capital spending for the balance of 2020, are idling rigs, and are implementing production cuts across their leases.

The Texas statewide rig count has been declining since the fourth quarter 2018. The Texas Alliance of Energy Producers' *Texas Petro Index,* an ongoing tracking device for the statewide upstream oil and gas economy, after flattening in the fourth quarter 2018 has been in a state of decline for all of 2019 and early 2020, and this trend was set to continue. As a result, statewide daily crude oil production was going to begin to decline in Texas in 2020 even before the coronavirus phenomenon. The onset of COVID-19 as a US and global economic event has hastened the decline in statewide E&P activities dramatically.

Since the week of March 9 when the price of crude oil began to fall rapidly, the statewide rig count has fallen from 408 that week to 338 this past Friday, a decline of 70 rigs in less than a month including a drop of 30 rigs in the last week alone. The US rig count has fallen by 128 since that same week, including 64 rigs in the most recent week. The sharp decline in the rig count is almost certain to continue, meaning that production growth from newly drilled wells is set to slow dramatically. That is not the only contribution to production decline, however, as operators are now also drawing down production from existing wells.

Recent data from the US Energy Information Administration (EIA) is a bit inconsistent in terms of monthly production estimates, but the peak in US crude oil production probably occurred in February and March 2020 at slightly over 13 million barrels per day. This week, the EIA revised its US production projections downward for 2020, predicting average daily production for the year at 11.76 million barrels. That would be a decline of 3.8% compared to average daily production of 12.23 million barrels in 2019.

Texas daily crude oil production by our assessments surpassed 5.4 million barrels per day in February and March 2020. The current market circumstances are unprecedented and very fluid, making any modeling of outcomes very difficult. That said, the Alliance now projects annual crude oil production in Texas to decline by 4.0% in 2020 compared to 2019, with average daily production for the year falling from 5.07 million barrels in 2019 to 4.87 million barrels per day on average in 2020. While that may seem a bit tame at first glance, the response in daily production by month to bring about that 4% annual decline is quite dramatic. By year's end, the December 2020 monthly year-over-year decline would be an estimated 18-20%. And most notably, from a daily peak of just over 5.4 million barrels in March 2020, *monthly average daily production by year-end will have fallen by over 1 million barrels per day in Texas, and by over 500,000 bpd in the next five months.* And by the way, under that scenario, Texas retains its US market share of over 40%.

The response at the US national level will be similar. To achieve an overall 3.8% reduction from 2019 to 2020 (should the EIA projections come true), monthly average daily production will have to fall sharply in the coming months and for the balance of the year. The actual numbers may be higher or lower (and in fact could vary dramatically) than these estimates depending on any number of factors between now and the end of the year, but Texas and US production is going to decline significantly, and in relatively short order, negating the necessity for the proration of Texas production.

Other arguments for proration suggest that a market-driven drawdown in production is chaotic and without order, and may result in significant amounts of physical and economic waste. Neither of these is the case, however. Conversations with our operator members suggest that a very orderly process at the firm level is now underway. Companies are methodically going through the exercise of reducing/shutting in production on a well-by-well and lease-by-lease basis. Our members tell us they are ordering their production plans based on their intimate knowledge of their own wells and leases. They tell us that they can reduce production on some wells, and fully shut down wells that have the best chance to be successfully brought back online at a future point in time. Many are re-negotiating production contracts with mineral owners to hold off on current extraction and save it for a time when it is more economically advantageous.

Our member companies are in survival mode. These steps are being taken by operators to *preserve* their businesses during this time of extraordinary economic pressure on the oil and gas industry.

These various responses in terms of drilling and production are the result of this very unique set of market circumstances. Unlike 2015-2016, declining production revenue from the falling price of crude oil is not the only factor at work pushing production downward. With each passing day, our operators are told that there simply is no market outlet for the crude oil they are producing. Purchasers are informing producers that they will not be buying the oil. This stark reality necessitates a quick and nimble response by oil and gas companies in advance of any action that may be taken by state government to limit production. It is quite likely that by the time proration can be feasibly put in place by the Commission production will have already fallen below proration-mandated levels of decline.

We acknowledge that we do have members who support proration, and we also acknowledge the extraordinary pressure faced by our great oil and gas service companies and drilling companies. We are proud to represent all of these companies. But if the goal of proration is to (1) draw Texas production downward, (2) do so in an orderly and methodical fashion, and/or (3) limit physical and economic waste, these things are already occurring by necessity.

The clear sense of the membership of the Texas Alliance of Energy Producers as represented by our Board of Directors is that proration is unnecessary and is unlikely to achieve its intended purposes. We also are leery of implementing a new set of regulations and reporting requirements that will newly burden our members when they need to be focusing on other matters. We are also wary of implementing a new regulatory structure with no sense of how long it may be in place.

In our view, even in this extreme set of circumstances, the outcomes are best determined by fully functioning markets and price systems. The appropriate decisions in response to current and ongoing market conditions are best left in the hands of individual companies and operators.

Respectfully submitted,

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