

Texas Railroad Commission Meets to Consider Proration

Yesterday (04/14/2020), the Texas Railroad Commission held a virtual public hearing on the motion of Pioneer Natural Resources U.S.A., Inc. and Parsley Energy, Inc. asking the Commission to use its power of proration to combat the sudden collapse in demand and prices for oil amid the COVID-19 pandemic. The Commission adjourned the hearing after more than 10 hours of testimony and comments by 55 representatives of producers, transporters, landowners, industry trade groups and others. The Commission did not act on the motion or indicate how soon it might do so.

The speakers were sharply divided on whether proration is warranted and would be beneficial under the circumstances. Advocates for proration, including Pioneer and Parsley, argued that proration is essential for the very survival of the oil and gas industry in Texas. Without proration, they predicted the imminent exhaustion of storage capacity, further collapse of prices, and scores of bankruptcies, all likely to decimate smaller companies. They urged the Commission to act swiftly to impose a 20% reduction of production allowables beginning in May.

Meanwhile, opponents of proration asserted that Commission intervention is unwarranted and would be far more detrimental than beneficial to the oil and gas industry in Texas. Companies like Marathon, Diamondback, Enterprise Products and Ovintiv were joined by the Texas Oil and Gas Association and others in stressing that the free market underlies the success of the Texas oil and gas industry and that market participants, not government regulators, are best positioned to respond appropriately to decreased demand and prices for oil. They emphasized that capital budgets were already being curtailed, the number of rigs had dropped, and the market is self-correcting.

Ahead of the hearing, and in response to OPEC's recent commitment to cut production, Commissioner Ryan Sitton issued a statement on April 13, 2020 clarifying that while he was not advocating for proration, he believed the Commission must remain willing to consider it.

Commissioner Sitton outlined three key questions the Commission should weigh during the hearing:

- Is waste occurring?

- If so, is that waste due to production in excess of market demand?
- If so, can that waste be effectively reduced by the Railroad Commission systematically prorating Texas production?

Aside from the propriety and potential effectiveness of proration, overarching questions suggested that the Commissioners were seriously grappling with how and whether any type of proration could be fairly implemented. Commissioner Christi Craddick commented that she was unsure if the Commission even retained the knowledge or expertise on how to enforce statewide oil production cuts, which have not been imposed in Texas in nearly 50 years.

We will continue to follow proceedings at the Texas Railroad Commission and report on significant developments. In the meantime, please reach out to us if you have any questions about yesterday's hearing or other issues relating to oil and gas operations.