

**MAY 1, 2020**

For more information,  
contact:

Marcella Burke  
+1 713 751 6231

Peter Hays  
+1 713 751 3274

Monica Hwang  
+1 713 276 7346

---

**King & Spalding**

Houston  
1100 Louisiana Street  
Suite 4000  
Houston, Texas 77002-5213  
Tel: +1 713 751 3200

## Railroad Commission of Texas ("TRRC") to Rule on Proposed Proration on May 5, 2020

---

Over a hearing that lasted over 10 hours on April 14, 2020<sup>1</sup>, the TRRC listened as oil and gas industry participants and stakeholders provided their input on a motion by Pioneer Resources USA Inc. and Parsley Energy Inc. requesting that the TRRC limit oil production in Texas. Following the hearing, the TRRC formed the Blue Ribbon Task Force for Oil Economic Recovery to review potential actions that may be taken to assist upstream operators in Texas, including proration.<sup>2</sup> Further, WTI crude oil contract traded at a negative price for the first time in history<sup>3</sup>, and the Oklahoma Corporation Commission (the "OCC"), the corollary agency to the TRRC in Oklahoma, issued an order allowing producer in that state to curtail or completely shut-in production if they determine such action is necessary and warranted to prevent economic waste, effective for 90 days starting April 17, 2020.<sup>4</sup> Now, the TRRC has issued a draft proration order for consideration at its upcoming May 5th meeting.<sup>5</sup> This article provides a summary of the hearing discussions and draft proration order.

### TRRC PRORATION HEARING

Advocates for prorationing at the hearing generally cited to the following benefits to support their position: prorationing will provide pricing support to protect the Texas oil and gas industry, prevent waste and reduce flaring; prorationing gives smaller, independent producers an opportunity to supply a portion of the reduced demand; reduced oil demand from COVID-19 and cheaper imported oil prices have disrupted free market dynamics and recently announced OPEC production cuts are not enough; and prorationing will help ease and mitigate the lack of downstream storage capacities. Those opposed to prorationing generally point to the following reasons: prorationing is unlikely to have much impact on oil prices, given the many dynamics that go into oil prices; prorationing will create a disadvantage for Texas producers as compared to those in other states; free market dynamics can better limit production levels than regulators; and the knock-on adverse effects of prorationing on oilfield



services industry and tax revenues for the state. Below is a summary of the participants at the hearing and their stated position on proration<sup>6</sup>:

For Proration	Against Proration	Neutral
<ol style="list-style-type: none"> <li>1. Pioneer Natural Resources</li> <li>2. Parsley Energy</li> <li>3. Latigo Petroleum</li> <li>4. Texland Petroleum LP</li> <li>5. Discovery Operating Inc.</li> <li>6. Elevation Resources</li> <li>7. Institute for Energy Economics &amp; Financial Analysis</li> <li>8. Quantum Energy Partners</li> <li>9. Honorable Kent Hance</li> <li>10. UT Engineering School</li> <li>11. Texas Campaign for the Environment</li> <li>12. Environment Texas</li> <li>13. Public Citizen org</li> <li>14. Alex Cranberg</li> <li>15. Fort Apache Energy</li> <li>16. Continental Resources</li> <li>17. Mark Stanger</li> <li>18. Incline Energy</li> </ol>	<ol style="list-style-type: none"> <li>1. Marathon Oil</li> <li>2. Ovintiv</li> <li>3. Enterprise</li> <li>4. Texas O&amp;G Assoc.</li> <li>5. Texas Alliance of Energy Producers</li> <li>6. Tx. Independent Producers &amp; Royalty Owners Assoc.</li> <li>7. Diamond Energy and Viper Energy Partners</li> <li>8. American Petroleum Institute</li> <li>9. Texas Pipeline Assoc.</li> <li>10. Mabee Ranch</li> <li>11. James LeBas</li> <li>12. Edward Hirs</li> <li>13. Baker Institute at Rice</li> <li>14. John Tintera</li> <li>15. Bradford Moody</li> <li>16. Canary LLC</li> <li>17. Institute for Energy Research</li> <li>18. R Street Institute</li> <li>19. Michael Collier</li> <li>20. Benjamin Zycher</li> <li>21. Edwards Energy Consultants</li> <li>22. Senator Bettencourt</li> <li>23. Rep Chris Paddie</li> <li>24. Rep Lyle Larson</li> <li>25. Rep Charlie Green</li> <li>26. Troy Eckard</li> </ol>	<ol style="list-style-type: none"> <li>1. Plains All American</li> <li>2. University Lands</li> <li>3. Texas Land and Mineral Owners Assoc.</li> <li>4. HIS Markit</li> <li>5. Rapidan Energy Group</li> <li>6. Environmental Defense Fund</li> <li>7. Sierra Club</li> <li>8. Sinclair O&amp;G</li> </ol>

Aside from prorationing, speakers at the hearing advocated for other actions that the TRRC may undertake to support the Texas E&P industry. These alternative actions include limiting the grant of flaring permits and a declaration of force majeure to prevent lease expiration from lack of production activity.

#### DRAFT PRORATION ORDER

The draft proration order is marked as an agenda item under Commissioner Sitton. This is unsurprising as so far Mr. Sitton has been the sole Commissioner to consistently champion the idea of a statewide proration order to address the issue of oversupply caused by COVID-19 and former OPEC wrangling.<sup>7</sup> The draft order takes official notice of various facts around the oversupply of crude oil in the State of Texas due to the crisis (mentioning Russia, Saudi Arabia and COVID-19 by name) and concludes based on these facts that “waste” of crude oil is occurring or is reasonably imminent in Texas.<sup>8</sup> The actual proration order contained in the draft order follows, and is issued based on, this finding of waste, under the TRRC’s authority to prevent waste.<sup>9</sup>



The draft order is materially different from the OCC shut-in order and has a number of interesting features, including the fact that proration is only triggered once all other U.S. state and foreign country jurisdictions (i.e., other than Texas) agree to curtail production by 4 million bbl/day, in addition to the prior OPEC cut. When triggered, proration under the draft order applies to 80% of production (subject to adjustment by the TRRC), with production being determined on an operator basis, aggregated across all of an operator's wells, based on a certain prior period benchmark (e.g., proration is not determined on a well or field basis).

Relevant provisions of the draft order are set out in more detail in the table below, but since the order's actual content enacting proration is contained in a single paragraph (with most action taking place in the definition of terms), the operative provision is quoted in full here:

*Commencing with the Initial Proration Month and ending on the last day of the Last Proration Month, each Applicable Operator shall restrict the aggregate volume of Oil produced by such Applicable Operator from Oil Wells during each Proration Month so that the aggregate total volume of Oil produced from all Oil Wells Operated by such Applicable Operator during each Proration Month, in the aggregate, does not exceed the Proration Volume applicable to such Applicable Operator for the applicable Proration Month (such restriction requirements referred to in this paragraph shall be referred to as the "**Prorationing Requirements**")*<sup>10</sup>

Material Terms of Draft Proration Order	
Proration Trigger (Initial Proration Month)	Proration starts on the Initial Proration Month, which is triggered upon the enactment of "Complementary Proration Measures" (being the calendar month following their enactment, if enacted before the 7th day of a month; or the second calendar month following their enactment, if enacted on or after the 7th day of a calendar month)  Complementary Proration Measures apply when the governments of all states in the U.S. other than Texas and/or all foreign countries other than the U.S. have enacted laws to curtail production of crude oil by, in the aggregate across all such state and foreign country governments, at least 4 million bbls per day, in addition to the 9.7 million bbl/day reduction already announced by OPEC+
Proration Term and Termination (Final Proration Month)	Proration ends at the completion of the Last Proration Month, which is the earlier of (i) the first calendar month following the month during which the applicable Complementary Proration Measures, or (ii) the month during which the Commission finds that global demand for crude oil exceeds 85 million bbls per day
Applicable Operator + Active Well Basis	Proration is determined on an operator-basis, and on an aggregate basis across all active wells operated by an applicable operator (not on a well by well basis), subject to exclusion for certain operators
Proration Volume	The volume subject to proration is equivalent to an operator's Benchmark Oil Production Volume multiplied by the Market Demand Factor (multiplied by the number of days in the applicable month), where:



	<p>Operator's Benchmark Oil Production Volume is the operator's highest daily average aggregate production volume (across all of its operated, active wells) during either October, November or December of 2019 (i.e., take the month with the highest daily average production volume and use that); and</p> <p>The Market Demand Factor starts at 80% under the draft order, and is subject to adjustment by the Commission from time to time if necessary to prevent waste</p>
Excluded Operators	Proration does not apply to operators with active wells that, in the aggregate, produce less than 1,000 bbls / day
Exempt Wells	Wells exempted from the TRRC's proration authority under Texas law generally are exempted from proration and are not counted for purposes of determining an operator's benchmark oil production

It is worth noting that the TRRC Chairman has already openly announced that he intends to vote against the draft order, describing proration as "an antiquated policy" and pointed to the Blue Ribbon Task Force as a means to develop ideas to save E&P jobs with industry input.<sup>11</sup>

#### TAKEAWAY

At the time of this article, WTI price has rebounded from negative territory but remains in the teens. On Tuesday, the upstream industry will likely watch closely the TRRC vote on the draft proration order. Given that two of the three Commissioners have openly expressed their reviews on the order, it appears that Commissioner Christi Craddick has the deciding vote. Irrespective of the outcome, additional proposed measures to support the Texas oil and gas industry may follow from the Blue Ribbon Task Force.

#### ABOUT KING & SPALDING

Celebrating more than 130 years of service, King & Spalding is an international law firm that represents a broad array of clients, including half of the Fortune Global 100, with 1,100 lawyers in 21 offices in the United States, Europe, the Middle East and Asia. The firm has handled matters in over 160 countries on six continents and is consistently recognized for the results it obtains, uncompromising commitment to quality, and dedication to understanding the business and culture of its clients.

This alert provides a general summary of recent legal developments. It is not intended to be and should not be relied upon as legal advice. In some jurisdictions, this may be considered "Attorney Advertising." View our [Privacy Notice](#).

ABU DHABI	BRUSSELS	DUBAI	HOUSTON	MOSCOW	RIYADH	SINGAPORE
ATLANTA	CHARLOTTE	FRANKFURT	LONDON	NEW YORK	SAN FRANCISCO	TOKYO
AUSTIN	CHICAGO	GENEVA	LOS ANGELES	PARIS	SILICON VALLEY	WASHINGTON, D.C.



---

<sup>1</sup> See meeting recording available at [http://www.adminmonitor.com/tx/rrc/open\\_meeting/20200414/](http://www.adminmonitor.com/tx/rrc/open_meeting/20200414/).

<sup>2</sup> See <https://www.rrc.state.tx.us/all-news/042120a-christian-discusses-proration-task-force/>.

<sup>3</sup> Cameron Wallace, *WTI Crude Price Goes Negative for the First Time in History*, WorldOil.com (Apr. 20, 2020).

<sup>4</sup> See *Oklahoma Corporation Commission Issued Order on Prevention of Economic Waste*, available at kslaw.com for further discussions on this order.

<sup>5</sup> May 4<sup>th</sup> meeting agenda is available at <https://rrc.texas.gov/media/57506/final-conference-agenda-for-may-5-2020.pdf>.

<sup>6</sup> Compiled from TRRC hearing minutes, available at <https://rrc.texas.gov/media/57365/rrc-open-meeting-minutes-april-14-2020.pdf>.

<sup>7</sup> Asher Price, *Texas Railroad Commission Holds Off Putting Cap on Oil and Gas Production*, The Dallas Morning News (Apr. 21, 2020).

<sup>8</sup> "Waste" is defined at Texas Natural Resources Code § 85.046.

<sup>9</sup> Texas Natural Resources Code § 85.051

<sup>10</sup> TRRC Open Meeting Notice for Tuesday, May 5, 2020, Appendix A, Order at para. 1.

<sup>11</sup> Wayne Christian, *Opinion: Texas Capping Oil Production? Chairman Wayne Christian Picks a Side*, Houston Chronicle (Apr. 29, 2020).