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Comment to Railroad Commission of Texas
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

Submitted on behalf of the Institute for Energy Research
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Dear Chairman Christian, Commission Craddick and Commissioner Sitton:

For the sake of the long-term viability and strength of the Texas domestic oil production industry, I write on behalf of the Institute for Energy Research, to express our opposition to any intervention by the Railroad Commission to prorate oil production. While oil producers face an extraordinary and unprecedented series of short-term factors at the moment, this cannot be a justification for abandoning the free market policies that created the domestic production boom in the first place.

Texas is too small a player. Texas produces about 40% of US oil (5.4 million bpd for Jan 2020). Estimates of global coronavirus-driven demand destruction range from 10-30 million bpd for an unknown amount of time. So even if Texas halted all its production, this would not even cover the demand loss. When in the past proration was regularly used, Texas was a dominant producer of the world's oil supply. It is simply not a useful tool for the current global reality where Texas is just one of many producers. The double blow of coronavirus demand loss as well as a supply side price war is certainly painful, but the Railroad Commission should have the humility to recognize that this historic confluence of factors cannot be fixed by government regulation.

Proration props up weaker players at the expense of stronger. Some companies have wells that are cheaper to produce from (whether because of geology or technology). Some companies are better hedged against lower oil prices. Some companies have better cash/debt balances. Forcing all producers to prorate indiscriminately eliminates the benefits of these distinctions. To illustrate: Company A chose to only operate in acreage that could produce at low prices, spurning the frantic rush to buy every acre and drill every well. Company B, arriving late the Permian boom, bought up more marginal acreage that only breaks even at high prices. Why should the Railroad Commission force Company A to prorate when through prudent business practices they are in good operational shape?

Proration eliminates incentives for efficiency. What we saw clearly during the last oil price drop in 2015-2016 is that American producers are champion innovators. The Saudis assumed that the high reported breakeven price levels for shale were fixed. But in response to low oil prices, shale operators figured out cheaper and more efficient ways of developing shale wells. What is needed now is more of that kind of ingenuity. Any action taken to prorate eliminates those incentives. If an operator knows that he can only produce a fixed amount set by the Railroad Commission, then he has less reason to innovate because he would not be allowed to take advantage of a breakthrough to pump more oil. Similarly, a new entrant who develops a novel technique or technology that he wants to introduce would be blocked by Railroad Commission proration limiting his ability to produce.

Proration limits creative destruction. For some time, analysts have been calling for consolidation in the shale patch. Some producers were already in precarious financial shape. Proration would obstruct the natural, market driven reorganization of the industry.

The oil isn't going anywhere. When a company goes out of business, its leased acreage does not disappear. The oil is still there and the acreage will be bought up by stronger players, or by future new entrants. When oil prices rise again, production will resume.

In closing, let me state clearly that production reductions should be made based on market signals. Each company has to assess its own situation: hedging positions, break even prices, access to pipelines, access to storage, whether a well can be slowed or shut-in, the factors are virtually endless. And importantly the factors are completely different for each company, each field, and even each well. In the last several weeks we have already seen this playing out, with numerous producers announcing slowing of investments and production in response to the market situation. Attempting to centrally plan this adjustment through proration would only interfere with the market driven process already underway. The Railroad Commission should not attempt to substitute its own judgment in place of the wider wisdom created through the free interaction of thousands of players in oil markets.