THE AMERICAN OIL & GAS REPORTER®
JANUARY 2019
The "Better Business" Publication Serving the Exploration / Drilling / Production Industry

Steady Texas Industry Greets New Year

By Del Torkelson

AUSTIN, TX.–As Eugene Garcia considers his state's oil and gas industry, the Texas Independent Producers & Royalty Owners Association Chairman lands on the term "stable." As anyone crossing a wobbly bridge or keeping watch over a loved one in the hospital may attest, stability is vastly underrated. And with memories of recent years' soaring highs and stomach-churning lows still fresh, it seems unlikely many oil and gas companies will argue.

"I think we will see a continued maturation of the process and techniques developed over the past decade," Garcia predicts. "It will lead to a more stable energy supply/demand balance, as long as outside forces do not destabilize the process by closing markets to U.S. energy, imposing undue burdens on operators, or significantly changing the economic structure we operate under."

As 2018 gives way to 2019, Garcia says he sees a Texas industry that is going strong, even as challenges abound. "Operators have been firing on all cylinders in developing the great, new trends of the past decade, but there are concerns on the horizon," describes the president of San Antonio-based Hurd Enterprises. "The concerns take the form of environmental regulations, trade policies, financial credit markets, infrastructure development and human resource availability. While the Texas oil and gas industry has brought about a U.S. energy renaissance previously unimagined, its success has also created some daunting challenges."

Fortunately, reflects TIPRO President Ed Longanecker, the association is doing its part to meet those challenges, many of which will figure prominently on the agenda of the association's 2019 annual convention, scheduled for Feb. 26-28 in downtown Austin. "There is generally a high degree of optimism within the Texas oil and gas industry, with continued growth in production and manageable market conditions expected by many in 2019," he characterizes.

The Permian Basin's staggering growth as the crown jewel of U.S. producing provinces offers examples of both the optimism and accompanying challenges, Longanecker suggests. He cites U.S. Energy Information Administration projections that Texas' portion of the Permian is on pace to account for half of all new global crude output during the next five years. Meanwhile, basinwide natural gas production appears likely to increase nearly 40 percent in the same period.

The area already faces transportation constraints, he observes, noting that Permian crude prices lagged those for West Texas Intermediate delivered to Cushing, Ok., by as much as $15 in 2018. "As midstream companies rush to add capacity to ease bottlenecks, several have accelerated their pipeline infrastructure projects," Longanecker observes. "Plains All-American Pipeline, for instance, announced that two West Texas crude oil projects would begin partial operations ahead of their original schedules, including the Sunrise expansion project in the fourth quarter of 2018 and the Cactus II line, which will begin partial service in the third quarter of 2019."

According to Longanecker, the Sunrise pipeline will move oil north from the Permian to a Texas hub, where it can connect to other systems to reach Cushing. Sunrise should be able to transport 360,000 barrels a day this quarter, with full capacity slated to reach volumes as great as 500,000 bbl/d. Plains All American Pipeline's Cactus II should begin partial service by the third quarter before starting full service of 670,000 bbl/d by April 2020.

For its part, he says, TIPRO continues to serve as an industry representative as companies race to bring midstream–and other infrastructure needs–on line. "TIPRO is supporting industry-led initiatives to address other priorities and challenges in the Permian Basin at the local level, including issues related to workforce, education and healthcare, all of which are critical in supporting a vibrant oil and gas industry in West Texas," Longanecker reports.

"TIPRO is actively engaged in addressing all the challenges the Permian has been facing," Garcia concurs. "In fact, our proactive stance in working with independents and royalty owners in the area over the years has laid a foundation that has enabled us to have a positive impact. These challenges are seen across the state, allowing TIPRO to bring its insight and learning from other areas to the Permian and vice versa. We do not act in silos."

That is important, he emphasizes, because the Permian is not the only area in Texas with drill bits moving to the right. "I am intrigued by all the activity across the state," Garcia says. "From offshore to the Haynesville/East Texas and legacy

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fields in South Texas, independents are pursuing new ideas and expanding on old ones across the state. We need to continue to support and recognize these efforts."

"We continue to monitor permits and drilling activity in key formations throughout the state, including the Barnett Shale, Eagle Ford and Haynesville, all of which are active," Longanecker affirms. "In addition to our state and federal advocacy, TIPRO directly engages in local issues that can impact our industry either negatively or positively through our Local Issues Task Force, including any proposed changes to drilling ordinances that conflict with state law or the dominance of the mineral estate, or that pose unnecessary challenges for operators."

Worse Than Tariffs

Longanecker cites a number of geopolitical wild cards influencing the global energy balance and companies' cost structures, before focusing on the specific concern of international trade as a particularly timely and pivotal issue that affects both hydrocarbon supply and demand. The cost and availability of steel–a necessary input for almost every facet of the industry–looms large for TIPRO, as do healthy trade avenues between the United States and key markets such as China, Canada and Mexico.

"The Office of the U.S. Trade Representative reportedly is considering replacing the 25 percent tariffs on Mexican and Canadian steel imports with quotas," Longanecker notes. "While this 25 percent border tax on imported steel is causing significant problems for American oil and gas producers already, quotas have been far more damaging, as projects increasingly face the risk of grinding to a halt while steel imports sit in warehouses waiting for the quota to open."

Meanwhile, he notes, the phrase "trade war" is being bandied about to describe the status of the United States' relationship with the world's largest importer of crude oil and second-largest liquefied natural gas market.

"While trade negotiations between U.S. and Chinese officials continue, this conflict has already had a negative impact on U.S. oil and LNG exports to China," Longanecker assesses. "If left unresolved, the U.S.-China trade war could be significantly negative for the U.S. oil and gas industry, although China ultimately has much more to lose."

The trade war apparently arrived at a cease fire at the beginning of December, press accounts note, when the United States and China agreed to a 90-day pause on new or higher tariffs while the countries negotiated a broader deal. Nevertheless, Garcia counsels against reading too much into the development.

"It is a step in the right direction," he affirms. "However, we still have a long way to go."

"Any progress is positive, but China has a history of broken promises, so we remain somewhat skeptical," Longanecker acknowledges. "The contrast in the narrative portrayed by both countries following the 90-day truce was also telling. China will continue to be one of the largest importers of oil and natural gas in the coming year, so we will continue to watch these negotiations closely."

With regard to U.S. steel and aluminum protectionism, he highlights the pivotal difference between pricier products and no products. The Commerce Department's steel quota agreements with South Korea, Argentina and Brazil are based on the anomalously low volume of steel the United States imported when the industry was in survival mode and did not invest much in steel for new production, he observes.

"While tariffs have a detrimental impact by increasing project costs, that approach at least ensures firms can still buy the steel needed to drill new projects," Longanecker details. "Quotas, in contrast, put up a brick wall that absolutely cuts off the supply of products critical to getting oil and gas from the ground and off to market."

Employment Impact

Texas has recovered 46 percent of the upstream jobs it shed between October 2014 and September 2016, and it now employs more than 220,000 people who earn an average of $124,000 a year, Longanecker observes; but continued regeneration is not guaranteed.

"Arbitrarily capping access to steel supplies potentially will choke off America's oil boom just as it's really taking off," Longanecker warns. "Oil development throughout the state almost certainly will suffer if a hard limit on steel from Mexico and Canada is imposed, causing real harm to the oil and gas industry here in Texas and to other critical industries that benefit from vital energy production."

Quotas that prevent companies from obtaining the tubulars and line pipe they need to drill new wells and lay pipelines will force them to trim their sails, he continues, shrinking U.S. energy output, contradicting President Trump's goal of U.S. energy dominance and hitting companies' payrolls.

"Under any scenario, quotas will result in a reduced workforce, threatening the historic statewide unemployment lows fueled by the Texas oil and gas industry." Longanecker cautions. "Slowing drilling while companies wait on steel product availability ultimately will decrease overall production as well as severance tax revenues that benefit the public."

At a minimum, he says, TIPRO encourages the Trump administration to avoid such outcomes by excluding steel products critical to the energy sector from the proposed quotas.

North American Trade

The momentary trade truce with China is not the only move away from trade barriers that encourages TIPRO. Longanecker says the association is pleased with the new U.S.-Mexico-Canada-Agreement, which is intended to replace the North American Free Trade Agreement.

"Energy integration with Mexico, the United States and Canada has been a success story that has created many new opportunities to improve trade relations across North America," Longanecker reflects. "One of the most significant provisions with the USMCA is the ability for the oil and natural gas industry to continue using a special dispute resolution process–from the original NAFTA agreement–with the Mexican government, which provides some protection to multinational companies that invest abroad.

"Another important element is continuing zero tariffs on oil and natural gas products, something TIPRO advocated for," he adds.

However, steel remains a sticking point for the association. "Imposing import quotas, or keeping tariffs in place for steel, would run contrary to the progress made with the USMCA," he assesses.

Longanecker notes that TIPRO has been very outspoken and highly visible on trade matters, outlining its concerns to Trump administration officials that include USTR Representative Robert Lighthizer, Commerce Secretary Wilbur Ross and U.S. National Economic Council Director Lawrence Kudlow, while also communicating the association's position to Texas' congressional delegation, Governor Greg Abbott, and state regulators.

According to Garcia, such advocacy is necessary in light of the Texas industry's growing global clout. "We have seen how foreign national oil companies have invested in Texas oil and gas to learn and benefit from our industry," he notes. "Over the past several years, crude oil and now LNG exports have taken this significance to a new level. A protectionist stance could negatively impact not only the cost structure under which the industry operates, but the available market to Texas oil and gas for investors and, ultimately, customers for our product."

Longanecker and Garcia readily acknowledge that the Trump administration has heeded industry input by improving or jettisoning a number of problematic Obama-era regulations. Longanecker praises the administration's sound, scientific approach to regulating oil and gas production, citing examples such as the U.S. Department of Interior's revisions to the Obama-era methane regulations for operations on federal lands, and the Environmental Protection Agency's proposed improvements to its 2016 New Source Performance Standards for oil field emissions.

The latter, Longanecker explains, are intended to ease producers' regulatory burden by modifying leak monitoring frequency at well sites and compressor stations, and adopting other important technical corrections to the original NSPS rule.

Nevertheless, TIPRO shoots down any suggestion that easing oil and gas companies' punitive regulatory burden enables them to bear costly trade decisions.

"I don't think we can compartmentalize actions," Garcia advises. "We need a comprehensive approach to energy policy. Taking one step forward and two steps back is not a good strategy, and we need to continue to encourage policies and an overall approach that supports oil and gas development and production." ❐

TIPRO Engages Session's Dynamics

-AUSTIN, TX.–The 86th Texas Legislative Session is under way, and even though the state has experienced a natural disaster, fluctuating energy prices and historical election results since the last session in 2017, it is business as usual for the Texas Independent Producers and Royalty Owners Association, reports TIPRO Chairman Eugene Garcia.

Although Garcia, president of San Antonio-based Hurd Enterprises, predicts the session's primary drivers will come from outside of the oil and gas industry, he assures that the association is ready to advocate for, or protect against, legislation that impacts the oil and natural gas industry. "TIPRO has been at the forefront of legislative and regulatory advocacy since its inception in 1947," Garcia comments. "This session will be no exception, and even though there are more pressing issues facing lawmakers in the months to come, the true risk for producers is whether or not the financial windfall our industry has brought Texas will be taken for granted. I think TIPRO's primary job this year is going to be stressing the importance of the industry to our elected officials and showing the numerous benefits it has provided for the entire state."

TIPRO's 2019 annual convention, scheduled for Feb. 26-28 in Austin, will offer members a chance to learn about issues affecting the oil and gas industry and to communicate with lawmakers about them, notes TIPRO President Ed Longanecker, who says some of the conference's confirmed speakers include Governor Gregory Abbott.

"TIPRO's 73rd Annual Convention will coincide with the 86th Texas Legislative Session, so we will put a heavy emphasis on policy matters facing the oil and natural gas industry at the state level," he reports. "The convention also will include a Capitol call-up, providing oil and natural gas executives an opportunity to interface with elected officials. Having this level of interaction between legislators and industry representatives is important in communicating the real issues facing independents and royalty owners."

According to Longanecker, the annual meeting will begin with an evening legislative reception on Tuesday, Feb. 26. The next day will feature presentations from prominent state elected officials and industry representatives covering a broad range of issues facing the Texas oil and natural gas industry, followed by the chairman's dinner. The Capitol call-up will take place on the morning of the convention's final day.

New Dynamics

The 2018 elections were historic for many reasons, TIPRO Director of Government and Regulatory Affairs Rusty Smith says, pointing to the altered dynamics in the legislative and judicial branches of government. In the Texas House of Representatives, for instance, Republicans commanded a 95-55 majority prior to November. That count now stands at 83-67 after the elections, and while the GOP still has an 11-vote majority it will certainly impact the way that legislators and stakeholders approach the legislative process.

"This chamber also is entering session with the first open race for speaker of the House in almost a decade, as current Speaker Joe Straus announced his retirement from the chamber late last year," Smith explains. "While numerous state representatives began the process of campaigning for the open position, Representative Dennis Bonnen, R-Angelton, has emerged as the front-runner within the last few months, garnering the unanimous support of the Texas House Republican Caucus as well as several Democratic elected officials."

In the Texas Senate, Smith continues, Republicans flipped a seat long held by Democrats in a special election a few months before November, but two Republican incumbents lost to their Democratic challengers in the general election. "The Senate currently has a rule that three-fifths of the chamber must first vote to allow a piece of legislation to even be considered, which in a body of 31 Senators means 19 votes are required to bring that bill up for discussion," he details. "Prior to this past election, the count was 21-10 Republican, meaning that some legislation could be considered without any support from Democrats. Although this scenario is still a possibility, with the margin now at 19-12, it is certainly going to increase across-the-aisle negotiations on legislation that does not have support from all 19 Republicans."

As far as major issues are concerned, Smith indicates that recovering from Hurricane Harvey's devastation and preparing infrastructure for the next major storm has been the subject of numerous hearings and discussions during the interim. "Hurricane Harvey was a storm unlike any other in this state, and while it may not be feasible to fully prepare for another storm of similar magnitude, Harvey also showed some defects in more basic levels of preparedness at the federal, state and local levels that must be addressed," he relates. "Resolving these issues will be very costly, and will take many years of planning and development in some cases."

Along with Hurricane Harvey, Smith predicts other prominent legislative topics will include many of the same issues that have driven previous sessions: school finance, tax reform, healthcare, and public and higher education.

One theme common in the last few legislative sessions that will not have to occur again in 2019, however, is advocating for reauthorization of the Railroad Commission of Texas through sunset legislation, which was accomplished in 2017 after two failed attempts in the sessions immediately preceding.

"Every state agency must undergo a review process by the Sunset Advisory Commission on a recurring basis, and this inward-looking audit scrutinizes the stewardship of taxpayer dollars and the agencies' performance," says Smith. "While most agencies only incur one sunset review every decade or so, the RRC endured three reviews in back-to-back-to-back legislative sessions.

"Ensuring that a state agency is operating efficiently and not mismanaging taxpayer funds is an exercise in good government, and these reviews are extremely thorough–and therefore time-consuming–for all involved," he continues. "With the support last session of TIPRO and numerous other engaged stakeholders, the RRC was approved as a state agency for another 12 years, and many recommended changes to the internal functions of the agency were approved through the process."

Industry Issues

The Texas Legislature kicked off its 140-day regular session on Jan. 8, and TIPRO comes at the session with several priorities. According to Longanecker, those priorities include transportation, inactive well legislation, critical infrastructure development, workforce development, water policy and ad valorem taxation.

On the matter of transportation, he says several bills will seek to address road repair and maintenance, including legislation that has already been filed to use a percentage of production taxes to create a tax trust fund for energy country infrastructure. With regard to transporting hydrocarbons, Longanecker indicates TIPRO will continue to advocate for a balanced approach to critical infrastructure needs that recognizes the dominance of the mineral estate, existing laws and regulations, and private property rights.

As for production, he notes, the industry slump forced many operators to shut in some wells. "The RRC has reported an annual average of more 100,000 inactive wells for the past few decades, many of which are still economically viable," Longanecker relates. "Texans know that every barrel counts, so TIPRO will continue to work with policymakers to find common-sense solutions to bringing inactive and orphaned wells back into production, and to providing the tools necessary to sustain that production regardless of the economic and regulatory climate."

TIPRO also will be keeping tabs on any legislation impacting water use, specifically as it relates to brackish groundwater development or groundwater exports, says Longanecker. "The past few sessions have seen bills that seek to change the way brackish groundwater is regulated as well as how groundwater exports, or movement of water across groundwater conservation district boundaries, are treated," he describes. "Brackish groundwater, and water in general, is a vital resource to our industry. Any legislative or regulatory proposals that could alter an operator's access to water will be highly scrutinized by the association." ❐

TIPRO Annual Meeting Austin, Tx.

Tuesday, Feb. 26

1 p.m. Audit Committee Meeting, Sheraton Austin Hotel at the Capitol
3 p.m. Board of Directors Meeting
5:30 p.m. Welcome Reception

Wednesday, Feb. 27

8 a.m. TIPRO Membership Breakfast, Sheraton Austin Hotel at the Capitol
9 a.m.-4:45 p.m. General Session
6 p.m. Chairman's Reception and Dinner Presentation: 2019 'Hat's Off' Award Presentation

Thursday, Feb. 28

8 a.m. Breakfast & Call-Up Meeting
8:30 a.m. Buses Depart for Texas State Capital
8:45-11:45 a.m. State Legislator Meetings
Noon Lunch and Departures

Permian Producers Hedge Their Bets

HOUSTON–Permian Basin producers increased their 2020 oil-basis hedge positions by 431 percent in the second quarter of 2018, Wood Mackenzie reports in its analysis of oil and natural gas hedging activity. It adds this surge in oil-basis hedges signals producers' misgiving that key pipeline projects may fail to start by their 2019 target dates.

"It was an anomalously high trading volume for this particular hedging derivative (2020 Mid-Cushing basis-swaps). The only reasonable conclusion one can draw from this surge is that Permian producers are concerned that key pipeline projects won't be completed on schedule," assesses Andrew McConn, corporate research analyst at Wood Mackenzie.

The Permian oil production forecast of increasing more than 400,000 barrels a day year-over-year on average through 2020 is overwhelming the basin's takeaway capacity, Wood Mackenzie says, causing oil and gas to sell within the basin at steep discounts to national indexes.

According to the analysis, as recently as 2015 significant pipeline constraints caused the Midland to Cushing West Texas Intermediate discount to widen to as much as $20 a barrel. This prompted many Permian operators to use derivatives to hedge against the risk of still wider price differentials, Wood Mackenzie says.

While midstream operators are racing to complete pipeline projects and expansion to help ease congestion, Wood Mackenzie points out it may take more than a year before West Texas producers see sustained relief. The analysis warns current underconstruction of final investment decision projects will not provide sufficient capacity until late in 2019.

"The more than 52 percent increase in 2019 Midland-Cushing hedge positions suggests that producers perceive risk for that year as well: specifically, the risk that Midland oil prices don't gradually rise and converge back to parity with the Cushing index, as futures markets currently imply," McConn says.

While infrastructure might have lost the race with production in 2018, the analysis says a massive build-out in late 2019 can flip that script. According to Wood Mackenzie's North American Crude Markets short-term outlook, more than 2 million barrels a day of capacity is slated to come on line beginning in late 2019/early 2020, which the report says will send the Permian Basin into a temporary medium-term overbuild.

John Coleman, Wood Mackenzie senior analyst, North American crude oil market, says, "As new pipelines flood the basin and excess capacity provides a cheaper route to the U.S. Gulf Coast market, Midland crude prices could shift from massive discounts to Cushing to slight premium pricing.

"We forecast potential for approximately 1.5 MMbbl/d of excess pipeline capacity in late 2020," he adds. "This will have ripple effects on basin pricing for years to come, with expected downward pressure on pipeline tariffs showing up in basin differentials well into the early 2020s." ❐

BLM Eases Sage Grouse Restrictions

WASHINGTON–With the intent of better aligning its resource management plans with state conservation plans, the U.S. Bureau of Land Management in December released final environmental impact statements and proposed RMP amendments addressing greater sage grouse on public lands in seven Western states.

BLM says the plans "reflect months of consultation and collaboration with Western governors on how best to avoid listing the species as threatened and endangered without stifling local economies. BLM developed the changes in collaboration with governors and state wildlife agency professionals in the affected states."

"We know the successful conservation of the greater sage grouse requires the shared stewardship vision of the states, private citizens, landowners and federal land management agencies," affirms Deputy Secretary of the Interior David Bernhardt.

The six state-specific proposals for Wyoming, Colorado, Idaho, Oregon, Utah and Nevada/northeastern California were published in the Dec. 10 *Federal Register.* They also may be accessed through the Interior Department's national project website at https://goo.gl/7wdKmM by following the individual state link and then clicking on "Documents & Reports."

They replace land-use plans released in May 2015 that industry representatives decried as top-down approaches that largely ignored good mapping and data from affected states (*AOGR,* July 2015, pg. 167). The Obama-era plans adopted a tiered approach of increasing restrictions in areas identified as General Habitat Management Areas, Priority Habitat Management Areas and Sagebrush Focal Areas. Industry representatives calculated the 2015 plans placed some sort of development limitation or restriction on 66 million acres, including 11 million acres of no surface occupancy without exceptions and 35 million acres of no surface occupancy with some exceptions.

Interior Secretary Ryan Zinke initiated the process of re-evaluating those plans with Secretarial Order 3353, which was signed in June 2017 and established an interagency team from BLM, U.S. Fish & Wildlife Service and the U.S. Geological Survey to review 98 land-use plans in 11 Western states (*AOGR,* July 2017, pg. 30).

Ease Restrictions

The Independent Petroleum Association of America says the proposed plan amendments limit sage grouse habitat off limits to development to 1.8 million acres, and eliminate a requirement of the 2015 RMPs that companies pay into a habitat preservation fund, although it notes that voluntary payments still will be accepted.

IPAA also quotes BLM spokeswoman Heather Feeney saying the proposed amendments remove the Sagebrush Focal Area designation from 9.0 million acres, but that "buffer zones will continue to ban the destruction of sage grouse habitat near nests, and companies will have to apply for waivers to develop that habitat."

In Wyoming, according to a concurrent announcement from the state BLM office, the proposed amendments remove the Sagebrush Focal Area designation from 1.9 million acres. The amendments also propose to adopt Wyoming's compensatory mitigation framework, clarify objectives for sage grouse habitat where livestock grazing is authorized, and increase flexibility to grant waivers, exceptions or modifications for energy leasing.

In Nevada and northeastern California, according to the Nevada state BLM office, the amendments would replace the 2015 adaptive management strategy with the causal-factor analysis strategy in Nevada's sage grouse plan.

The Colorado BLM office says the proposed amendments will open 224,000 acres near greater sage grouse leks in that state to fluid minerals leasing under a no-surface-occupancy stipulation. The amendments also "revise the language for waivers, exceptions or modification to no-surface-occupancy stipulations to reflect the state's authority over wildlife management and consider Colorado's unique habitat and management issues. The proposal also provides a process for adjusting habitat boundary maps to account for future changes," the Colorado BLM office says.

Governors Respond

BLM's national announcement carries endorsements from governors in six of the seven affected states. "It is refreshing to have a federal agency willing to listen to the people in Idaho on an issue so important to our state and the West," BLM's news release quotes Idaho Republican Governor Butch Otter.

Utah Republican Governor Gary Herbert calls the proposed changes "a great example of federal leaders listening to state leaders, valuing their expertise, and changing their plans based on that input. It is the right approach for the species and the state."

Oregon Democrat Governor Kate Brown adds, "This agreement is a critical step that makes a shift away from planning toward active conservation and landscape management."

Environmental groups are less complimentary. The *New York Times* quotes Bobby McEnaney, who is described as an expert in Western land use at the Natural Resources Defense Council, as calling the announcement a gift to the oil and gas industry. "It is hard to pretend at this point that Zinke is a steward of America's public lands," McEnaney is quoted.

Another published report says federal officials also have dropped plans to conduct a five-year status review of the greater sage grouse's endangered species status.

The Fish & Wildlife Service announced in September 2015 that it would not list the bird as threatened or endangered, based largely on BLM's land use plans (*AOGR,* October 2015, pg. 130). However, USFWS said it would review the species' status in five years.

USFWS spokeswoman Jennifer Strickland says in media reports the agency will work with state officials to document the BLM plans' effectiveness. ❒