The Saudi Price War

The Saudi-OPEC price war is now nine months old. Two OPEC meetings have passed without revisions or changes in strategy. It is a war against high cost unconventional American producers as the principal threat to market share.

The West Texas Intermediate price per barrel has recovered since the low of the mid 40 dollar bottom to slightly above 60. This has become a trading range with algorithms following momentum making a price range. Financial or paper traders and speculators have moved the price of oil in a “rally” up 15 dollars.

Oversupply still overshadows the market. The balance of supply and demand awaits the onset of winter or 2016. The market share for OPEC and Saudi Arabia continues to expand at the expense of Non-OPEC, but American shale or unconventional production has not declined to the point that an acceptable world balance between supply and demand appears to be in the making.

The CEO of ConocoPhillips was invited to the recent preliminary OPEC meeting and he challenged the producer countries with a warning: American “high cost” production will survive the price war with cost-saving efficiency in process and yet to come. This promises American oil supply at less cost and a prospect of little change in world supply while demand remains weak and possibly weaker with China importing less crude as well as iron ore and other commodities.

What is now the play in oil price formation is geopolitics. The Gulf in the Middle East is in a war -- Shia and Sunni, Iran and Saudi Arabia—with the frontline in Iraq. Is the Islamic State of Iraq and the Levant (ISIS) a threat to the OPEC supply of crude oil? The reality “on the ground” is negative. ISIS requires the revenue from oil and not its disruption.

If, however, one day there is a confirmed attack upon Saudi Aramco oil fields and refinery infrastructure, the speculators and hedge funds will buy oil and the price could reach $75 or more per barrel. If the damage was serious enough to take Saudi production off-line at the rate of 300,000 barrels per day the price of oil could approach $90.

Libya is too small a producer to matter as a geopolitical variable in an upward price move. Military events in Iraq could affect oil production in a downward supply scenario. However, no war induced “scorched earth” option is likely as the Kurd interest continues to sustain oil production and pipelines to export markets.

At the end of the month, the geopolitical impact of a nuclear non-proliferation treaty with Iran would release Iranian oil supply from the constraints of sanctions. Iran can export 1,500,000 additional barrels per day. The Iranian post-treaty supply to an over-supplied global market would lower the price of West Texas Intermediate indirectly to a range of $38 to $46 which eliminates the recent rally of this year.

It is not clear if OPEC can manage the Iranian supply which creates new conflicts for the cartel. It also creates cash flow pressures upon Southwest and Dakota unconventional producers and a new round of efficiency and cost measures.

Saudi cont’d on p. 4
FROM THE WELLHEAD

As you can see preparation for the 86th Annual Meeting and Convention is well underway. The plans indicate an exciting line up and a few interesting changes to Hospitality night. Convention packets will soon be in the mail allowing you the opportunity to sign up early as exhibitors or sponsors. The same information will soon be available on our website www.pproa.org where you can also sign up and pay online.

In this issue you will see a very impressive panel for the Wednesday Forum ready to speak on the most recent legislative and industry topics so have your questions ready.

Prepare for our Clay Shoot and our Golf Tournament. Again, not only does it give us a great chance to network with decision makers and industry supporters but it provides fun, food, prizes and a lot of “tall tales”. I can be bribed to not share what I already know!

************

Our industry seems to be a constant target for environmentalist. We no sooner won the legislative victory for “frac bans” than Ryan Sitton with the Texas Railroad Commission was charged with combating the seismicity issues dealing with injection wells and earthquakes. On Friday, June 5, 2015, Commissioner Ryan Sitton and RRC technical staff met with authors of a study entitled, “Causal factors for seismicity near Azle, Texas.”

Also in attendance was Dr. Dan Hill, Chair of the Petroleum Engineering Department at Texas A&M University, and scientists from EnerVest Corporation. All in attendance agreed that the researchers’ work was important and a good first step in beginning to understand very complex models, assumptions and preliminary conclusions regarding seismicity in Azle and across Texas.

The researchers stated that hydraulic fracturing was not a cause of these earthquakes, and that this is a common misconception in the public and media that should be resolved. The researchers made it clear that the vast majority of disposal wells do not have associated seismicity. The researchers stated that disposal wells in close proximity to critically stressed faults could change pore pressure and reduce effective stress, resulting in seismicity if faults are oriented in a particular way.

No doubt this will be another “long” battle and our industry will be leading the way to resolutions.

If you are ever in doubt about how important your memberships are, the prairie chicken, frac bans, water and now seismicity give you a pretty clear picture of the on-going conflicts we face.

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**EVP NOTES**

**PPROA - A Big Bang for Your Buck!**

I have known about PPROA since I was in high school (don’t ask!). I have been a corporate member of PPROA for the last 10 years and consistently attended the annual meeting. I often wondered what does PPROA really do for its members?

**So! What does PPROA do for its members? What would I want from someone who was hired to ensure the “best possible solution” was reached with our governing agencies? Are they from my area? Do they understand our industry? When needed, will they be strong enough to stand their ground against the odds and not be afraid to speak their mind?**

I would want someone whom I could have a relationship and felt like I could trust. Having started in a legislative year, I was quickly educated about the importance of having a local representative to guard your interest whether you are a producer, operator, royalty owner, and service or support company. I can assure you I not only witnessed but participated in the drafting, reviewing and revising of bills that were introduced to our legislators. I will personally vouch that association representation is truly “in the trenches” focusing on the cause and effect of legislation, regulation, public and industry affairs in order to be responsive to demands made on our industry by state and local governments. Nothing could have made that more clear than the passing of HB 40 or the “frac ban” bill which made Texas law clear and fair to both parties when it came to the right to extract minerals with reasonable setbacks.

**What happens if we didn’t have local representation?**

Almost without being said, you are turning over and putting at greater risk any outcome that is personal to your immediate area. No legislator, lobbyist or representative that is over 100 miles of your “home” can truly portray the emotion or the instinctive protection of boundaries like a local representative. It is important to have people who know your people and stand ready to answer to you. It’s a “buy local” philosophy.

**The Texas Legislature meets every two years. What do you do in an off year?**

I wish I could say there is “an off year” but there really isn’t. The “off year” is the current meeting of the legislative branch of the United States federal government, composed of the United States Senate and the United States House of Representatives and is scheduled to meet in Washington, D.C. from January 3, 2015 to January 3, 2017 and while PPROA is not as active in the US Congress there are times where it may be necessary to attend; however, it is always necessary to stay informed for the sake of our members and industry.

**In closing, what value does membership hold and how can it be better?**

PPROA membership or yearly dues is a very small price for each member to have their own personal lobbyist, defender and voice with peer members, associations, the regulatory agencies and the legislators. Being the keeper of those whose vested interest is the survival of one of the most lucrative natural resources available in the world is not a simple job. The dissemination of information is critical. The opportunity to “kick into action” at a moment’s notice and with that ability to call on “membership experts” is critical. PPROA, our industry and our members benefit can only be better by involvement. We need your input both positive and negative. Attend the quarterly meetings. Volunteer to serve on the Board of Directors. Come to the Annual Meeting and Convention. At the very least call or email your Executive. For $14.58 a month I’d say it’s a Bang for Your Buck!!!

_Judy Stark_
The other principal geopolitical threat to the price of oil is Russia and Ukraine. While the conflict is seen in Europe from the perspective of natural gas supply and dependence, the potential disruption to oil supply or Russian exports is serious. Russian production is now well over 10 million barrels per day with exports at 75%.

Should the Minsk standoff agreement fail and military confrontation expand, the market perception would factor in a war over resources with accidental events escalating into a NATO response via Eastern European members. Naval interceptions of Russian crude oil would drive the financial services to speculative buying of oil. The West Texas Price of oil would reach $100 per barrel before U.S. Government margin (deposits in the future markets) restrictions and attempts at market containment.

The South China Sea is a new threat since it is the sea-route of Middle East oil to Asia. China is building an island-base to defend its supply of oil imports. Vietnam in particular claims the same territory and has the capability to challenge China. Gun-boat diplomacy or worse will be buy signals to oil traders from now on.

Geopolitical events such as these are short-lived. Physical supply and demand remains the long-term reality of the oil exploration and production company.

The price war or market share OPEC alignment is against is the unconventional producers in the San Juan and Permian Basin. They must have a rapid response capability in their corporate structure to capture momentary price surges based on geopolitics through hedging. This is selling forward through derivatives and exchanges the in a geopolitically induced upward price move. And this depends on timing in the hedging or financial departments which has nothing to do with management at the well-head.

Dr. Daniel Fine is an Associate Director of the New Mexico Center for Energy Policy and is a Senior Policy Analyst in the New Mexico State Department of Energy Minerals and Natural Resources.
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The following bills related to oil and gas have been vetoed by Governor Abbott.

HB 1633  
Author: Romero, Jr.  
Sponsor: Uresti  
Last Action: 06/20/2015 E Vetoed by the Governor  
Caption: Relating to application and notification requirements for a permit to drill an oil or gas well in or near an easement held by the Texas Department of Transportation.

HB 2466  
Author: Collier | Guillen  
Sponsor: Eltife  
Last Action: 06/20/2015 E Vetoed by the Governor  
Caption: Relating to the creation of a safety reimbursement program for employers participating in the workers' compensation system.

HB 2647  
Author: Ashby | Larson | Paddie | Clardy | Lucio III  
Sponsor: Estes  
Last Action: 06/20/2015 E Vetoed by the Governor  
Caption: Relating to a limitation on the authority to curtail groundwater production from wells used for power generation or mining.

HB 2826  
Author: Murphy | Parker | Keffer  
Sponsor: Huffman  
Last Action: 06/20/2015 E Vetoed by the Governor  
Caption: Relating to the eligibility of certain property located in multiple school districts for a limitation on appraised value for school district maintenance and operations ad valorem tax purposes under the Texas Economic Development Act.

HB 3291  
Author: Raymond  
Sponsor: Zaffirini  
Last Action: 06/18/2015 E Vetoed by the Governor  
Caption: Relating to transactions involving oil, gas, or condensate; creating a criminal offense. Relating to conflicts of interest by members of state agency governing boards and governing officers and the contents and amendment of financial statements filed by certain persons; creating a criminal offense.

HB 4025  
Author: Keffer | Guillen  
Sponsor: Uresti  
Last Action: 06/20/2015 E Vetoed by the Governor  
Caption: Relating to funding to counties for transportation infrastructure projects located in areas of the state affected by increased oil and gas production, including money from county energy transportation reinvestment zones.

See Governor Abbott’s veto statements on these and other vetoed bills at this link: http://gov.texas.gov/news/bills/veto.

A full list of vetoed bills is available at pproa.org.
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Four Price

State Representative Four Price is honored to serve the people of Texas' House District 87, which consists of Carson, Hutchinson, Moore, Potter, and Sherman counties.

As a fourth generation Texan, born and raised in the Panhandle, Representative Price brings to the Texas Capitol a strong sense of conservative values and a deep love of the Lone Star State. As a young man, he learned the importance of one's word and the value of a dollar by working on area farms and ranches.

Price serves as a member of the House Committee on Appropriations, the Article II Subcommittee, the House Committee on Human Services and the House Committee on Calendars. In addition to his service on a number of House Committees, Representative Price also serves as Vice Chair of the Sunset Advisory Commission and is an active member of several caucuses in the Texas House of Representatives: Community College Caucus, Republican Caucus, Rural Caucus, Sportsman's Caucus, Tourism Caucus, and Veterans Caucus.

Ken King

Ken is currently serving his second term as State Representative for House District 88. His district includes 17 counties in the Panhandle and the South Plains of Texas. He currently serves on the House Public Education Committee, the House Environmental Regulation committee, the House Administration committee, the House Calendars committee, the Energy Council and is the only representative from Texas appointed to Legislative Energy Horizon Institute. He also has been appointed to the House Research Organization Board of Directors as well as the Republican Caucus Policy Committee. In addition to these committees, Ken is also a member of various caucuses in the House.

Ken has been active in organizations related to his energy service businesses including: American Petroleum Institute, Association of Energy Services Company, Independent Producers Association of America and PPROA. Ken is a lifetime member of the National Rifle Association, a member of the Texas State Rifle Association, a member of Texas and Southwestern Cattle Raisers Association as well as a member of the Texas Farm Bureau.

Ken was born and raised in Canadian, Texas. He is President of Black Gold Pump and Supply Inc, in Canadian.

Kel Seliger

Kel Seliger was first elected to the Texas Senate in 2004. Senate District 31 currently spans 37 counties from the Panhandle to the Permian Basin and includes Amarillo, Midland, Odessa and Big Spring.

Born in Amarillo and raised in Borger, Senator Seliger is a graduate of Borger public schools and Dartmouth College. He spent 35 years in the steel industry.

Lieutenant Governor Dan Patrick appointed Senator Seliger to serve as Chairman of the Senate Higher Education Committee for the 84th Legislature. Senator Seliger also serves on the Senate Education Committee, Senate Finance Committee, Senate Committee on Natural Resources and Economic Development, and the Senate Committee on Business and Commerce.

Prior to his election to the Senate, Senator Seliger served four terms as Mayor of Amarillo and as a member of the Amarillo City Commission and the Amarillo Civil Service Commission. Senator Seliger is currently a member of the National Rifle Association, the Texas Farm Bureau, and the Harley-Davidson Owners Group.
Gloria Leal

Gloria is an Attorney at Law and a Consultant in Austin, Texas currently. In addition, she has been an International Regulatory & Special Counsel to the Commissioner, Texas Department of Insurance, Austin, Texas; General Counsel, State Board of Insurance; In-house Counsel, Southern Union (Gas) Company, Austin, Texas; Senior Trial Attorney, Transportation Division/Torts Section, Attorney General's Office; and Assistant Attorney General, Energy Division Attorney General's Office, Austin, Texas.

Gloria received her Juris Doctorate from the University of Texas School of Law and a B.A. with Honors from The University of Texas at Austin. She attended Catholic University in Lima, Peru, South America for the U.T. Foreign Exchange Program.

Gloria has been active in several professional associations, including the American Bar Association, State Bar of Texas, and the Hispanic Bar Association. She has a wide array of speaking engagements to her credit.

Ryan Sitton

Ryan was elected to the Railroad Commission in 2014, is a native Texan and a 1998 graduate of Texas A&M University, where he obtained a degree in Mechanical Engineering.

In 2006, Ryan and Jennifer founded PinnacleAIS, an engineering and technology company focused on reliability and integrity programs for the oil, gas, and petrochemical industries.

With over fifteen years of experience in the oil, gas, and petrochemical industry, Ryan is an active member of several industry groups, including the Texas Alliance of Energy Producers (TAEP), American Society of Mechanical Engineers (ASME) and the American Petroleum Institute (API).

Ryan is considered a leading expert in his field, consulting to a wide range of oil and gas companies, ranging from independent producers to some of the world’s largest integrated operators, serving as an expert witness in both regulatory and civil court cases.

Luke Legate

Luke Legate helps organizations and individuals communicate about their issues effectively, conduct community education and build relationships for federal, state and local issues. He regularly travels to Washington, DC to discuss issues that matter in Texas with members of Congress, as well as in Austin, before leadership offices of the state, Senate, State House, state agencies and regulatory bodies.

Luke advocates for the Texas energy sector as part of the Statewide Joint Association Education Initiative, whose participants include the Texas Oil & Gas Association, Texas Pipeline Association, Texas Alliance of Energy Producers, South Texas Energy and Economic Roundtable, Texas Independent Producers and Royalty Owners, Texas Royalty Council, Permian Basin Petroleum Association, and PPROA.

Luke began his career on the political campaign circuit before joining G. Fox Consulting more than 12 years ago. He is a native of Klein, Texas and has a B.A. from the University of Texas. In addition to the Statewide Joint Association Oil and Gas Education Initiative, he is also active with the West Texas Energy Consortium, Permian Basin Coalition, Midland Odessa Transportation Alliance, TXDOT’s Energy Task Force Subcommittees on Safety and Public Awareness, Texas House of Representatives Energy Caucus and Texas State Operations Center.
Chesapeake Exploration, L.L.C. v. Hyder, 427 S.W.3d 472 (Tex. App.—San Antonio 2014, pet. filed), held that post-production costs are not deductible if the royalty clause contains the words “free and clear” or “cost free.” Chesapeake, as lessee, produced gas and sold it at the well to a Chesapeake affiliate, which took title. The affiliate gathered and transported the gas to a “delivery point,” where an unaffiliated third party took possession and transported downstream to a “point of sale,” where another unaffiliated third party purchased the gas and took title. Chesapeake accounted to the royalty owners on the sales price at the point of sale. The lease contained a royalty clause applicable to production from wells located on the lease and an overriding royalty clause applicable to certain nearby wells located off lease. The issue was whether the lessors must bear post-production costs under the two royalty clauses.

The royalty clause provided that Chesapeake would pay royalty as a percentage of the price “actually received by [Chesapeake] for such gas” and that the royalty would be “free and clear of all production and post-production costs and expenses . . . incurred between the wellhead and point of delivery or sale . . . to a third party.” In addition, the royalty clause specifically stated that “Heritage Resources, Inc. v. NationsBank . . . shall have no application to the terms and provisions of this Lease.” The royalty owners contended that this language indicated that their royalty interest was not subject to any post-production costs and expenses, regardless of where such costs were incurred. Chesapeake contended that post-production costs between the point of delivery and the point of sale (i.e., third party costs) should be deducted. Chesapeake pointed to the “or” language in the royalty clause, arguing that it was disjunctive and allowed Chesapeake to deduct post-production costs incurred after the point of delivery, but before the point of sale.

The court acknowledged the general rule that post-production costs are deductible from royalty, but the parties may modify the general rule by agreement. Heritage interpreted a no-deduct provision from the “value of the Lessor’s royalty” as surplusage as a matter of law because the “value of the Lessor’s royalty” was the market value of the gas at the well. In this case, the court held that the parties modified the general rule in their agreement by expressly excluding all post-production costs. The court then reasoned that it would be contrary to the plain reading of the royalty clause to interpret the lease language to exclude post-production costs from the wellhead to the point of delivery, but include post-production costs from the point of delivery to the point of sale. The court also noted that its conclusion was reinforced by the parties’ agreement that the holding in Heritage did not apply to the terms and provisions of the royalty owners’ lease, but apparently that was not determinative. This case did not involve market value, but turned on the price received. Thus, the tension in Heritage between market value at the well and “no deduction” from market value at the well, did not exist in this case.

The lease also provided that Chesapeake would pay a “perpetual, cost-free . . . overriding royalty” on production obtained from certain off-lease wells. The royalty owners contended that this “cost-free overriding royalty” meant that it was free of both production and post-production costs. Chesapeake contended that the language simply reinforces the nature of an overriding royalty which is that an overriding royalty is not subject to production costs but is subject to post-production costs. The court acknowledged the general rule that an overriding royalty does not bear production costs and that post-production costs are deductible, but that the parties may modify the general rule by agreement. The court held that “cost-free” would be given its plain meaning and it did not exclude post-production costs.

By express provisions, parties may agree to effectively exclude post-production costs, notwithstanding industry custom that royalties are subject to these costs. The case highlights specific language royalty owners might utilize when negotiating both royalty and overriding royalty clauses to avoid deduction of post-production costs in a proceeds lease. The opinion construes Heritage very narrowly, so that at least as to a proceeds lease, drafting language to avoid deduction of post-production costs should be easy.

Jeff McCarn may be contacted at (806) 345-6340 or jmccarn@bf-law.com
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# Active Drilling Locations By County - PPROA Service Area

Texas Panhandle/western OK, SW KS - 6/19/15 RigData, Inc.

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Data provided by RigData.com
Drilling Permits By County - Dist. 10
5/21/15 – 6/21/15 DrillingInfo.com

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RRC District 10 Production Data
May 2014 - April 2015

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source: http://webapps.rrc.state.tx.U.S./PDQ

COWGIRLS & COCKTAILS
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