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Surviving Low Oil Prices in the Covid-19 Economic Downturn

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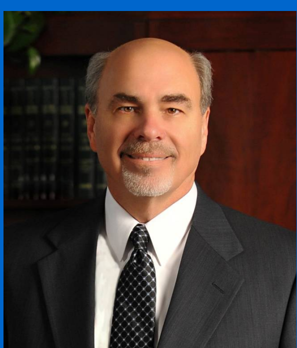

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Feud or Conspiracy
(Either Way, a Struggle to Survive)

The first quarter of 2020 brought two unique forces together sending oil and gas prices to historic lows. This ill-timed combination of reduced demand for oil (resulting from Covid-19 "shelter in place" orders) and increased oil production (brought about by the feud between Saudi Arabia and Russia), has caused oil prices for West Texas Intermediary or WTI (the primary oil pricing standard in the USA) to plummet below $20/Bbl. Recently the price of crude in the Permian Basin reportedly sold for less than $6 / Bbl.!! One Texas RR Commissioner believes this is the "greatest oversupply in the history of the oil and gas industry." This one-two punch of reduced demand and a worldwide glut in production has triggered the free market law of supply and demand - causing a drastic reduction in prices for this over supplied commodity.

Some say that the Saudi's and Russia are actually conspiring (not feuding) to dump oil on the market and temporarily reduce prices, with the intent to drive their main competition (US Oil Companies) out of business. Whatever the real reason, this drastic reduction in commodity prices has caused producers, and the oil patch service industry, to facedown a strategy of survival.

In general, oil and gas companies need commodity pricing between $40 - $50 Bbl. just to cover operating expenses and make a small profit. New drilling is barely economic at those levels. Each field has different economic pressures, but with oil prices in the $20/Bbl. range, many producers will not only struggle to meet operating expenses, but have to adapt to even stay alive (or out of bankruptcy). Faced with these economics, and no immediate end in sight, what can an oil company do to cut expenses, maximize profit and out of bankruptcy court. To combat this price decline, Texas, New Mexico and the USA are considering measures that would allow temporary cessation of production or storage of oil without the payment of royalty (if storage facilities can be found with open capacity).

Producers in the USA do not have a level playing field with the Russian and Saudi governments, who own virtually the entire net revenue stream in their countries' minerals or the state run operators (such as Saudi Aramco).

Not a Level Playing Field Worldwide

It is important to note that the Russian and Saudi Arabian governments do not have the same system of ownership and operation that we have in the USA. These governments lease to government controlled producers (such as Saudi Aramco) and the entire net revenue stream on production gets back to the government in some form. Even if a royalty is technically paid by the foreign operator (i.e., the government run company) a larger share of net revenue flows back to the government, who benefits as both the mineral owner and owner of the company that operates the field.

In the USA, the government does not own or control the oil company. The government grants a mineral lease to the operator and receives lease royalty. This lease burden on producers in the USA often takes up to 25% of the value away from the producer and is paid to the mineral owner as a lease royalty. Simply put, domestic producers do not have a level playing field to start with, and the dumping of oil on the world market is simply dangerous to our energy independence.

Based on this un-level playing field for royalty and control of net revenues, the first issue to be considered is whether the playing field can be temporarily leveled by deferring lease royalty until prices rise back to normal levels. If the operator continues to produce *but stores production for a later sale*, can royalty payments be deferred? In fact, some royalty reductions or deferrals have been granted on leases taken from the United States government, but to my knowledge relieve from the private landowner has not been addressed.

During times of low commodity pricing, an operator should consider various legal options that may help them survive these difficult times.

Legal Issues May Help Alleviate the Pain

Over the next two weeks, we will identify and discuss several related issues and attempt to outline some possible solutions or ways to ameliorate these economic problems. Even if relief does not come from the government, each operator should consider what options are available to them to reduce the impact of this market glut. The issues include, but are not limited to, (i) storage of production and deferral of

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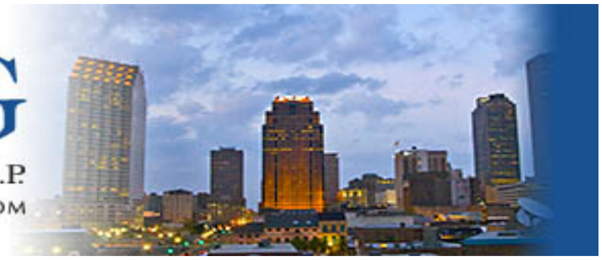

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royalty payments, (ii) possible shut-in payments if production is suspended, (iii) governmental orders reducing production allowables, (iv) the impact of temporary curtailments of production on paying quantities, (v) continuous drilling or production clauses, (vi) the lessee's marketing obligations, (vii) force majeure issues, (viii) US Tariffs to combat illegal dumping of oil on the market to gain worldwide control and (xi) other issues that may arise in this tumultuous period.

In the next issue, we will examine whether royalty payments can be deferred by oil and gas produced but stored for later sale when commodity prices rise back to economic levels.

Next Issue:

Can Production be Stored without Triggering Royalty Payments?

Please feel free to contact me if you have any questions or need additional advise on staying alive in these difficult times for the industry. I am working at home where possible under the Shelter-in-Place Orders. The best way to reach me is on my cell phone (337-280-6873).

Stay safe, Stay Inside (*where feasible*) and Stay Alive:

https://www.youtube.com/watch?v=nmUXntGlqFI

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