E&P NEWS

More Consolidation Among Canada E&Ps as One Deal Signed, Another Proposed

Strength in numbers emerged Monday as a survival strategy for depressed fossil fuel prices and the Covid-19 pandemic among independent Canadian oil and gas firms as announcements of a merger and a proposal for a second pairing were made.

Whitecap Resources Inc. and NAL Resources Ltd. made a corporate marriage deal valued at C$155 million ($116 million), while Obsidian Energy Ltd. posted an offer to discuss terms for a combination with Bonterra Energy Corp.

“Whitecap’s increased scale and financial strength is expected to enhance its credit profile and ...cont' pg. 3

MIDCONTINENT

Oklahoma Keeps Natural Gas Proration Formula at 50%

The Oklahoma Corporation Commission (OCC) has voted to leave a proration formula in place that limits natural gas production from some of the state’s most prolific wells.

In a 2-1 vote, with Chairman Todd Hiett and Commissioner Dana Murphy in support of the current formula, operators are required to limit an unallocated gas well’s absolute open flow to 50%, or cap the maximum allowable production at 2 MMcf/d, whichever is more. Oklahoma is home to an estimated 40,000-50,000 unallocated gas wells, which produce outside of specific fields, such as the Anadarko Basin. Regulators separately allocate output from these wells based on market demand. ...cont' pg. 4

PIPELINES

Phillips 66 Seeking to Expand Gray Oak Southbound Crude Service from Permian

Phillips 66 Partners is launching an open season Tuesday to gauge interest in additional crude oil transportation capacity from the Permian Basin to South Texas.

The new takeaway capacity along the Gray Oak Pipeline would terminate in Victoria, 85 miles northeast of Corpus Christi. In-service is targeted in the first half of 2022.

The 850-mile Gray Oak began limited operations in November 2019, from West Texas to Central Junction near Three Rivers, about 75 miles southeast of San Antonio. It has since expanded service to include more grades of crude and extends south and east to the coast. ...cont' pg. 6
Permian Highway Cleared to Continue Building 2 Bcf/d Texas Pipeline

The Sierra Club’s allegations “come close” to demonstrating “harm to the environment,” but a district court in Texas still shot down a request to halt construction of the Permian Highway Pipeline (PHP), a conduit designed to move about 2 Bcf/d to the Texas Coast.

Sponsor Kinder Morgan Inc. earlier in August reaffirmed the 42-inch diameter, 430-mile pipeline would be completed in 2021. The system in July was about 80% mechanically complete, with mainline compression 97% complete.

However, the pipeline has been plagued with litigation since it was launched. Opponents gained momentum in March when a horizontal directional drilling (HDD) incident during construction caused a 36,000 gallon drilling fluid spill east of the town Blanco in the Texas Hill Country.

In April, the Sierra Club argued in a lawsuit that the U.S. Army Corps of Engineers had failed to comply with the National Environmental Policy Act, arguing that a more indepth environmental review was needed. The analysis, it argued, should integrate the biological opinion and incidental take statement issued by the U.S. Fish & Wildlife Service into the Army Corps’ Nationwide Permit 12 (NWP 12) authorization.

The Sierra Club in June then requested a preliminary injunction to halt construction across 129 waterways (Sierra Club v. U.S. Army Corps of Engineers et al, No. 229:20-CV-460). Kinder was an intervenor for the defense.

The Army Corps may issue permits allowing for utility line construction in U.S. waters provided the activities do not result in the loss of more than one-half acre for each “single and complete project.” PHP’s route traverses 449 water crossings, but for 330, it did not have to notify the Army Corps because construction did not trigger any of general conditions, the court noted.

In denying the injunction, Judge Robert Pitman wrote that the allegations about noncompliance “come close.” The Sierra Club “has marshaled a great deal of evidence that demonstrates harm to the environment,” but the allegations do not show “irreparable harm at this juncture.”

Still he said the Sierra Club may provide supplemental declarations regarding water quality concerns related to HDD.

ClearView Energy Partners LLC analysts in a note Monday said “irreparable harm may have occurred, but due to timing, granting an injunction at this point does not undo it; therefore a injunction does not actually provide legal relief…”

The judge explained that granting the injunction would not “unring the bell” of the harm that did occur and to the extent future irreparable harm is alleged as a risk, Sierra Club failed to demonstrate a definitive threat.”

![Permian Highway Pipeline Map](map.png)
reduce its cost of capital,” said the announcement of the arrangement with NAL.

“Both equity and debt capital markets have been sending a clear signal for over two years that they are no longer supportive of small to mid-cap sized upstream energy producers,” said Obsidian’s proposal to Bonterra.

No cash would change hands in either exploration and production (E&P) merger.

Whitecap plans to trade 58.4 million of common shares for all the stock of NAL, which is held as a private investment by Manulife Financial Corp. Combined output in 2021 is forecast to to be 81,000-83,000 boe/d.

Obsidian disclosed an initial offer to pay two common shares for each share of Bonterra. Obsidian predicted the combination would have oil and gas production equivalent of 35,000 boe/d.

Bonterra gave no immediate reply to the public over...
“Engaging with Obsidian Energy is a far better outcome for Bonterra shareholders,” said the public proposal. “Adding more debt to an already over-levered balance sheet is a vastly inferior outcome.”

The E&P marriage of Whitecap-NAL and Obsidian’s courtship of Bonterra echo an announcement earlier in August of a C$111 million ($83.3 million) friendly takeover of Montney shale gas producer Painted Pony Energy Ltd. by Canadian Natural Resources Ltd.

In combination with soft investment markets for E&P shares, severe energy price lows inflicted by the pandemic “deprived Painted Pony’s asset base of the capital necessary to fund meaningful development.”

Oklahoma Keeps Natural Gas Proration Formula at 50%

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Hiett said the decision had been difficult as reducing output could impact the state’s revenue. However, “I feel confident that this order today is the right decision, going forward. We can all learn together as this moves forward.”

Vice Chairman Bob Anthony was in dissent. “With federal unbundling, there is no longer much in the way of limited merchant...cont' pg. 5

Source: Tallgrass Energy LP, NGI calculations. For more info and daily 10am ET updates of this chart, go to natgasintel.com/rextracker.
pipeline market demand to allocate through production allowables,” he said. “If Oklahoma curtails production, other states can fill in the gap on the national level.”

Most of the state’s producers had argued for maintaining the status quo, including Oklahoma City-based Devon Energy Corp. “We believe market forces are already in play to more effectively balance the Oklahoma natural gas market,” wrote Executive Vice President David G. Harris, who oversees exploration and production. “While Devon believes no action on proration is necessary on a go-forward basis, the responsible action today is to make no changes for at least six months to better observe the effects of market forces.”

Continental Resources Inc., also headquartered in Oklahoma City, was in favor of changing the formula. “As the largest operator in Oklahoma, we will be disproportionately impacted by this policy change,” executives told the commission. “However, we feel this change is necessary to maintain proper market balance of the state’s natural gas production.”

At a public technical conference in July, some natural gas producers operating in Oklahoma advocated for setting the allowable rate at up to 100% of the CAOF, or 10 MMcf/d. Others favored a return to 65% of the CAOF, or 2 MMcf/d. Some proponents of the 50% proration formula argued that the global gas oversupply existed before the Covid-19 pandemic, and while rig counts are down and activity has slowed, the state’s gas market remains oversupplied. Advocates of raising the proration rate, with whom Anthony concurred, argued that lower rates and regulatory uncertainty would...cont’ pg. 6
create disincentives to drill new wells. They also said it would give companies incentives to divert their resources to states with fewer restrictive rates, making Oklahoma less competitive in the national market.

According to the U.S. Energy Information Administration (EIA), Oklahoma had the fourth-largest gross withdrawals of natural gas among the Lower 48 in 2019. Additionally, the state accounted for roughly 9% of the nation’s marketed production. The EIA also showed the predicted total consumption of natural gas could average 82.4 Bcf/d in 2020, down 3% from 2019.

“With today’s threat from Hurricane Laura to U.S. offshore natural gas production, Oklahoma should let markets work and allow wide open production for its gas wells,” Anthony said.

Although the EIA noted that the average spot price for the fuel at Henry Hub averaged $1.77/MMBtu in July, it predicted the average price would increase to $2.11 in September, and to $3.14 in February because of increased demand and reduced production.

**Phillips 66 Seeking to Expand Gray Oak Southbound Crude Service from Permian**

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Work to connect Eagle Ford production to Gray Oak was completed this summer, expanding the system to deliver up to 900,000 b/d to destinations including Buckeye Partners LP’s South Texas Gateway Terminal, which went online July in Ingleside, and the Phillips 66 Sweeny Refinery.

Last year, Phillips 66 said that it would add delivery points on Kinder Morgan Crude & Condensates LLC’s system at or near the Houston Ship Channel. The Cactus II and Epic crude oil pipelines also started operations last year. For more information on the Gray Oak expansion, contact GrayOak@P66.com.