

The Oil Price War and COVID-19: What Results for Natural Gas Producers in Appalachia?¹

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I. Introduction

The world is now in crisis due to the COVID-19 pandemic and shutdown of large segments of the economy. In addition, a recent oil price war between Saudi Arabia and Russia triggered a collapse in oil prices. As a result, natural gas producers in Appalachia must think strategically about the impacts of the oil war and COVID-19 in a post-2020 world. Surprisingly, low oil prices may actually be good news for certain Appalachian producers.

II. Oil Price War

On April 9, OPEC reached an agreement providing for cuts of 10 million barrels per day.² However, prices are still expected to remain below \$40 a barrel for the foreseeable future, and some are therefore calling the OPEC production deal³ “a drop in the bucket.”⁴

With expected prices, U.S. oil producers “could see declines of 2 to 3 million B/D just from so called ‘organic declines’ that are the result of existing wells drawing down or being shut in voluntarily.”⁵ Producers such as Pioneer Natural Resources and Parsley Energy attempted to go a step further, requesting that the Railroad Commission of Texas (the “RRC”) shut-in at least 20% of the state’s production.⁶

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² Trent Jacobs, *OPEC+ Moves to End Price War With 10 Million B/D Cuts*, <https://pubs.spe.org/en/jpt/jpt-article-detail/?art=6871>, *Journal of Petroleum Technology* (April 10, 2020).

³ Clifford Krauss, *As Russia and Saudi Arabia Retreat, U.S. Oil Industry Avoids the Worst*, *The New York Times*, <https://www.nytimes.com/2020/04/11/business/energy-environment/russia-saudi-arabia-us-oilcoronavirus.html> (April 11, 2020).

⁴ Jacobs, *supra* note 2. (“the cuts address only a portion of even larger and unprecedented oversupply that on the high end is estimated to be moving swiftly toward 35 million B/D.”).

⁵ *Id.*

⁶ *Id.*

Though the RRC has not ordered a cut in oil production since 1973, the hope is that a mandated cut of production would be more orderly and fair than the “organic decline” noted above.⁷ For example, it may have been easier for producers to rely on force majeure protections if the RRC ordered the cut.⁸ However, on May 2, 2020, the RRC denied the request.

Any oil production cut will likewise impact the midstream sector by reducing transportation volumes.⁹ Financing deals dependent on defined volumes are also at risk.¹⁰ However, some attorneys say “midstream companies might also welcome less oil coming their way, given the coronavirus-fueled collapse in demand for gasoline and other refined products and global storage capacity quickly filling up.”¹¹

While the recent oil price war may have only lasted a month, it will take much longer for the price of oil to recover due to the decrease in demand. This price environment could present natural gas producers in Appalachia with a unique opportunity.

III. Natural Gas Production in Appalachia

Approximately 40% of natural gas production in the U.S. is tied directly to contemporaneous oil production.¹² This “associated gas” production will likewise decline if U.S. oil wells are shut-in for the reasons discussed above. One commentator summarizes the issue as follows:

That means the sharp drop in domestic crude output will result in a significant reduction in gas production, too. And many experts think this could result in a faster, sharper recovery in prices for U.S. gas compared to oil, where it could take a couple years to work off the vast inventories that are now building due to today’s unprecedented supply surplus.¹³

Producers in Appalachia that concentrate on dry natural gas from Shale wells are well positioned to make up for this shortfall in natural gas production.¹⁴ Moreover, any recovery in natural gas

⁷ Keith Goldberg, *What Attys Must Know About the Push for Texas Drilling Cuts*, <https://www.law360.com/articles/1259775/what-attys-must-know-about-the-push-for-texas-drilling-cuts>, Law360 (April 3, 2020).

⁸ *Id.* (“The viability of contracts and efforts to terminate them due to RRC action would be a ripe source of litigation, and attorneys say now is the time for industry players to examine the force majeure language in their contracts and start thinking about contract frustration and whether they’ll still be able to perform under their contracts.”).

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.*

¹² Dan Eberhart, *Higher Natural Gas Prices Could Lead Recovery of U.S. Energy Industry*, <https://www.forbes.com/sites/daneberhart/2020/04/08/higher-natural-gas-prices-could-lead-recovery-of-us-energy-industry/#b2781957902d>, Forbes (April 8, 2020).

¹³ *Id.*

¹⁴ *With Condensate Near \$0, Utica Drillers Shift Permits to Dry Gas*, <https://marcellusdrilling.com/2020/04/with-condensate-near-0-utica-drillers-shift-permits-to-dry-gas/>, Marcellus Drilling News (April 13, 2020) (“Utica drillers

prices would be welcomed news, especially after years of low gas prices. Some suggest that natural gas prices could double by this winter, estimating prices of between \$3.50 and \$4.50 per MMBtu.¹⁵

The demand for oil is also in drastic decline. One estimate provides that the U.S. demand for oil will drop by approximately 4 million barrels per day because of COVID-19.¹⁶ Whatever the actual number, COVID-19 related shutdowns to large segments of the economy will certainly result in an extreme drop in demand for oil, with the one bright spot, at least for dry natural gas producers in Appalachia, being the additional hit and reduction of “associated gas” production.

IV. Conclusion

Natural gas production is currently classified as an essential activity in Ohio, Pennsylvania, and West Virginia, allowing those operations to continue. However, many E&P employees are working from home or practicing restrictive social distancing. Assuming the energy industry can adapt to these challenges for an extended period, Appalachian dry natural gas producers may benefit from low oil prices and lack of demand caused by the price war and COVID-19.

who target ‘wet gas’ areas, or NGL-heavy areas, are choosing to close in those wet gas wells and not drill new wells because NGLs (including condensate) are circling the price toilet.”).

¹⁵ Eberhart, *supra* note 12.

¹⁶ Ramanan Krishnamoorti, *Lower for Longer: Covid-19’s Impact on Crude Oil and Refined Products*, <https://www.forbes.com/sites/uhenergy/2020/03/22/lower-for-longer-covid-19s-impact-on-crude-oil-and-refined-products/#13eda1962fe8>, Forbes (March 22, 2020).