COVENANT CONTRACTS, LTD.
13000 S. FM 1258
Amarillo, TX 79118
Tel. (806) 576-1325
Fax (806) 576-0475
Email: tom@makarpc.com

RECEIVED
DEC 27 2016
Chairman's Office
Railroad Commission of Texas

December 16, 2016

The Honorable Chairman Christi Craddick
Railroad Commission of Texas
P.O. Box 12967
Austin, Texas 78711-2967

The Honorable Commissioner David Porter
Railroad Commission of Texas
P.O. Box 12967
Austin, Texas 78711-2967

The Honorable Commissioner Ryan Sitton
Railroad Commission of Texas
P.O. Box 12967
Austin, Texas 78711-2967

Re: DCP Midstream, LLC Conduct

Dear Commissioners,

Beginning approximately eighteen months ago, DCP Midstream, LLC ("the company") began the process of systematically causing the renegotiation of existing gas purchase contracts that were coming up for renewal. The company began notifying affected oil and gas operators that their contracts were expiring, proposed new purchase terms, and indicated if the terms were not agreed to they would be implemented unilaterally by the company for all leases covered by the contracts. In many cases the company's employees under whose signatures the cover letters were mailed either did not take calls from the affected operators or simply refused to return the calls that were left on voicemail. As a result of this avoidance, the company was able to unilaterally implement the modified terms, which were highly beneficial to them. This has resulted in financial distress for many operators, some of which have resulted to shutting in or plugging some of their wells. While the company has unilaterally implemented the new, unfavorable terms for small operators, large operators have been able to sell gas under the old contract terms while they are in negotiations with the company.

Starting in September of this year, I have been engaged by several oil and gas producers in the Texas Panhandle who have received such notifications to assist in their negotiations with the company. I am not an attorney but have been involved in gas contract negotiations and audits for over twenty years. My first objective has been to assist my clients in the resolution of the Informal Complaints that they previously filed against the company with the Texas Railroad Commission and to assist other clients who were having difficulties getting their negotiations completed but had not yet utilized the Informal Complaint process. My operating company, Makar Production Company, also filed an Informal Complaint in June 2016 but withdrew its complaint after successfully concluding its contract negotiation for gas sold from one of its leases.

Unfortunately, I have found it necessary to file six additional Informal Complaints on behalf of my operator clients, including one for my operating company for another contract that expires on 12/31/2016. Since early May 2016, approximately twenty-one Informal Complaints have been filed against DCP Midstream, LLC and only one has been resolved as mentioned above. I participated in an Informal Complaint Hearing for two of my clients, H&L Exploration and CSODA Energy Operating Co LLC, on 11/7/2016, which lasted for 3 hours and I have spent over 10 hours in discussions with the company's representative. From the start of my efforts, I told the company's representative that the issues of concern would be the same for all of the operators I represent. Not one of those contracts has been resolved at this time and another RRC Informal Complaint hearing is scheduled with the company for Tuesday, 12/20/2016 which will cover three of my clients including a continuation of the H&L negotiation, Travelers Oil Company, and WBD Oil & Gas.

I am writing to inform each of you that I now believe that DCP Midstream, LLC is unwilling to negotiate in good faith or take the Informal Complaint hearing process seriously. Their response to the filing of the complaints includes in the 3rd paragraph of their letter to the Commission a justification of their actions, which states "DCP Midstream, LLC lost approximately $1.1 billion in 2015. The loss of $1.1 billion in 2015 is a direct reflection of the recent dramatic commodity price drop and the effect of that drop on the substantial number of 'percentage of proceeds' contracts in DCP's inventory." However, a review of the company's 2015 Audited Financial Statements (enclosed and available on its website) shows the company's $942 MM loss was actually largely a result of a $912 MM Asset Impairments charge (write down of asset value). The company's **profits** from the sale and purchase of natural gas and petroleum products, which include the components covered by these contracts, was $459 MM. When this point was raised in the Informal Complaint hearing the response was that the company was losing money in the Texas Panhandle but no substantiation was provided then or since.

I specifically asked on several occasions if the company signed contracts that resulted in a financial loss to the company. Each time their response has been "no." Recently I obtained a copy of a contract that was executed by the company involving gas sales from EOG Resources, Inc. and copies of the associated gas purchase statements for leases covered by the contract. The terms of this contract are superior to those offered to my clients. A comparison of the gas composition from these wells and those owned by my clients shows that on average my clients' gas is of better quality than those covered by the EOG contract. Additionally, many of my clients' wells are located in the general area of the EOG wells. Since the company has acknowledged they are making a profit on the gas from the EOG wells and the quality of the gas from my clients' wells is better, repeated requests for the company to agree to similar terms have all been refused. I believe this clearly demonstrates the discriminatory practices DCP is employing in the Texas Panhandle.

In addition, discussions with the company's representative have resulted in the company's refusal to work to an agreement on nearly every issue and management has not given her authority to negotiate the contract terms but rather to only express the company's inflexible position on each of the important contested issues. Historically, parties that negotiate in good faith work to close the gap that exists between them and to find a mutually beneficial solution. This has not been the case with negotiations involving DCP Midstream. They are effectively picking winners and losers since companies receiving superior contract terms are able to be more aggressive in mineral acquisition, the drilling of new wells and the rework of existing wells.

At the conclusion of the 11/7/2016 Informal Complaint hearing, the company indicated they had a sincere interest in working to resolve the outstanding issues. Little to nothing has been resolved since that time and while the company has agreed to appear at the follow-up hearing on 12/20/2016, there is little indication they will utilize the opportunity to resolve even one of the Informal Complaints. For this process to be effective, the gas purchaser must be sincere in attempting to work toward a mutually beneficial solution. Unfortunately, the company's conduct is consistent with that of a monopoly. They offer contract terms and the only choice available to the producer is take it or leave it.

By this letter, I am requesting that you actively engage senior corporate management of DCP Midstream, LLC requesting the company modify its approach in their negotiations with operators in the Texas Panhandle and that they exert a sincere effort to resolve the Informal Complaints that have been filed against the company. If DCP refuses to engage in good faith negotiations it is clear to me the Texas Legislature should seriously consider statutory changes to prevent and penalize discriminatory practices by companies with monopoly power, like DCP.

Please let me know if you have questions or need additional information.

Thank you,

Tom Mechler
Manager

Enclosure

cc: Landon Hawke, DCP Midstream, LLC
Phil Gamble
State Representative Four Price
State Representative Drew Darby
State Senator Craig Estes

DCP MIDSTREAM, LLC
CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	2015	2014	2013
		(millions)	
Operating revenues:			
Sales of natural gas and petroleum products	$ 6,030	$ 11,378	$ 9,807
Sales of natural gas and petroleum products to affiliates	765	2,030	1,732
Transportation, storage and processing	532	517	463
Trading and marketing gains, net	119	88	36
Total operating revenues	7,446	14,013	12,038
Operating costs and expenses:			
Purchases of natural gas and petroleum products	5,571	11,361	9,679
Purchases of natural gas and petroleum products from affiliates	418	467	288
Operating and maintenance	742	780	691
Depreciation and amortization	376	348	314
Asset impairments	912	18	—
General and administrative	278	281	280
(Gain) loss on sale of assets, net	(42)	7	(22)
Restructuring costs	11	—	—
Total operating costs and expenses	8,266	13,262	11,230
Operating (loss) income	(820)	751	808
Earnings from unconsolidated affiliates	182	83	35
Interest expense, net	(320)	(287)	(249)
(Loss) income before income taxes	(958)	547	594
Income tax benefit (expense)	102	(11)	(10)
Net (loss) income	(856)	536	584
Net income attributable to noncontrolling interests	(86)	(248)	(93)
Net (loss) income attributable to members' interests	$ (942)	$ 288	$ 491

See Notes to Consolidated Financial Statements.

2017 Legislative Session Oil & Gas
Fairness Bill Backup Summary

Basis of problem: Gas purchasers' monopolistic practices
Evidence of problem: Discrimatory pricing and theft of NGLs
End result of problem: Loss of income to producer and royalty owners, loss of state severance tax income & lower property taxes due to reduced well value

Discrimatory Pricing Example
Gas Purchaser: DCP Midstream

Helium Val	$2.20 per MCF
Helium Ttl Val	$3,103.87

	Gross Proceeds
Previous Contract	$2,806.69
Proposed New Contract	$1,604.56
EOG Comp Contract	$2,479.79
Difference from orig/prop	$875.23
DCP addl profit w/ Helium	225%

-DCP disclosed they don't lose money on contracts & their target profit after expenses is 8%
-A sample lease in TX Panhandle which generated $2806.69 in July 2016 was offered a replacement contract with fees which would result in revenue of only $1604.56
-DCP offered a large producer better terms for inferior quality gas which if offered to producer of sample lease would result in revenue of $2,479.79 ($875/mth more than small producer)
-DCP refuses to pay producer for Helium which is extracted and sold by them ($3100/mth)
-Texas severance natural gas severance taxes (7.5%) are based on wellhead gas sale price
-County and school district taxes (2% mil rate) are based on value of well which is determined from gas price

Lost yrly income due to discrimatory pricing to producer and roy owners	$48,000.00
Total severance tax lost due to discriminatory pricing (yearly)	$3,600.00
Total lost property tax revenue (yrly, based on 60 mth value)	$4,400.00
Total yearly tax loss to state & local	$8,000.00

Theft of natural gas liquids (NGLs)
-Percent of proceeds contracts provide producer gets paid a percentage of all products collected and sold
-Gas purchasers remove & sell NGLs prior to processing plant from gas stream, keeping 100% of proceeds
-Estimated loss from sample lease for December 2016 pricing is $1590.35

Lost yearly income due to NGL theft to producer & royalty owners	$19,000.00
Total severance tax lost due to NGL theft (yearly)	$1,400.00
Total lost property tax revenue (yrly, based on 60 mth value)	$1,900.00
Total yearly tax loss to state & local	$3,300.00