The Biden Ticket: What Does it Mean for US & International Oil & Gas?

21 October 2020

For the US oil & Gas sector, there is much to be concerned about from the looming presidential election, most notably from the uncertainty of the result, but also just what the Democrats intend to do.

Biden and Harris have repeatedly highlighted that they intend to ban fracking, only to have a change of heart post securing the Democrat nomination.

Coupled with the ban on drilling in Federal lands, the proposed changes to oil & gas taxation, tighter methane standards, the phasing out of natural gas in the energy mix within 15 years, it is difficult to imagine that a Democrat Presidency can have anything positive to offer for the US industry.

In that context, what is bad for the US, would result in a net benefit for the international segment.

Increasingly, the US would start to become a net importer of energy, and the oil price supercycle, which has been tipped to be relatively distant and short, would at once be accelerated and extended, potentially breaking $200/bbl.

Between now and November 3rd, there is much to watch for and interpret.

Is there a Difference Between the Republicans and Trump for Oil & Gas?

As the US enters the final stages of campaigning the presidential candidates (Republicans: Trump & Pence; Democrats: Biden & Harris) will strive to differentiate themselves from each other.

In all this, one area that hasn't received much attention recently is the oil & gas industry. But the question is, is there enough to be able to infer an outlook?

We think that there is.

Figure—White House

Source: iStock & OGA data

Trump has made it evident that his presidency will continue to ensure US energy independence and therefore do as much as possible to support domestic oil production.

While this has been undermined to some extent by September's moratorium on oil and gas exploration in Floridian, Georgian and North Carolinian waters, the remainder of his proposals have been broadly supportive.

We are certain that the lack of discussion about oil & gas has not been engineered, certainly not by the Republicans who in maintaining the status quo, have more to gain from their Democrat counterparts who have been more vocal about winding down the oil & gas segment in the US.

Historically, irrespective whether Democrat or Republican, the governmental focus has been to try to encourage changes to consumer patterns. However, there has been a shift in the tone and approach, with Democrats often articulating differing proposals and policies, with each stating that they represent the Democrat position.

Assuming the majority of the Democrat's public discourse has been "hustings talk" to woo voters on the left of the political spectrum, that they have no intention of fulfilling, there is still sufficient commonality in what has been said by both candidates to suggest that there will be a significant shift in the approach by a Democrat presidency.

From what has been said thus far, the Democrats will switch focus from the demand side stimulus, to supply-side control. In its recent "Town Hall," the Democrats outlined their $2,000bn clean-energy plan, which one of the key takeaways was the phaseout of natural gas from the energy mix within 15 years.

As we have seen with the Trump presidency, an incumbent president's plans and programmes can be hamstrung by an unwilling Senate.

In this context, what makes it particularly important this time around, is the added frisson that could arise should Biden and Harris be voted into the White House in conjunction with a Democrat-controlled Congress.

Fracking

The most direct, and hotly debated issue, has been fracking. Biden and Harris' stance before the Democrat nomination was secured decried fracking on numerous occasions. Biden himself has stated that he would look to implement restrictions and phase out the practice, stating:

> *"No more drilling on federal lands. No more drilling, including offshore. No ability for the oil industry to continue to drill, period. Ends! No new fracking."*

Following the Democrat nomination, however, Biden, and to a lesser extent Harris, have changed the narrative, changing tack on any discussions regarding fracking, with the oft used phrase:

> *"…Fracking has to continue because we need a* ***transition****…"*

Bold and italicising our emphasis.

Figure—Frack Spread

Source: iStock & OGA data

The question is, how long is the transition that the Democrats are considering? In this context, therefore, whether a Democrat president is returned with a Democrat controlled Senate is important, as a number of Democrats (such as Elizabeth Warren and Bernie Sanders), have been vocal opponents of fracking.

Given Biden's "flip-flopping" on the issue and his neutral and nondescript use of "transition," there is no confidence that Biden the President would oppose a ban on fracking if it were posed by the Senate.

So the critical question is whether this is deliberate so they can say that it was never a promise, or whether they are kicking it down the road to allow it to be initiated from Senate, and the would-be President to absolve himself of the responsibility.

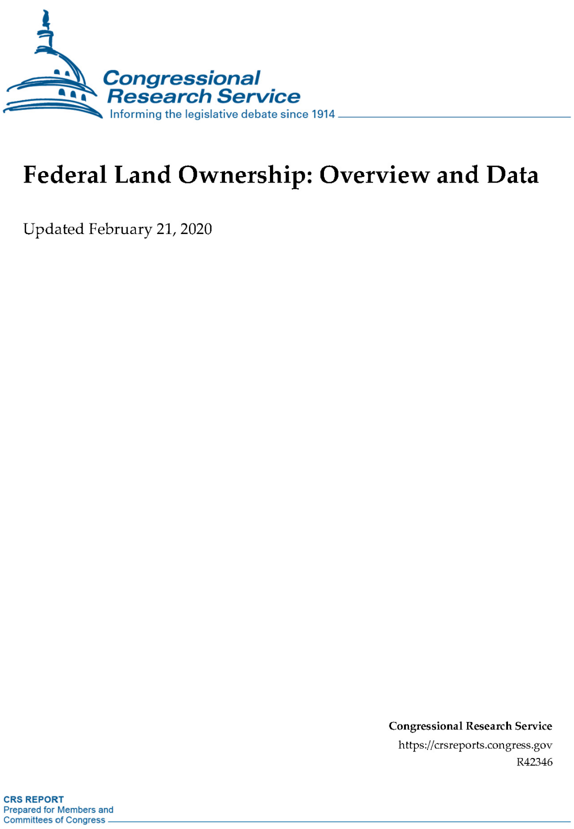
Drilling Ban

Also included in the Democrat plan is the ban of new exploration drilling on Federal lands. All offshore areas are Federal, but the onshore areas have a patchwork of

Federal lands. Consequently, such a ban will have different effects on different states, which have varying percentages of Federal lands.

In February 2020's report entitled "The Federal Land Ownership: Overview and Data," it highlights that Federal land accounts for less than 5% of the area of Louisiana, Texas, Oklahoma, Ohio and Pennsylvania, while other states have over 50% (Alaska, Nevada and Utah).

Figure—Federal Land Survey


Congressional Research Service
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Federal Land Ownership: Overview and Data

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Prepared for Members and Committees of Congress

Source: Congressional Research Service & OGA data

Assuming that oil & gas prospectivity is equally distributed within the states, this disparity would impact the different states differently. In all states, in the near term at least, there is to be a switch in focus from Federal to private lands.

For states like Texas and Louisiana, there will be relatively little impact. In states where there is between 25 – 50%, however, the impact will be less easy to predict. However, prospectivity isn't equally distributed over the federal and private lands. By comparison, Federal lands are underexplored.

This fact hasn't been lost on New Mexico Republican Senate candidate Alexis Johnson. She pointed out in a recent article that in New Mexico, with ~32% of its land area in Federal ownership, its growing shale oil & gas sector is primarily located on Federal lands. She contends that the Democrat's bill would not only see progress on Federal halted, but would, due to the limited size of oil & gas on private lands, see oil & gas activity fall to zero.

Methane Venting

In May 2019, the Democrats introduced legislation requiring oil and gas producers to capture >95% of the natural gas produced on public lands. This legislation would effectively ban methane venting and flaring at new wells and is representative of the Democratic Party's position on regulation of methane emissions.

Although approval hasn't been forthcoming to date, it is reflective of intent. Biden and Harris' Energy Plan, which focuses on reducing GHG emissions, means that there is a strong possibility that any wells currently that vent or flare residual gas, would be at risk of being required to be shut in or an alternative for the gas found.

For fields where the gas volumes are small, it is likely to require a cessation of production. For larger volumes, there is the possibility that gensets could be installed and the electricity exported to the grid. How this would be set against the aim to eliminate gas from the energy mix over the next 15 years remains to be seen.

This, however, means that again, a Democrat Senate coupled with the Democrat president could reshape the US oil & gas segment.

Tax Breaks for Oil & Gas

How the Democrats view tax breaks for oil & gas is instructive. By calling them "subsidies," it is evident that Democrats view them as an unfair benefit. To that end, there is likely to be a significant change to the current regulation; the questions is, how quickly.

The Democrat's Energy Plan has indicated that if elected, that those oil & gas tax breaks will be eliminated within the first term.

33 of the 100 Senate seats being contested in November on the same day as the presidential election. A further 33 seats will be contested in 2022.

Consequently, if the Democrats win 2020's presidential and Senate elections, Biden the President will not want to risk failing to push through these changes before 2022's election, where the composition of Senate could change again.

Therefore, the proposals will need to be placed before Senate in plenty of time; we think it is likely to be within the first year of the Biden presidency.

Pipelines & LNG Exports

A Biden Presidency will also change the frame of reference for the Federal Energy Regulatory Commission's ("FERC's") policy on approving new gas pipeline and LNG projects, demanding that new projects demonstrate that they will not contribute to climate change.

Should this be implemented, it would significantly increase the cost and difficulty of developing new pipeline infrastructure and is likely to further constrain pipeline capacity in areas that already have limitations.

One silver lining, is that the Democrats have outlined specific scenarios where FERC could allow new infrastructure to be built, such as when the construction has a perceived net positive impact on the climate, such as if a modern gas Combined Heat and Power ("CHP") generating plant replaced a coal or oil facility.

Given that these opportunities are likely to be limited, it is a very thin silver lining and given the limited number of opportunities that this could be applied to, is most likely a fop for those on the right of the party.

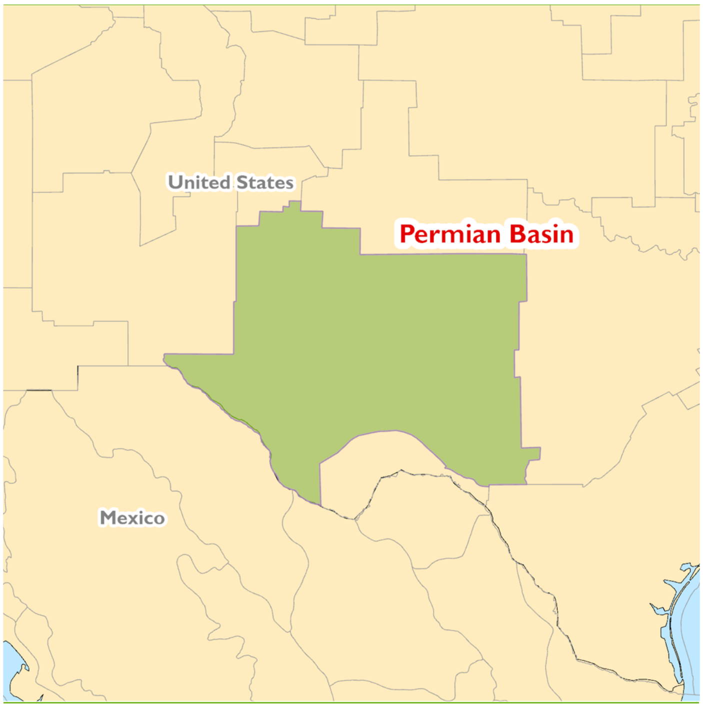
Industry Response

Up to this point, the industry's response has been mixed and muted. More specifically, the response from large companies has been muted, while smaller independents have been highly vocal. We believe that the smaller independents are most likely a better reflection of the feeling within the industry.

To understand why, is to understand that larger companies have deeper pockets to navigate any changes, are more likely to have a wider variety of play types and are far more likely to have international operations.

Smaller independents are less likely to have a variety of play types in their portfolio, so those exposed to an area that is at risk (Federal lands, fracking, etc.), will have a proportionately greater impact on their ability to operate. Coupled with this, is the fact that smaller companies are less likely to have sufficient funds to refocus away from the impact area, means that in many instances, it may feel like a battle for survival.

Figure—Permian Basin



Source: ESRI, USGS & OGA data

Providing a counterpose to this is ConocoPhillips' $9.7bn acquisition of Concho Resources, who operates solely in Texas' Permian basin (see following). There may be reasons for this, that they: (i) are confident in a Trump victory; or (ii) believe Biden is true to his word regarding fracking; or (iii) are confident that Senate will remain Republican.

It is a big call, and one that the shareholders will not tolerate if management have got it wrong.

Conclusions

Should a Democrat get elected to the White House, the first 100 days will be instructive. Long before any proposals are implemented, their impact will be felt as the industry adjusts.

Industry will not wait to see how painful things are before looking to reinvest elsewhere. Ultimately, what befalls a nascent oil & gas province like New Mexico, would, in time, befall the rest of the United States.

Oil & gas is one of the few industries that regularly operate cross-border and manages international, geopolitical and technical risk simultaneously on a regular basis. Consequently, it is difficult to see why the industry, being free and comfortable to invest globally, would continue to invest in the US.

In a scenario where a Democrat is returned to the White House and Senate, projects that could be delayed would be, and those projects that couldn't be cancelled would be scaled back as much as possible.

In this scenario, US oil & gas investment would start to look outside of the country for a home, and US supply would fall away. As it struggled to maintain production, US supply would struggle to meet domestic demand, meaning that it could no longer be a swing producer.

While the withdrawal of investment from the US would have a near-term, almost immediate impact on the outlook for US domestic production, however, there would be a hiatus between the time that the scaling back of investment in the US occurred and the impact of investment elsewhere was felt. We estimate it could be as much as five years.

S&P Global Platts has estimated calculate that Democrat proposals are likely to eliminate ~2m bpd of current production over the next three years. To what extent this includes an estimate of investment that is withdrawn as a direct response to the Democrat plans is unclear. Consequently, the S&P estimate could be deemed to be conservative.

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About Us

Oil & Gas Advisors (OGA) is an oil & gas advisory firm. Our experience crosses oil & gas operations and finance, as well as debt and equity capital markets. We provide corporate M&A, asset A&D, debt and equity capital markets access and strategic advisory in the oil & gas sectors.

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