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State Of The Oil And Gas Industry: Midyear Report

By **Keith Goldberg**

Law360 (July 2, 2021, 2:57 PM EDT) -- The first half of 2021 has encapsulated the shifting policy and financial winds buffeting the oil and gas industry as the energy sector continues its low-carbon transformation.

A new U.S. presidential administration has made tackling climate change a priority and has taken steps to curtail new oil and gas development. Meanwhile, regulators and investors are heaping more pressure on companies to reduce their greenhouse gas emissions and embrace cleaner energy technologies.

An oil price recovery has sparked a long-awaited industry consolidation, but the dealmaking reflects investor demands for developing existing oil and gas assets more efficiently rather than splashing cash to develop new ones.

Attorneys that work in the industry say the transition toward a decarbonized energy sector and economy is forcing oil and gas companies to think more about their long-term survival.

"They have to start thinking about how they continue attracting capital ... and what does being at the forefront of what the energy market looks like 10 years from now ... require," said Paul Hastings LLP partner Kfir Abutbul, who co-chairs the firm's recently formed global energy transition and infrastructure team. "We certainly see it as an inflection point, and our clients are telling us they want us to think about it."

Here's a look where the oil and gas industry stands on several fronts, in what's already been an eventful year.

Policy & Regulation

After the pro-fossil fuel administration of former President Donald Trump, the oil and gas industry was braced for increased scrutiny under President Joe Biden, who made climate change a priority on the campaign trail and has set a goal of a net-zero carbon economy by 2050.

"I've never been so tied into a change in administration," Holland & Hart LLP oil and gas partner Angela Franklin said.

Biden canceled the cross-border permit for the Keystone XL pipeline, which led to the controversial project's demise. He also issued a moratorium on new federal oil and gas leasing amid a broader review of the federal leasing program, although the pause was recently blocked by a federal court.

Congress also recently voted to undo a Trump-era rollback of methane regulations for the oil and gas sector, setting the stage for the U.S. Environmental Protection Agency to craft even tighter standards.

Elsewhere on the regulatory front, the Federal Energy Regulatory Commission has stepped up its scrutiny of climate change impacts of gas infrastructure projects, while individual states propose stricter drilling regulations or decarbonization goals.

Biden, however, has also walked a bit of a regulatory tightrope. Attorneys noted that his administration has supported a large ConocoPhillips Co. drilling project in Alaska and Enbridge Inc.'s controversial Line 3 pipeline replacement project, while still issuing drilling permits for existing federal leases.

"On the one hand, he came out guns blazing to take all these steps to show he's focused on climate change and promote investment in renewable resources and projects," said Kirstin Gibbs, who co-leads Morgan Lewis & Bockius LLP's energy practice group. "But as time has gone by, he's also shown a more balanced approach by supporting some oil and gas projects."

Still, the overall policy path being charted is creating industry uncertainty, attorneys say.

"The first six months have been interesting, but in some ways predictable," Gibbs said. "What will be more interesting to me is how the second half [of the year] unfolds."

Capital Markets & Investors

While rebounding oil prices have thawed things a bit, oil and gas companies still face a chilly reception from investors still smarting from losing billions of dollars during the price plunge exacerbated by the COVID-19 pandemic.

In a quarterly oil and gas industry survey recently conducted by the Federal Reserve Bank of Dallas, one anonymous drilling company executive said of the approximately 400 relationships the company has with institutional investors, "approximately one is willing to give new capital to oil and gas investment."

"It'll take some time for the private institutional money to come back into the space," Kirkland & Ellis LLP partner Anthony Speier said. "A lot of those dollars are now focused on energy transition or infrastructure."

Meanwhile, existing investors are ratcheting up the pressure on oil and gas companies to embrace climate or sustainability initiatives, and even the industry's biggest players are feeling the heat. On May 26, ExxonMobil Corp. shareholders voted in a slate of company board candidates from a hedge fund that would push the company to take more action on climate change. That same day, Chevron Corp. shareholders approved a proposal — over the recommendations of the company board — requiring the oil giant to reduce indirect emissions from the use of its products.

"Large asset managers, institutional investors are really putting an emphasis on a movement toward a reduction in fossil fuels over a period of time," McDermott Will & Emery LLP energy partner Parker Lee said. "What that's done in the public markets, it has certainly encouraged many of the large, integrated oil and gas companies to allocate more of their resources toward green energy projects and green energy development. We're starting to see a bit of a trickle-down effect onto the private markets."

Litigation

On the same day Exxon and Chevron shareholders threw their support behind more climate action, a Netherlands court dropped a ruling with industrywide reverberations when it ordered global oil giant Royal Dutch Shell to slash its GHG emissions by 45% compared with 2019 levels in the next 10 years.

"What those two developments have crystallized is that the energy transition to electrification, whether it's renewables or less fossil fuel-based feedstock, is happening, and it is happening in ways that are beyond naked economics," Lee said.

Oil and gas companies continue to fight legal efforts to hold them liable for the climate impacts of their products. The U.S. Supreme Court in May gave companies another chance at having climate torts brought by state and local governments heard in federal court, but a Massachusetts court last month rejected Exxon's bid to dismiss a climate fraud suit brought by that state's attorney general.

And while Shell has vowed to appeal the Dutch court ruling, Lee said it's worth noting that the company has also announced its intent to accelerate its decarbonization plans.

"This expressed goal of a heightened focus on reducing carbon emissions, in tandem with Shell appealing the Dutch court's decision, is reflective of the current power of the court of public opinion, including the opinions of public and institutional shareholders, over oil and gas industry participants," Lee said.

Mergers & Acquisitions

A year ago, the oil and gas dealmaking environment was stagnant as the COVID-19 pandemic sent oil prices to plumb historic depths and drove dozens of companies into bankruptcy. Now as oil prices climb above $70 a barrel, attorneys say the market is positively frothy, with several multibillion-dollar tie-ups just in the past couple of months between oil drillers, gas producers and pipeline companies.

"Everyone's talked about consolidation for so long, and I've expected to see it for so long, and it's certainly here," said Skadden Arps Slate Meagher & Flom LLP energy and infrastructure partner Cody Carper. "We've really shifted from the majority of oil and gas deals being distressed to now just seeing healthy energy M&A, both at the corporate level in seeing a ton of stock-for-stock deals, and at the asset level."

Attorneys say the flurry of stock-for-stock deals underscores the trend of not splashing additional cash or taking on additional debt to fund growth, with investors demanding better returns and lower debt. Other aspects of the deal trends include expansion of a company's existing footprint in particular drilling regions, as opposed to entering new regions, and a focus on drilling assets that are already producing oil and gas.

That's going to be a lasting shift, said Kirkland's Speier, who worked on the May merger of Colorado drillers Bonanza Creek Energy and Extraction Oil & Gas and the new company's subsequent June acquisition of fellow Colorado driller Crestone Peak Resources.

"People have realized that in this industry, the approach of taking on a lot of debt to buy a bunch of undeveloped assets just doesn't work anymore," Speier said. "Inventory is being valued again, but the value is heavily weighted toward proved developed producing reserves and flowing barrels, and there's a reluctance to pay cash premiums for inventory."

Project Development

Drilling activity slowed considerably during the pandemic-exacerbated oil price plunge but is starting to pick up again as oil prices rebound. But attorneys say regulatory changes and investor demands are coloring development decisions.

"I think that on a day-to-day basis, it's generally business as usual," Haynes and Boone LLP oil and gas counsel Sara Glover said. "I think from a long-term perspective, when it comes to the financing that's coming in and out of the industry, people are thinking about the regulatory environment they're going to find themselves in and whether it's a good investment."

Holland & Hart's Franklin, who mostly works in the western U.S., said the Biden administration's federal oil and gas leasing moves have caused many of her drilling clients to shift their focus to nonfederal lands.

"The decrease in federal interest is bleeding over into an interest in state, private and tribal lands," Franklin said.

In the midstream space, Morgan Lewis' Gibbs said she's seeing an increase in pipeline project planning. But she said developers are spending more time on figuring out how long projects will actually take and the best ways to approach the approval process at FERC, given the agency's increased scrutiny on the climate impacts of gas infrastructure projects.

"The planning horizon is longer and investors need to understand that, and they just have to be more strategic in the size and scope of the project," Gibbs said.

--Additional reporting by Michael Phillis and Clark Mindock. Editing by Orlando Lorenzo and Alyssa Miller.
