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Bailing Out Big Oil: Timeline & Analysis

Like many others, the oil and gas industry is now reeling from the dramatic economic impacts of COVID-19. But unlike most other industries, the oil and gas market's downturn is rooted in factors separate from the pandemic – the current oil glut and price drop has been years in the making. The Trump Administration has given special attention to the oil and gas industry and economic relief for it, but its proposals and actions to date fail to recognize the deeper causes of drillers' current distress.

Recent actions by the Federal Reserve to expand the qualifications for its Main Street Lending Program were at least in part designed to bail out oil and gas companies and their backers, though in a less obvious way.

The sector's balance sheets were keeling over, long before the coronavirus contagion swept the globe. For years, oil and gas companies had financed the U.S. shale revolution by drilling deep on debt. When the price of oil dropped in late 2014 and 2015, oil companies and their backers began to buckle. At the time, domestic exploration and development companies' debt topped $200 billion. In 2015 and 2016, more than 100 firms filed for bankruptcy. Banks who had supported the companies during the boom were hurting too, even those as big as JPMorgan Chase.

After easing a bit in 2017 and 2018, persistent low global prices brought on by rising production and stagnant demand began to bite again. By the summer of 2019, headlines noting hard times ahead were emerging. By the end of the year, oil and gas bankruptcies had surged by more than 50 percent compared to 2018.

Unfortunately for taxpayers, in the current downturn, federal officials are rushing out relief ideas, most of which would make the problem worse.

Oil and gas companies' boom and bust cycle is important context for gauging the White House's string of suggestions to save the day, as are the market fundamentals. The recent record low oil prices are a direct result of over-supply met with dropping demand. Any proposal that makes it cheaper to drill will only stimulate more supply and exacerbate the problem. For this reason, the American Petroleum Institute – the largest and most influential industry mouthpiece – has opposed most interventions. But that hasn't stopped it from pursuing some under-the-table direct financial infusions.

Below is a list of each administration proposal floated to date, and a brief assessment of its merits and potential costs to taxpayers.

Loans to Oil and Gas Companies

What was initially proposed around **April 23** was always murky, but press reports suggested the White House and Treasury Department officials were considering at least two different programs to offer loans to oil and gas companies. One of these would seemingly provide "bridge" loans to help larger companies with poor financials avoid filing for bankruptcy. In exchange for the riskier loans, officials floated the idea of requiring borrowers to reduce their oil production or give the government some ownership stake.

Expansion of the Fed's 'Main Street' lending program

The second option, which has since been adopted, was to modify current lending programs administered by the Federal Reserve to accommodate oil and gas companies' poor financials. **On April 30**, the Fed announced it was modifying the eligibility criteria for its "Main Street Lending Program," after lobbying from the White House and industry supporters in Congress. Many oil and gas companies failed to qualify under the program's initial criteria that a borrower's total debt, including the new loan, could not exceed four times its income. This was relaxed to allow companies to borrow up to six times their income. Loans are also now available for companies with up to 15,000 employees or $5 billion in revenue in 2019, up from being available only for those with up to 10,000 employees and $2.5 billion in revenue. Crucially, the terms of the "Main Street Priority Loan Facility" now allow companies to use the Fed-backed loans to refinance pre-existing debt. Lastly, the maximum loan size was increased from $150 million to $200 million per company.

Under the Federal Reserve Act, the Fed is prohibited from creating emergency lending programs designed to help specific industries or companies that are insolvent (12 U.S.C. 343(3)). While the Fed's announcement of the expansion of the Main Street Lending Program omitted mentioning the oil and gas industry or any other by name, press reports suggest the move was motivated by a desire to help drillers.

Lowering Federal Royalty Rates

In weeks leading up to a White House meeting with the President on **April 4**, industry executives and their congressional supporters were clamoring for blanket royalty relief on federal leases. Of all ideas before or since, reducing the amount companies have to pay taxpayers for pumping publicly-owned oil is the most costly and least sensible. The fact is that federal taxpayers already lose billions every year because federal onshore royalty rates lag those on state and private leases. Dropping royalty rates would not only cost billions of dollars more, it would also make the global supply glut worse. The last thing the industry needs is more production.

While President Trump eschewed the idea of blanket relief, which may not have been legally possible, Secretary of the Interior David Bernhardt has promised he'll give relief to those who apply to the normal channels. In guidance released by the Bureau of Land Management (BLM) in late April, the agency demonstrated how companies could ask for relief and specify the new rate they wanted, using 0.05 percent as an example. The standard onshore rate is 12.5 percent.

The BLM has also released guidance to operators on how to request a suspension of operations or production for onshore federal oil and gas leases. The standard primary term for BLM leases is 10 years, after which the lease is terminated unless the operator is producing oil and gas in paying quantities. Under a suspension of operations, the operator is allowed to maintain drilling rights on federal land past the primary term without actually producing oil or gas. The BLM's guidance indicates suspensions will be initially issued for up to 60 days, but can be extended repeatedly, seemingly without limit.

Market Supply Interventions

Buying Oil for the Strategic Petroleum Reserve (SPR)

One of the administration's first ideas (**March 13**) after the price of oil dropped in early March was to increase oil stocks in the SPR. Buying oil for the SPR when prices are low is generally the right approach, but at the time SPR inventory already made up roughly 60 percent of **ALL** U.S. crude oil stocks. Filling up the Reserve's remaining capacity – from 635 million barrels to 714 million barrels – would have accomplished little to mitigate the surge in private inventories.

Leasing SPR Capacity

Leasing space in the SPR, originally floated around **April 1**, would cost taxpayers less, but accomplish no more than buying the oil would have. The administration moved forward with the idea, nevertheless. On **April 14**, The Department of Energy announced it was negotiating nine separate leases with oil and gas companies to store 23 million barrels of private oil in the Strategic Petroleum Reserve. Reports indicate the nine leases, offered to Chevron Corp, Exxon Mobil Corp, Alon USA Inc, Atlantic Trading, Energy Transfer, Equinor Marketing & Trading (US) Inc, Mercuria Energy America, MVP Holdings, LLC and Vitol, Inc., were signed on **April 29**.

Paying producers to stop producing

After promising to find storage space above and beyond the SPR's capacity, the administration floated the idea around **April 15** that rocks and basins where oil currently sits could serve as storage. That is, the administration briefly considered paying producers not to produce. With its century-old tax subsidies, preferential leasing terms and generous regulatory regime, the oil and gas industry already a poster child for corporate welfare. Sending checks for companies to do nothing would be a gross escalation of the driller's welfare dependency.

Timeline of White House Bailout Proposals

Date	Proposal/Action
March 13	Buying oil for the SPR
April 1	Leasing space in the SPR
April 4	Royalty rate reduction on federal lands/waters
April 14	DOE negotiating SPR leasing
April 15	Paying producers not to produce
April 21	BLM sends royalty relief & suspension application guidance to producers
April 23	Treasury/Fed loans
April 29	DOE signs nine leases for 23 million barrels in SPR
April 30	Fed expands Main Street Lending Program