Riverstone Commentary: "U.S. oil industry group pledges to fight possible Biden fracking limits"

The oil and gas industry, along with the rest of the United States, waited anxiously on election night for the official results to be reported. As the final votes trickled in, and subsequent legal challenges dismissed, it became increasingly clear that Joe Biden would be inaugurated as president in January 2021. During Trump's tenure as president, he vocally supported and enacted energy policies to help the domestic oil and gas industry. He and his team rolled back Obama-era regulations and allowed operators to drill in previously unavailable federal lands. However, even with his verbal backing and accommodative legislative actions, the domestic oil and gas market struggled during his tenure due to negative macroeconomic factors and the Covid-19 pandemic. President-elect Biden's public statements and current climate plan, on the other hand, seem to indicate a tougher stance on the domestic oil and gas industry, particularly around fracking on federal lands. Nonetheless, we believe any legislative actions Biden may pass will have a marginal impact on the performance and valuation of domestic oil and gas companies due to the overwhelming influence of global supply and demand economics.

Over the past 20 years proponents and critics of oil and gas have used the terms fracking and horizontal drilling synonymously. Hydraulic fracturing, or "fracking," has been a part of the oil and gas lexicon since the mid-20th century. The process involves stimulating a well through the high-pressure injection of fracking fluid (water, sand, and other proppants), creating openings in otherwise dense rock to allow the flow of hydrocarbons. Horizontal drilling, on the other hand, is a relatively new technique created to access greater reserves by drilling horizontally from the wellbore as opposed to vertically. These two techniques, when used in conjunction with one another, enabled a U.S. oil and gas renaissance over the past 20 years. Domestic production grew from 5.8 million barrels per day in 2000 to a record 12.9 million barrels per day in November 2019. As a result, the United States transformed from a net importer of oil to a net exporter, a previously inconceivable notion.

If president-elect Biden proposed a future drilling ban on federal lands, we believe the legislation will face steep legal challenges and could potentially cause economic harm to the western U.S. where 97% of federal land is located. According to the most recent data, roughly 25% of domestic oil and gas production is produced on federal leases. In 2019 alone, various government agencies collected $11.7 billion in royalty payments. Of those payments, roughly half goes to the U.S. treasury with the other half directed towards states and Native American reservations where the federal land is located. The economics department at the University of Wyoming recently published a lengthy study on Biden's hypothetical fracking ban. The report's findings indicate 73,000 in annual job cuts, $14.8 billion in lost wages, a $43.8 billion decrease in economic activity, and a $10.8 billion reduction in tax revenues over the next four years. Regardless of the theoretical negative economic impacts, the legal challenges from states and industry groups would be fierce and swift. Already, the American Petroleum Institute, the largest U.S. oil and gas trade group, has vowed to use every tool available if Biden were to propose fracking legislature.

Since inception, the RCP deal team has been incredibly prudent with regards to assessing the risks around drilling and leasing on federal lands. As a result, the current portfolio of loans in RCOI is well insulated from a hypothetical fracking ban on federal land. Out of the seven existing loans, only one is directly reliant on federal land. However, that borrower already has approved permits in place, which would not be affected by the potential legislature. One silver lining to the ban would be higher oil and natural gas prices for other operators as economies and traders around the world would have to assess the future of global oil and natural gas growth without U.S. federal lands. Ultimately, we believe any possible legislative actions will have a minor impact on our portfolio companies and their performance.

RCP remains confident in our ability to navigate the continually changing landscape of the energy world and will regularly update investors with our analysis. The current RCOI portfolio is well-positioned to withstand the coming challenges as we manage risk and seek to diversify investments across the energy spectrum.