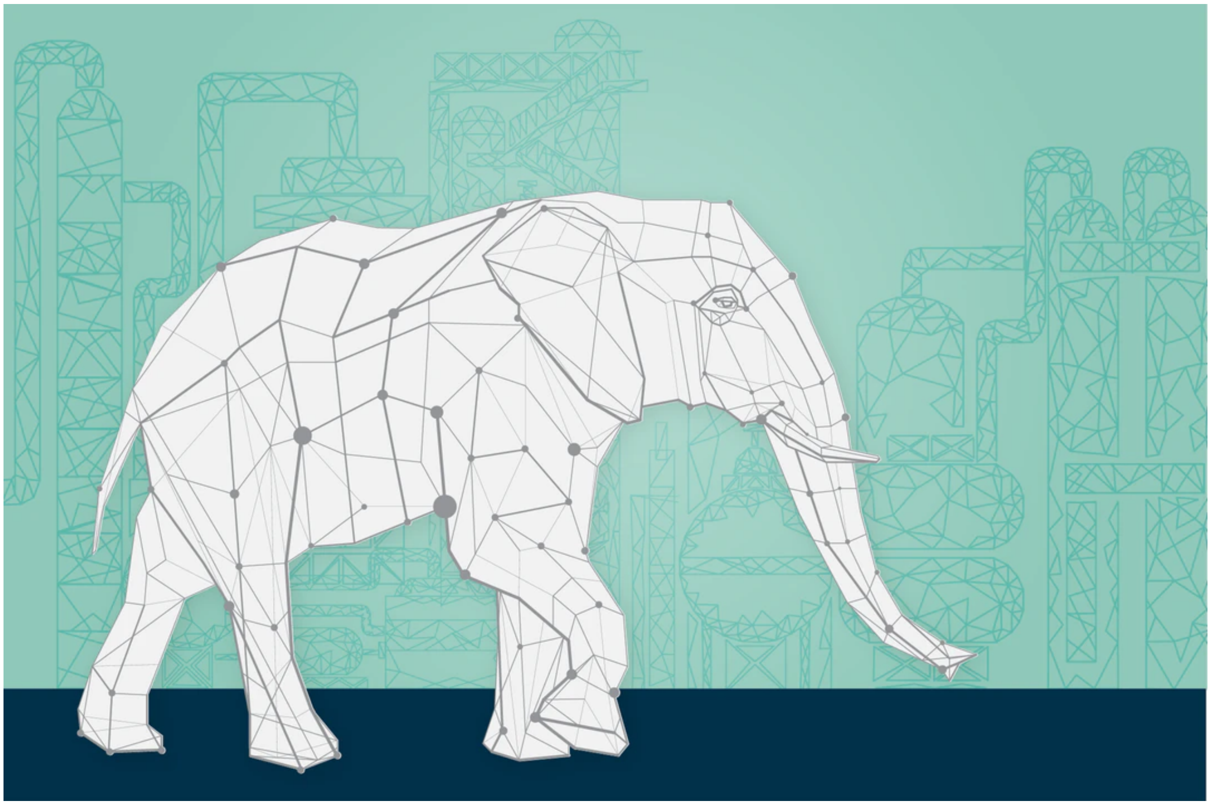
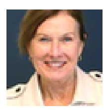
THIRD WAY

**BLOG** *Published May 7, 2020 • 4 minute read*

# The Elephant in The Room: What About the Oil and Gas Industry?




**Andres Prieto**
Climate and Energy Fellow
@ThirdWayEnergy



**Ellen Hughes-Cromwick**
Senior Resident Fellow for Climate and Energy Program
@EllenHughesCrom


With lockdown in place in countries around the world and a crashing global economy not seen since the Great Depression, it's not surprising that the oil and gas industry is suffering from collapsing demand. Last month oil prices even went negative, setting new records and upending the energy world. But what does this mean for the future of oil and gas? Is the industry "too big to fail"?

It certainly seems like big oil companies think they are. Already, smaller oil, gas and utility companies were overrepresented in the first round of the Paycheck Protection Program (PPP), compared to companies in other sectors like manufacturing, retail, and construction. Oil and gas is also set to be a major beneficiary from the recent changes to the Federal Reserve's Main Street Lending Program, which allows highly levered companies to apply for loans and use the funds to pay down their debt. Now, bigger oil companies have approached the administration with new requests for the industry at large. Some of these "asks" include:

- Using the Strategic Petroleum Reserve to buy oil above market value. This is an implicit subsidy to oil companies considering that the Reserve is already well stocked, and its main purpose is to prevent oil supply shortages, not assist domestic producers with demand shortage.

- Paying oil and gas companies to halt production in order to raise prices. Again, this is a subsidy that companies in other industries will not receive.

- Suspending royalty payments from oil and gas operations on federal lands to the federal government. The government would no longer receive revenue for use of this public land, and it gives oil and gas an unfair advantage over clean energy sources that are vying for this land use.

Going forward with any of these would be political hardball, let alone all three. Most importantly, if oil prices remain low for the short- and medium-term future, none of these "asks" may be enough to salvage most oil and gas companies.

This is where policy makers need to face reality. Bailing out an industry that continuously lobbies against clean energy is bad enough. But added to that, any intervention to bail out oil and gas means bailing out an industry that was already faltering and where most companies may not recover anyway.

For the decade preceding this health crisis, many oil and gas companies did not generate a positive cash flow. For a lot of the small shale companies, this was in part due to an expectation of higher prices than what occurred. Today, the majority of shale companies need at least around a $40 price per barrel of oil just to break even (not even considering the added costs of shutting down wells and paying for storage). The Energy Information Agency's (EIA) forecast for the average price for a barrel in 2020 is $33. For 2021 it is $46.

Most Big Oil giants like BP, Chevron, Exxon, and Shell might be able withstand low oil prices for longer but have still acquired what looks like an unsustainable amount of debt. One of the main reasons many investors have not pulled away from major oil & gas companies is their dedication to high shareholder dividends. But for years, Big Oil has not collected the profits to finance them, so they've instead acquired large amounts of debt to keep them at their current level. Some are still doing it today. But can they keep it up for long? In this economic environment? At least one oil giant, doesn't think so. Shell has now slashed their shareholder dividends for the first time since WWII. Along with Exxon reporting its first quarterly losses in three decades, warning signs abound.

Of course, fossil fuels are still integral to the economy and, for certain sectors, do not have scalable substitutes today. But now is the time to begin addressing this challenge head on. It is vitally important for policy makers to come to terms with the financial and environmental unsustainability of the industry. Balancing today's reality with a future that will clearly focus on reducing climate risks means that our investment in clean energy and workforce development will have much bigger payoffs than tailoring energy policy to the short-term financial woes of oil companies.