Trends in Oil & Gas

2023 and the Year Ahead

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Contents

Introduction

The past 12 months have been some of the trickiest to navigate for oil & gas companies in recent memory. Despite high energy prices and record cashflows, there is still uncertainty about what future paths to growth might look like.

With volumes of activity for both M&A transactions and debt & equity capital markets deals at historically low levels, many are sitting on their cash (or distributing out their cash through dividends or stock buybacks) while those companies without large cash piles have turned to alternative lenders to fund growth.

Decarbonization remains a key driver of both deal activity and policymaking, creating challenges and opportunities in equal measure. As we go into a U.S. presidential election year, the polarized split between Democrats and Republicans on energy policy has the potential to either turbocharge energy transition efforts or pivot back to or in favor of traditional fossil fuels, scaling back much of the focus in recent years.

At the same time, certain individual investors and other funding sources remain guarded on the extent to which they want to continue supporting oil & gas, creating new dynamics for the pursuit of both public and private capital.

Still, there are signs of a turning tide. In the latter part of 2023, we saw several definitive megadeals and hints of an IPO window opening, suggesting we may be in for a wave of consolidation in 2024 and that investor appetite for oil & gas may be reviving.

But as we explore in the following commentary, the evolving macro and political backdrop cannot be ignored—how hydrocarbon prices will fare, how the U.S. electorate will vote, how markets will react and how legislators will respond all remain to be seen.

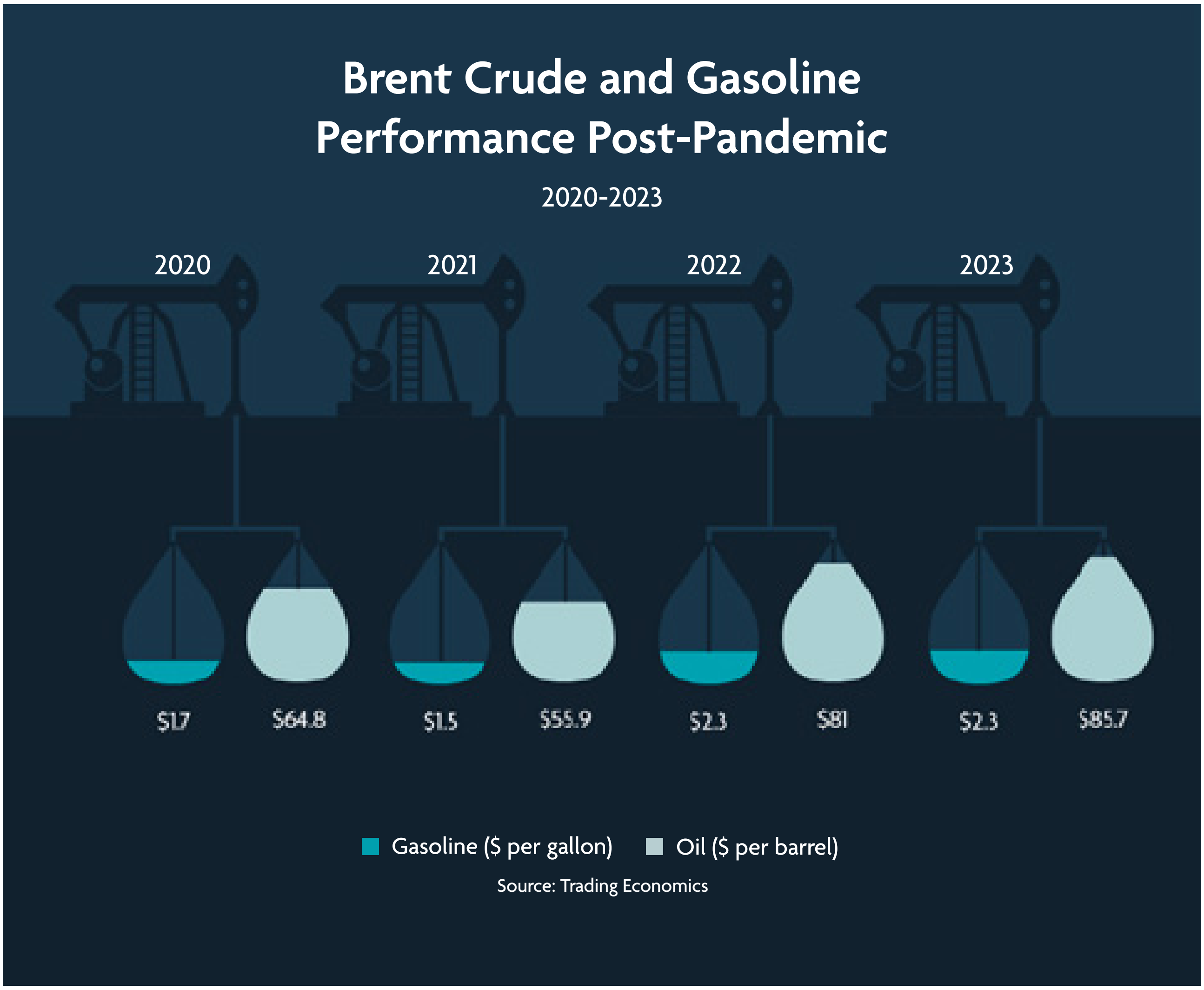
Our view is that the next 12 months are set to be more active than the prior year on many fronts as the oil & gas industry's longer-term trajectory continues to take shape. We hope the insights we share here will prove useful to those exploring new opportunities and addressing challenges.

Pursuing Capital for Growth

The past year has been broadly characterized as one of limited public market activity and rising interest rates putting a dampener on access to capital. For the oil & gas industry, higher and relatively steady commodity prices going into 2023 led commentators to predict a busy year for U.S. energy IPOs, but the volume of debt & equity offerings remained at historically low levels, at least for the first half of the year. With bank lenders and some institutional investors also continuing to retreat from the market, it has been a year in which alternative sources of capital have come to the fore.

Capital Markets

Oil & gas companies have traditionally raised equity & debt in the capital markets during times of strong oil & gas prices and the capital markets have typically been closed during periods of price weakness. That cycle began to change in 2019 as investors started to leave the traditional hydrocarbon space—often in favor of tax favored energy transition investments. When hydrocarbon prices strengthened post pandemic, the demands of existing investors led now-profitable oil & gas companies to focus on cash flow instead of growth.



The energy transition will not mean the end of traditional oil & gas, but rather a move to a much more diverse range of new and existing energy sources.

As a result of both investors cycling out of traditional hydrocarbons and the focus on cash flows, many of those companies generally chose not to attempt to access the capital markets outside of garden-variety refinancing of maturing paper, leading to a sustained period of depressed capital markets activity in the sector.

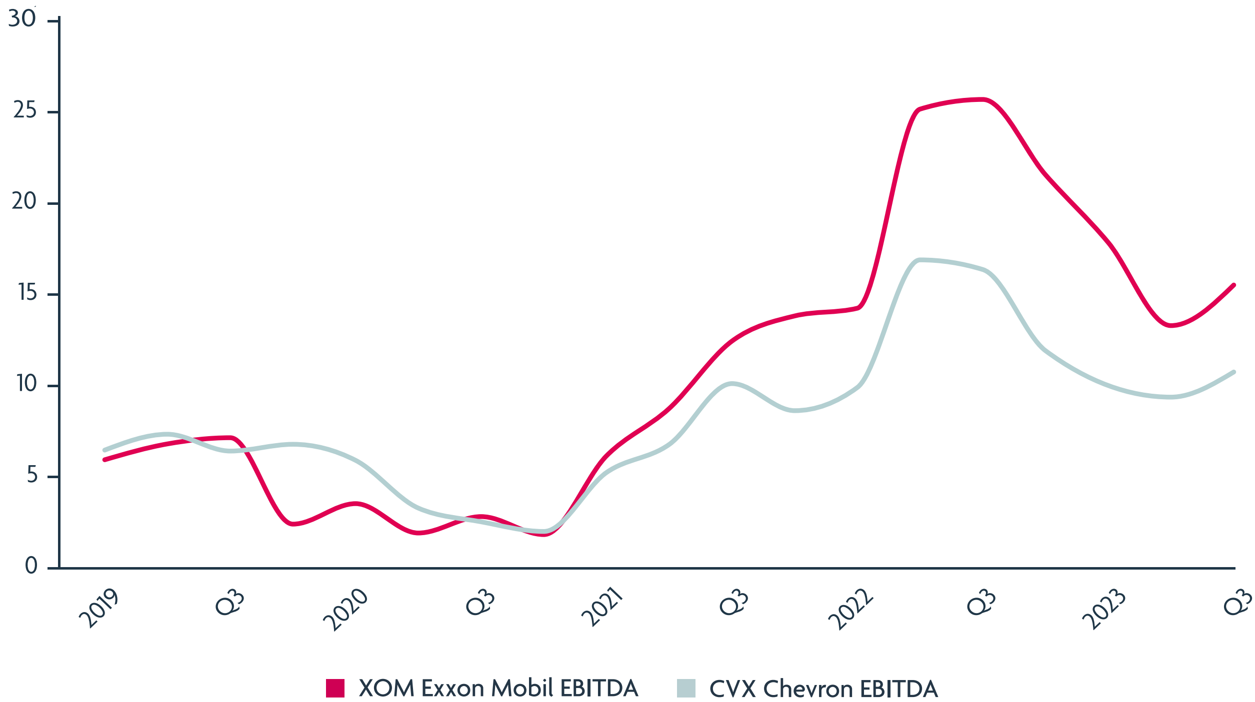
As we move into 2024, that impasse has begun to unlock across the space. We have seen a significant increase in high-yield activity, as well as a larger volume of public equity offerings in the traditional hydrocarbon market in the second half of 2023.

Non-energy participation in the U.S. capital markets has been choppy for some time, with stock prices hit hard by interest rate increases and post-pandemic instability, but investors appear to have noticed that oil & gas companies have been enjoying strong profitability for the past two years. That is, in part, aligned with a growing understanding that energy transition will not mean the end of traditional oil & gas, but rather a move to a much more diverse range of new and existing energy sources.

We expect this increased activity in oil & gas capital markets to continue for the next 18 months or more, assuming no significant recession. Oil & gas has long been viewed as a reasonable inflation hedge and there appears to be an IPO window opening up going into the new year. While recent large consolidations raise questions about the depth of investor appetite for public energy companies, we do see the markets warming for follow-on investments, as well as targeted IPOs, and expect the next 12 months to be considerably more active than the last three years.

“Big Oil” Profits – Chevron and Exxon Mobil EBITDA

2019-2023 ($ Billions)



Source: Trading Economics

Private Credit

For mid-market oil & gas companies in particular, the past year has been challenging on the fundraising side, as it has proved difficult to access capital from both traditional bank lenders and the capital markets.

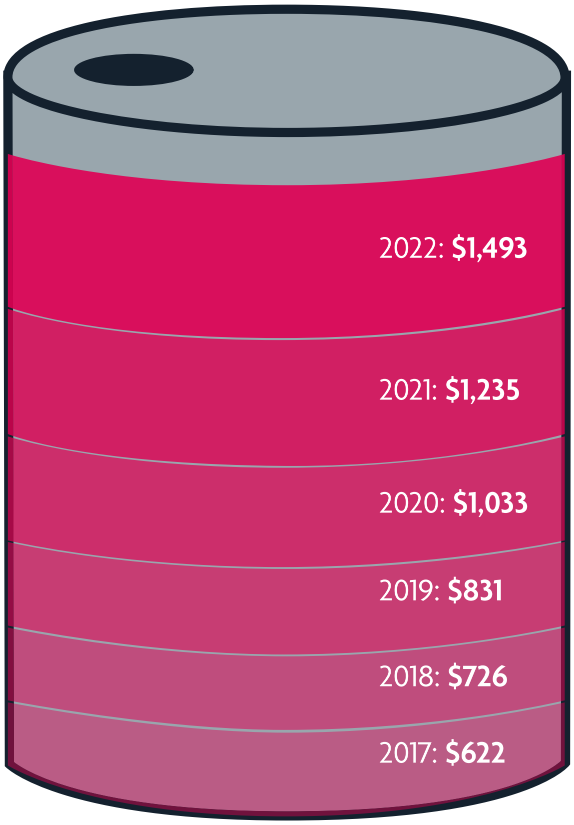
Coupled with a heightened focus on ESG concerns, we have seen more major banks and large financial institutions pledge to stop supporting upstream oil & gas projects, and in certain cases, actively pull back from lending to hydrocarbon-focused companies, even seeking to exit their existing credit facilities.

Given this backdrop, private credit funds have been quick to step in and fill the void, seizing an opportunity to build market share. Credit funds are traditionally industry agnostic in nature, but the oil & gas space has proved different given the specialized knowledge required to value the underlying assets. That perhaps led to some initial reticence from funds embracing oil & gas lending, but as the private credit industry matures, we see more and more examples of funds replacing banks as lenders.

The attractiveness of private credit to oil & gas borrowers has grown, with much of the surge on the demand side driven by the flexibility in structuring that can be offered through bilateral lending arrangements. Upstream oil & gas companies have been using their proved, developed and producing reserves and related cash flows as collateral for asset-backed financings, for instance, which has proved an easier and more efficient structure to execute and is just one example of the creativity possible outside of traditional bank syndicates.

U.S. Private Credit AUM Since 2017

($ Billions)



Source: Preqin/Alliance Bernstein

Upstream oil & gas companies have been using their proved, developed and producing reserves and related cash flows as collateral for asset-backed financings.

Private Equity

Private equity sponsors with traditional hydrocarbon focused funds still face challenges as a result of continuing pressure on institutional investors to pull back from funding hydrocarbon projects.

Universities and other endowments, in particular, have received pushback from their constituents and that has changed fundraising dynamics, often resulting in less investor overlap from one flagship fund to the next and the need for new categories of investors to bridge the gap. Private sources of capital, and particularly family offices, have emerged as increasingly active backers of oil & gas funds as they are often less constrained than the larger institutional players.

There is a geographical element to the shifting investor appetite, with U.S. domestic-focused funds finding less of an issue with maintaining their hydrocarbon allocations while those with more investors coming out of Western Europe are facing more challenges.

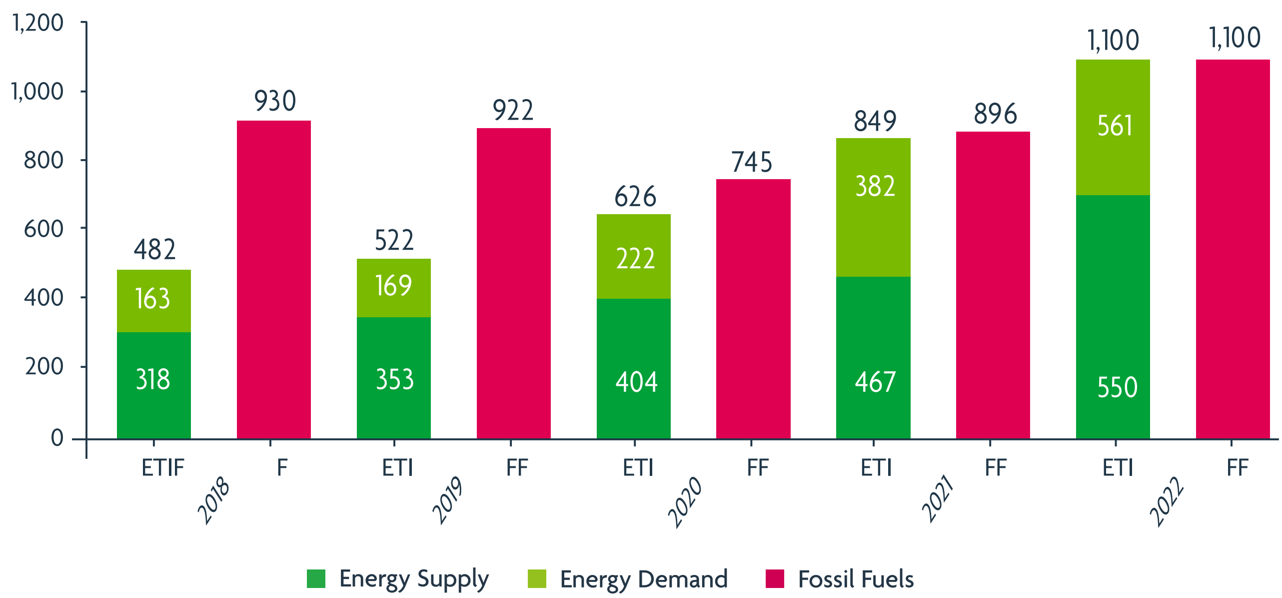
Still, many of the largest energy fund managers that remain are continuing to either pivot their strategies to energy transition or low-carbon themes or expand to include those alongside their fossil-fuel related efforts. As investors seek returns, it remains uncertain how well many energy transition investments will ultimately perform.

We continue to see innovation around the ways in which private equity is backing oil & gas, with the growing use of drillco structures as an alternative source of financing being a prime example. In those transactions, an investor agrees to fund some or all of the exploration and drilling costs for a number of wells in exchange for a percentage interest in the wells drilled, and we see those types of mechanisms continuing to be popular.

Meanwhile, private equity funds had one of their busiest years on record in terms of monetizing assets, with Occidental Petroleum's $12-billion purchase of private equity-backed CrownRock LP, making 2023 the busiest year for PE exits in at least five years. Data from Enverus Intelligence Research shows private equity exits hit $30 billion in 2023, versus $23.3 billion in 2022, as they benefited from a strong group of well-capitalized public buyers in the market.

Global Energy Transition Investment Has Matched Fossil Fuels for the First Time

$ Billions



Source: BloombergNEF

Note: ETI stands for energy transition investment. FF stands for fossil fuels. 2018-21 FF values were derived from IEA World Energy Investment 2022 report. 2022 fossil fuel investments are BNEF estimates, and include upstream, midstream, downstream sectors and unabated fossil power generation.

Looking Forward

Barring a major U.S. economic recession and significant instability in commodity prices, we expect capital to continue to be more available to the oil & gas industry through 2024. Increased activity in the oil & gas capital markets looks likely to be a feature, with an IPO window opening up and growing investor appetite for follow-on investments.

In the private markets, the opportunity for private credit funds to continue to build market share in lending to oil & gas companies is evident. It is unlikely that 2024 will see the same volume of exits by private equity, but sponsors with funds dedicated to this market will have capital to deploy and so will remain active. We expect to see them exhibit an increasing propensity to either pivot towards greener strategies or bring energy transition assets into their portfolios alongside traditional oil & gas investments.

M&A Activity Remains Cool Despite Megadeals

After a fairly slow first half of 2023, a moderate pickup in oil & gas M&A over the summer months culminated in the announcement of two megadeals in Q4 that defined the year.

When ExxonMobil, the largest U.S. oil producer, announced in October that it had agreed to buy Pioneer Natural Resources in an all-stock deal valued at $59.5 billion, it created the biggest producer in the Permian Basin and secured for ExxonMobil a decade of low-cost production.

Soon afterwards, Chevron announced its plan to buy rival producer Hess for $53 billion, signaling what may be the start of a trickle-down wave of consolidation as midsized independents think about how they can achieve more scale through combinations or acquisitions to compete.

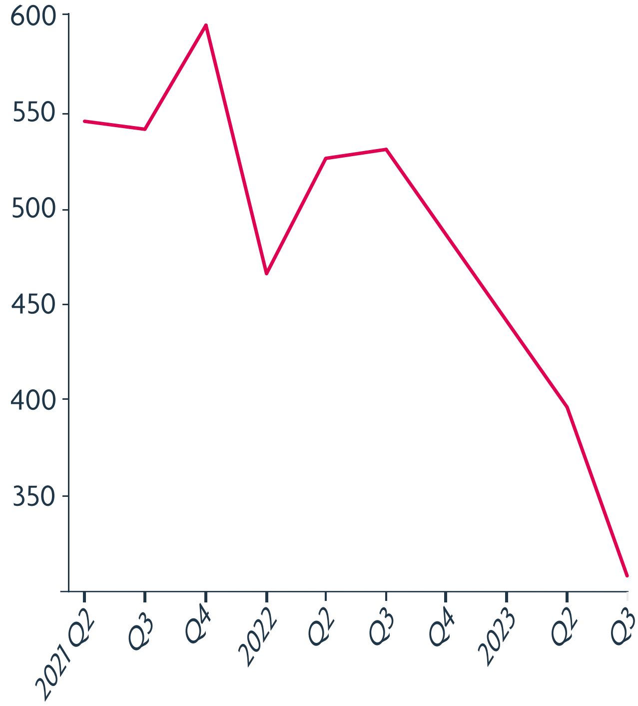
Most recently, on December 11, Occidental Petroleum announced its $12-billion acquisition of CrownRock LP, a Permian Basin operator backed by private equity firm Lime Rock Partners.

Mega transatlantic oil mergers now look less likely after the two U.S. giants showed a preference for acquisitions focused on the Americas, quashing expectations that they may try to buy European rivals BP and Shell. Domestically, we continue to see increased interest in upstream deals driven by a scarcity premium.

From a deal count perspective, 2022 was historically low and 2023 looks set to finish even lower, even though the two Q4 megadeals fueled the cumulative value of 2023 transactions.

Global Oil & Gas M&A Deal Volume Before Exxon and Chevron Deals

($ Billions)



Source: GlobalData Oil & Gas Intelligence Center

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Challenges Remain for the Year Ahead

We expect additional megadeals to potentially occur in 2024 as the bigger exploration & production (E&P) companies seek to keep up, while Permian Basin M&A could also increase as crude prices settle at a point where people feel comfortable transacting and companies seek to invest for the future.

One challenge to further deal activity is the potential shortage of attractive assets coming to market. Deal count was slowing before the Covid pandemic, in part because of an urgency on the part of producers to clean up balance sheets and right size for a leaner environment.

Today, many of those businesses appear to be in much better shape and may be more reluctant to bring assets to market. Likewise, private equity (PE) firms holding noncore assets that do not attract premium prices may be reluctant to exit, further hampering the seller landscape. Whether or not those PE firms, that have accumulated or retained significant positions through the present, view 2024 as an opportunity to try and monetize in a potentially scarce market remains to be seen.

Another hindrance to the depth of the M&A markets is the ongoing, and widening, valuation gap between the big energy giants and the smaller producers that is now reaching historic levels. Looking at forward 12-month EBITDA valuations, the premium on bigger producers currently sits at around 44% compared to an average of 10-14% over the past 20 years. Investors are rewarding scale in the public markets and that should continue to drive the bigger producers to scoop up assets.

On the buy-side, private equity firms appear much more selective about the teams that they are prepared to back in the industry. They are increasingly risk averse and are seeking management with proven track records, and thus, we do not anticipate PE spending as much as they have in the past.

Furthermore, the hydrocarbon space remains highly dependent on commodity prices and the current macro and geopolitical challenges may deliver further volatility to those through 2024. As a result, many potential buyers may be reluctant to make big bets on deals in such an uncertain climate.

Finally, the industry is keeping a close eye on the FTC and U.S. Department of Justice as they review the ExxonMobil and Chevron transactions from antitrust perspective. The federal government's interactions with those parties and views on those transactions will likely reveal much about just how aggressive a stance it is likely to take on continued consolidation over the short term.

Steady Deal Drivers for 2024

The theme of energy transition continues to be a driver of M&A activity, with Deloitte estimating that more than a third of publicly announced oil & gas joint ventures have been specifically targeted at the "clean energy" space in the recent period.

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The natural gas market could be an interesting source of deals over time. Natural gas prices have been low for a while, but with a tremendous amount of LNG export capacity coming online on the U.S. Gulf Coast in the near future, that may become more of a focus as a long-term play.

On the financing side, many E&Ps have gained significant financial strength in recent years due to high commodity prices and an investor-driven focus on profitability and cash flow, resulting in large cash pools, improved cashflows and lower leverage positions. Only 7% of oil & gas deals are currently being funded by debt, minimizing the impact of interest rate hikes and faltering credit markets and positioning oil & gas businesses as potential buyers.

We have observed an increasing willingness on the part of smaller private equity sellers to take public company stock, which can be used as currency if appropriately valued. We have seen a growing number of deals with meaningful stock components and we expect that to continue.

Other factors that may signal more activity in the year ahead include the next wave of sophisticated technology entering the oil & gas markets, with businesses focusing on automating processes with AI, maximizing efficiencies and driving down costs. Many of the companies tapping these tools to find advantage are the same ones chasing additional scale through M&A.

Lastly, we think water assets will be an area to watch, as recycled water increasingly becomes not only feasible but desirable, particularly for public E&Ps operating in constrained water areas, including in regards to new and future energy transition projects.

More than nine in 10 (92%) oil and gas companies worldwide are investing in AI or planning to do in the next five years, according to EY.[1]

Water assets are increasingly desirable to E&Ps in areas like the Permian Basin, where only 15% of water used for fracking operations is currently recycled.[2]

[1] https://www.ey.com/en_uk/applying-ai-in-oil-and-gas
[2] https://www.nytimes.com/interactive/2023/09/25/climate/fracking-oil-gas-wells-water.html

Looking Forward

In summary, we expect 2024 to be another year of consolidation, with the large public E&Ps striving to grow and the mid-market players pursuing different strategies in a bid to gain scale and continue to compete.

A huge factor for all will be the political backdrop, particularly at the federal level, where the outcome of the presidential election has the potential to create either more momentum for energy transition or some significant unravelling of the policy objectives that have made headway in the past few years.

Something of a deal backlog has undoubtedly built up, and we can expect that to unlock, should both commodity prices and the macroeconomic environment stabilize. Chevron, ExxonMobil and Occidental have quite possibly kicked off an oil land grab, but overall, it seems likely the year ahead will see only a modest rebound in M&A activity.

Developments in Reserve-Based Lending Facilities

Reserve-based loans (RBLs) are an important part of the capital structure for many oil & gas exploration & production (E&P) companies. RBLs provide a floating availability amount, or borrowing base, which is determined by the lenders based on the borrower's latest reserve report, expected commodity prices and other factors, and redetermined periodically, typically every six months.

The RBL product has existed for decades, during which time the market has seen multiple cycles of commodity price increases and decreases, recessions, inflation and many unexpected geopolitical changes. Over the years, this stress testing has led banks to converge on an almost formulaic approach to RBLs for domestic E&P companies.

Of course, the market is not entirely static. Drilling technology has continued to advance, hedging strategies have become more sophisticated, and changes in lending practices in general have filtered into the RBL market. While the traditional RBL market for domestic E&P companies did not move significantly during 2023, it is noteworthy to observe a few shifts in the use of several of the mechanisms found in RBL credit agreements.

Oil and Gas Financing Trends

1. Hedging Limitations

One of the more significant developments in RBLs over the last 10 to 15 years has been an increased focus on the management of borrowers' commodity hedging programs.

In response to steep downturns in commodity pricing in the mid-2010s, the RBL market implemented limitations on the amount that producers could hedge. When oil & gas prices started to rise in the aftermath of the pandemic, many producers experienced significant commodity hedging losses due to the lower prices realized on commodities under Covid-era hedging agreements.

Since then, producers have tended to slow their hedging programs and become more judicious in their use. While limitations on hedging remain, requirements to hedge a certain amount of production, often up to half of reasonably anticipated production, have become more common in RBLs, especially for less established producers. In addition, hedging periods for oil, which used to be set at 12 months, have lengthened to be more in line with the 24 months common for natural gas.

2. Anti-cash Hoarding Provisions

With the pandemic, anti-cash hoarding provisions began to re-emerge, and in 2023 they continued to survive in many credit agreements.

Anti-cash hoarding provisions exist to prevent borrowers from accessing credit to fund cash reserves in excess of the amount needed for operations, especially prior to a default.

These provisions limit borrowing capacity or force repayment of the loan if the borrower holds above a specified level of cash. They first came to prominence during the oil downturn in 2014, at a time when many existing RBLs did not require perfected security interests in deposit accounts. Later, anti-cash hoarding provisions started to become less common as oil prices stabilized and lenders started to require perfected security interests in deposit accounts.

With the pandemic, anti-cash hoarding provisions began to re-emerge, and in 2023 they continued to survive in many credit agreements, largely as a result of increasing economic and geopolitical uncertainty. Some RBLs now link the anti-cash hoarding provision to the borrowing base, requiring payments of cash in excess of a percentage (e.g., 10%) of the borrowing base or the greater of a set dollar amount and a percentage of the borrowing base (e.g., the greater of $X million and 10% of the borrowing base).

3. Investment Grade Period Toggle

While reserve-based lending is more common for non-investment grade E&P companies, investment grade borrowers are typically subject to a different, more lenient, loan structure.

For borrowers that are near investment grade, the investment grade period toggle structure has begun to be included more frequently in the past few years. This structure toggles the covenant package to the lighter investment grade package when the borrower achieves investment grade status, allowing for improved margins for borrowers and the suspension of collateral requirements and certain negative covenants. In some cases the toggle is permanent, while in others it is only in effect so long as the borrower maintains investment grade status.

4. Financial Covenants

Reserve-based loans typically contain financial covenants that limit lenders' exposure to market risks such as oil & gas price drops. Two common covenants are a leverage ratio (total or net debt to EBITDA or EBITDAX) test and a current ratio (current assets to current liabilities) test. In the current market, leverage ratios are typically in the 3.0-4.0x range, and current ratios typically require coverage of at least 1.0x.

Looking Forward

As we move into 2024, world events are conspiring to make the lending climate more interesting. The growing need for energy worldwide, along with the impact of geopolitical unrest in the Middle East and the ongoing war in Ukraine, may provide a more favorable pricing environment for domestic oil & gas production. If commodity prices do increase, we can expect more fields to become viable and more drilling and other activity to increase.

As prices climb, we would expect lenders to be more bullish, but given other factors in the macro backdrop, including inflation and economic challenges both domestically and outside the U.S., lenders may opt to remain conservative.

The structural issue that led to the failure of Silicon Valley Bank is still present in the market and could lead to more bank failures, so borrowers are advised to maintain relationships with several banks, and to consider nurturing relationships with alternative lenders, who are increasingly active at the smaller end of the market.

One wild card is ESG. The reserve-based lending space has so far been slow to adopt ESG key performance metrics, but as more and more focus is given to the environment and climate change, we may begin to see more pressure for ESG performance metrics in RBLs in the year ahead. On the other hand, the political climate may force an overall retreat from ESG, particularly in some of the key oil & gas producing states.

Finally, although RBLs have become somewhat formulaic, each credit is unique, and the details matter. There is no one-size-fits-all approach to RBL lending, particularly in a world where "black swan" events seem to be occurring with increasing frequency. Lenders and borrowers must strike the right balance in any RBL, giving lenders sufficient comfort with the risk and a corresponding return, while giving borrowers the capital resources needed without unduly burdening their ability to operate their business.

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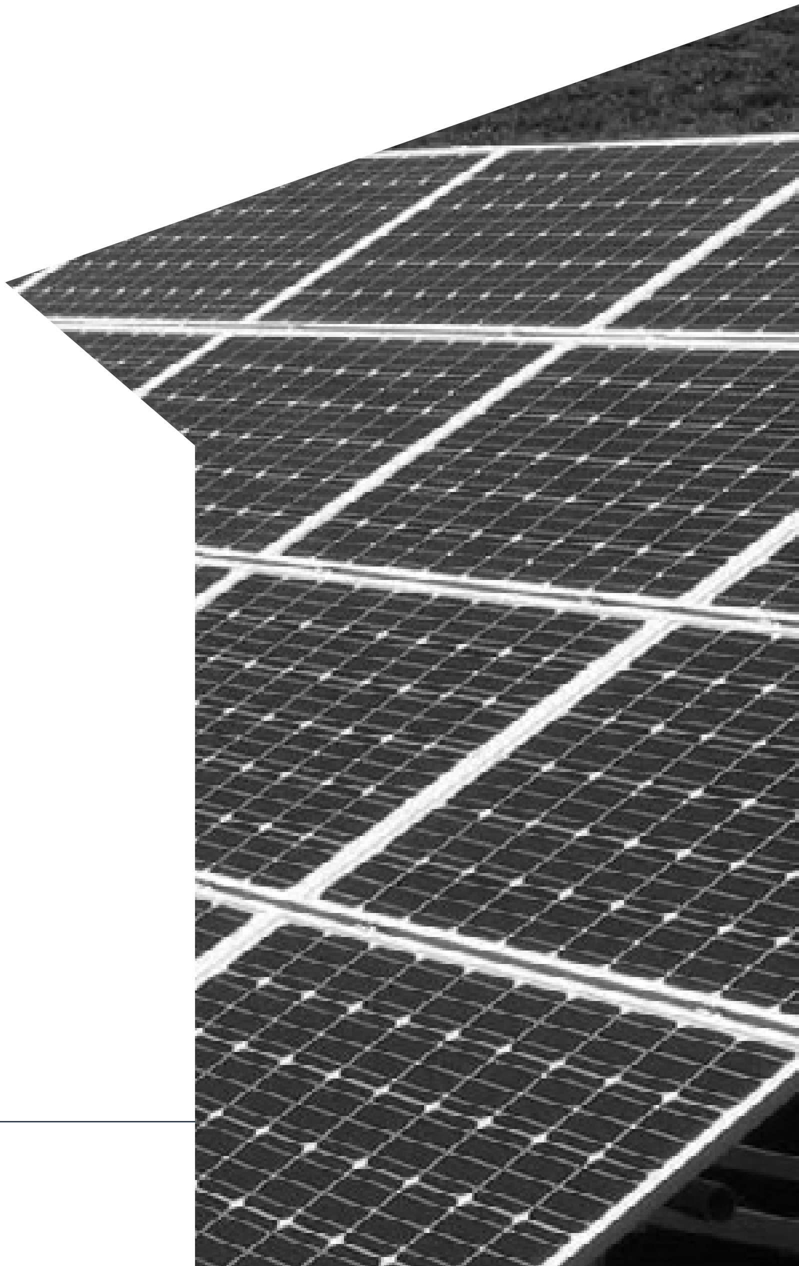
Opportunities for the U.S. Oil & Gas Industry in the Energy Transition

Advancing the energy transition remains a key focus in both policymaking and deal activity across the U.S. oil & gas landscape and traditional energy industries.

Supportive policies and incentives, combined with strong oil & gas cashflows and growing concerns over energy security, have accelerated efforts to modernize the industry and invest in technologies that will accelerate decarbonization. The implementation of new technologies and efficiencies to reduce emissions from the oil patch, including the electrification of oil & gas operations, is well underway and we see ongoing efforts to drive those efforts forward. Industry players that implement these changes may benefit from the current wave of energy transition investment.

Pipeline operators, power producers and asset owners see a wealth of opportunities in advancing carbon capture, utilization & storage (CCUS) projects, and 2023 saw a significant increase in CCUS deal volume. However, while federal government incentives are compelling, a big theme in 2023 was how complex those projects are to deliver and advance. Despite the recent increase in number of CCUS projects, the industry is nascent, and valuable opportunities remain for early-movers.



CCUS Capture Capacity Planned in 2030 by Region

(MT = Oil Quantity)

REGION	MT OF CO_2 PER YEAR
1 North America	24.7
2 Central and South Americas	8.7
3 Australia and New Zealand	4
4 Middle East	3.7
5 Asia Pacific	2.4
6 Europe	2.4

Source: IEA

We also see a steady building out of infrastructure to support new technologies like hydrogen, ammonia and other less carbon-intensive fuels.

When some traditional energy assets are repurposed for CCUS, as expected with the Trailblazer Pipeline Company conversion from natural gas pipeline to carbon dioxide transmission, new pathways become available. Still, the value of oilfield services skills, and the fact that CCUS hubs are typically located around oil & gas centers, creates numerous opportunities for synergies and continued growth of the traditional energy industry.

We also see a steady building out of infrastructure to support new technologies like hydrogen, ammonia and other less carbon-intensive fuels (such as sustainable aviation fuel, renewable natural gas and other bio-fuels). It is clear these fuels will coexist alongside petrochemicals and liquefied natural gas (LNG) for some time to come.

Switching LNG export and import facilities to transport ammonia and hydrogen is feasible but remains far-off. Nonetheless, that sort of repurposing exemplifies the potential for capital deployment in the energy transition that would directly benefit traditional energy players. More imminent, perhaps, is the ability to use ammonia (either as a complete replacement or to blend with natural gas) in existing natural gas generating assets.

Perhaps one of the biggest drivers for significant interest in these technologies are policy initiatives like the October 2023 announcement of seven regional clean hydrogen hubs that may be eligible to receive up to $7 billion in federal funding to accelerate the domestic market for hydrogen. These hubs are expected to catalyze a further $40 billion of private investment and should bring ancillary benefits, while additional funds will go to demand-side support to drive more innovative end-uses of clean hydrogen for the future. Even the hub projects that did not secure funding are expected to benefit from broader industry growth.

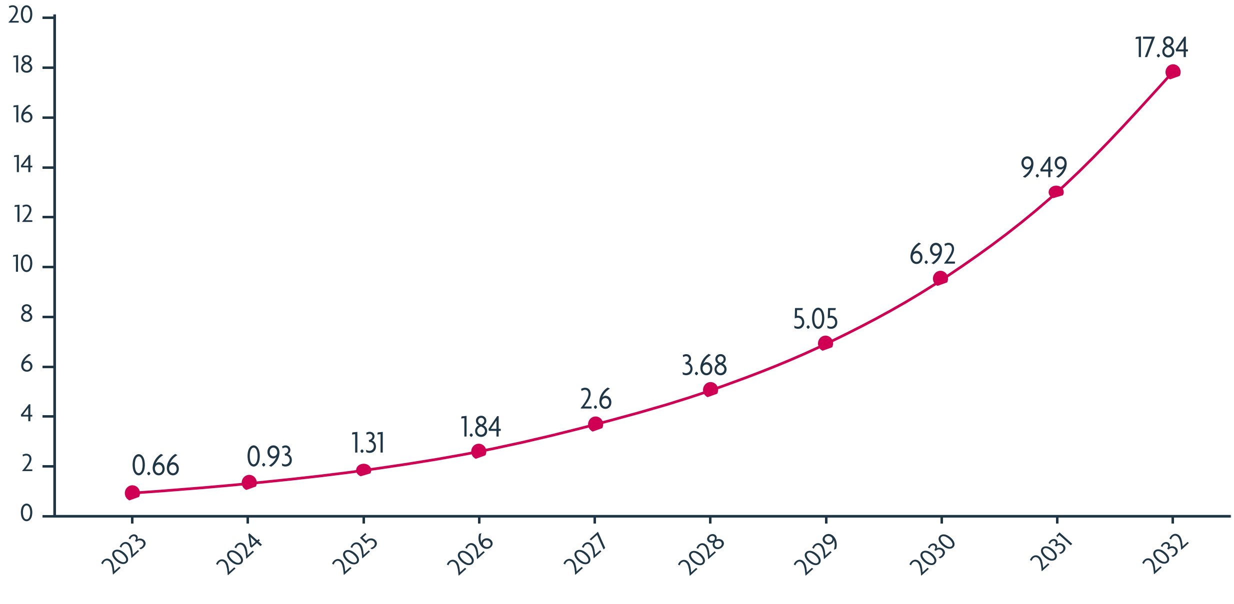
Elsewhere, we are also witnessing growing interest from the oil & gas industry in renewable natural gas as one way to reduce agricultural methane release. Saltwater recycling is another area gathering momentum as projects benefit from R&D tax-saving credits.

Among the new green incentives included in the Inflation Reduction Act (IRA) are tax credits for clean hydrogen projects. The IRA required the IRS to issue hydrogen credit regulations by August 2023, but those regulations are yet to materialize, with speculation building that they could be released prior to the end of 2024. On December 5, 2023, Bloomberg and POLITICO reported on a leak of draft regulations. According to those sources, the leaked guidance would implement highly restrictive rules that could limit the number and type of hydrogen projects that can get underway. It is unclear whether formally issued regulations will be more lenient, but the purported leak garnered significant concern among industry participants.

The IRA also includes a new law allowing many project owners to sell renewable energy tax credits directly to buyers, which was impermissible under prior law. Even more appealing for some developers, the IRA allows for a period of direct payments from the Treasury Department in lieu of CCUS and hydrogen tax credits. We are fielding numerous inquiries on innovative structures that allow oil & gas and traditional energy companies to benefit from tax credits under the IRA.

Projected Growth of the U.S. Domestic Hydrogen Market

2023-2032 ($ Billions)



Source: Precedence Research

Looking Forward

By focusing on decarbonization and the energy transition, oil & gas companies will make the traditional energy industry more efficient and cleaner while maintaining the industry's relevance through increased sustainable energy investments and resulting production.

This will be especially true as federal incentives help unlock some of the balance-sheet barriers to investing in these opportunities. First movers driving innovation will have an advantage over time, but there remains a need to educate the market to achieve buy-in for projects, particularly on the CCUS front and other capital-intensive technologies. Companies that succeed in this transition will proactively showcase their increased efficiency and success in decarbonization and communicate with stakeholders using an authentic voice to demonstrate the changing way in which they are doing business.

The traditional energy industry has long achieved attractive rates of return by deploying capital in accordance with a set schedule and a set budget. Allocating efforts towards decarbonization strategies will simply be an extension of these existing business practices and should continue to drive long-term returns for oil & gas players.

Regulatory, Political and Policy Issues

Antitrust Gets Political

Two megadeals in the oil & gas industry have highlighted the elongated timelines and political nature of antitrust processes for these businesses and others in 2023 and beyond.

Both the $53-billion all-stock acquisition of Hess by Chevron, announced in October, and the $60-billion deal signed by ExxonMobil and Pioneer Natural Resources earlier that same month, have led to calls from environmental interest groups for the Federal Trade Commission (FTC) to intervene despite a lack of obvious antitrust issues.

The FTC suffered several court losses in 2023 and would appear to have an uphill climb in prevailing in a suit against either the Chevron or ExxonMobil deal.

Large deals such as these are often subject to a standard timeline of twelve or more months to get antitrust regulatory approval, though there are strategies to achieve sign-off in closer to five months. Whether the agency will sue to block the deals remains to be seen—the FTC suffered several court losses in 2023 and would appear to have an uphill climb in prevailing in a suit against either of these deals, though that may not stop it from pursuing cases to meet political ends.

In the past year, the agency has tried to extend and grow its enforcement reach bringing cases on nontraditional theories and requiring more from companies in its consent orders. That said, the FTC has not yet moved to extend its reach in this sector. There has not previously been a combination in the Permian Basin that has caused concern based on the entities' presence in the Permian. And these deals do not appear to raise cause for concern in the Permian either—at least on traditional theories.

Still, at a time of increasing pressure from environmental groups and some Democrats to bring more suits, balancing the antitrust laws against other concerns may prove difficult for the FTC.

Indeed, looking at other examples of broadening FTC concern shows that the FTC may seek a creative solution to address nontraditional concerns. For instance, the FTC was recently concerned about minority interests in EQT's $5.2-billion cash-and-stock acquisition of Tug Hill's upstream assets and XcL Midstream's gathering and processing assets. Instead of taking issue with the deal, the agency focused on the deal structure and required divestments before giving the go-ahead.

Finally, the FTC is not just focusing on sizeable deals. The FTC appears to be launching Second Request investigations into smaller deals more than ever, apparently issuing Second Requests whenever there appears to be a vertical or horizontal overlap of almost any size.

The FTC currently has two (of five) vacant Commissioner seats. While those seats will likely soon be filled and will provide more partisan balance in the FTC leadership, we do not expect the current aggressive enforcement to change.

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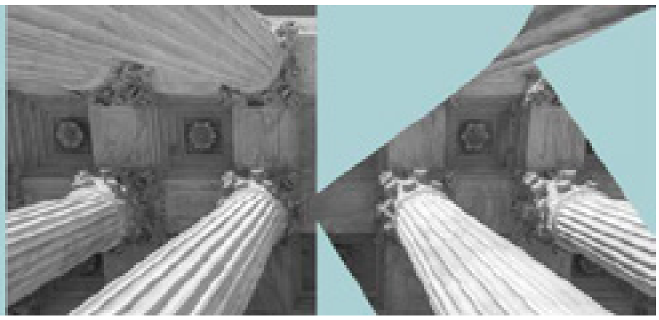

It is unlikely that a future committee chairman will be as sympathetic to oil & gas interests if the Democrats retain Senate control in 2024.

FERC Looks to Fill Seats

By the start of 2024, the Federal Energy Regulatory Commission (FERC) could have two empty seats, having been down a commissioner since early 2023 following the departure of former Chairman Richard Glick, with another vacancy likely when Commissioner James Daly's term expires.

While FERC has generally been able to operate without incident in 2023 despite depleted numbers, the strength of oil & gas interests at FERC has been bolstered by Democrat Joe Manchin sitting at the helm of the Senate Energy and Natural Resources Committee, with authority to confirm commissioner nominees. With the announcement that Sen. Manchin will not seek reelection, it is unlikely that a future committee chairman will be as sympathetic to oil & gas interests if the Democrats retain Senate control in 2024.

Control of FERC, and who is chosen to fill the vacancies, may determine the resolution of one issue that has remained a hot topic for the agency throughout 2023, and which will continue to do so as we enter 2024—how FERC accounts for greenhouse gas (GHG) emissions under the National Environmental Policy Act, in light of the Natural Gas Act "public interest" test.

That issue has been going back and forth for at least five years and is the subject of a case pending on the D.C. Circuit that will attract attention through 2024. At the same time, the Commission also faces questions over its obligation to consider impacts to environmental justice communities when assessing gas projects. New environmental justice guidance is expected in 2024.

In relation to oil & liquids pipelines, FERC's focus has been firmly on ratemaking, issuing landmark orders on cost-based rates and market-based rates for legacy systems like Colonial Pipeline, at a time when historic inflation is colliding with obligations to implement new environmental and pipeline safety regulatory schemes that necessitate squeezing as much as possible out of existing infrastructure.

Inflation resulted in FERC authorizing oil and liquids pipelines charging so-called index rates to increase rates by over 13% in 2023, while simultaneously defending its 2022 decision to lower index rates in federal court. These swings in ratemaking policy are likely to carry over into more pipeline rate litigation in 2024.

Looking Forward

As we step into an election year in which vast differences of opinion exist between party base supporters on oil & gas, the threat of a change in administration could have a chilling effect on M&A in the first part of 2024, and we would expect Chevron and ExxonMobil to try to get their deals cleared by midyear to avoid the threat of politically appealing lawsuits being launched in the run-up to voting.

We should also see a series of new regulations targeting methane emissions from the oil & gas sector. At the outset of COP28, the Biden Administration released the final rule for limiting emissions from new and existing oil & gas production, processing, transport and storage facilities.

Other initiatives include regulations from the Bureau of Land Management (BLM) to address leakage from production on federal lands, as well as a Department of Transportation rule for pipeline leak detection and repair. Finally, in early 2024, the Environmental Protection Agency (EPA) is expected to finalize regulations related to the Inflation Reduction Act's methane fee, which will be the first punitive GHG emissions tax in the U.S.

Proposed changes to the HSR reporting form, aimed at delivering more efficient merger screening within the initial 30-day waiting period, may also be finalized before the end of 2023.

There is also a new set of merger guidelines covering both horizontal and vertical combinations that is pending from the FTC and the Antitrust Division of the Department of Justice (DOJ). The new guidelines describe how the agencies will review transactions in the future. While these guidelines are largely already being followed by the agencies, their formal approval could have a real impact.

Indeed, they carry a presumption that any combination that is going to create a market share in excess of 30% will get an extended review regardless of the number of other competitors.

In relation to FERC, the takeaway for clients is that projects are going to take longer to gather approval, meaning timelines will need to be extended, more money will need to be set aside for public relations and more thought will need to be given to force majeure provisions and longer sunset periods to avoid contracts expiring due to approval delays. In the pipeline space, smaller projects that do not have to be reviewed in the same manner by FERC will likely be prioritized to counter the slowdown.

Finally, on tax policy we do not expect much legislative activity in 2024, given the split in Congress and the fact that the real reckoning on taxes is due in 2025 when the Tax Cuts and Jobs Act (TCJA) expires. To the extent oil & gas companies are dependent on bonus depreciation or interest deductibility, there is a chance that Congress can extend past law this month or early in 2024.

Agency Activity Expected in 2024

Projects are expected to take longer to receive approval.

Pending guidelines for how merger transactions are reviewed.

New methane regulations and grant programs to drive emissions reduction.

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