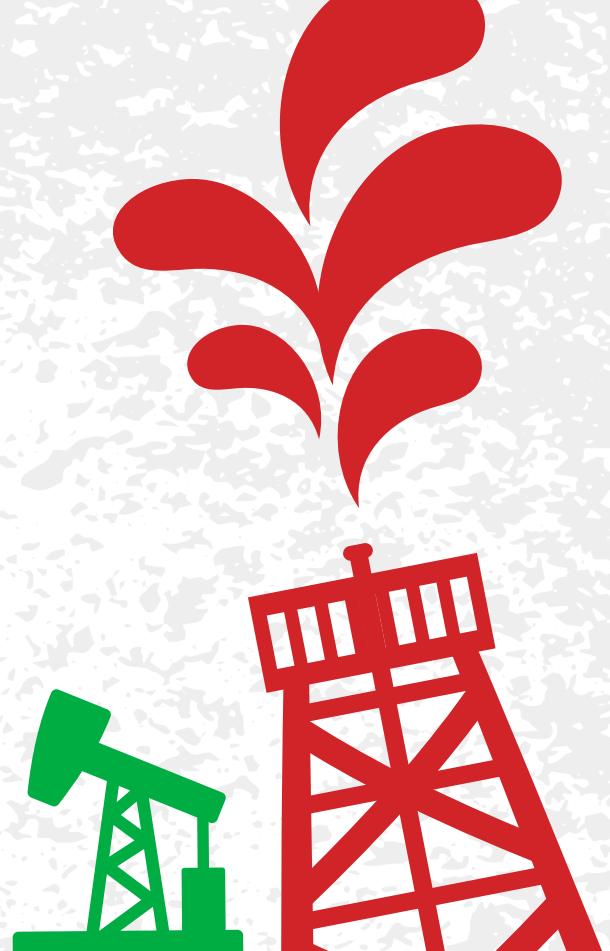




Big Oil's \$100 Billion Bender:

How The U.S. Government Provided a Safety Net for the Flagging Fossil Fuel Industry

By Lukas Ross, Alan Zibel, Dan Wagner, and Chris Kuveke | September 2020



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The U.S. government's efforts to stabilize the financial system at the start of the global pandemic last spring have propped up the fossil fuel industry, which entered the year with heavy debt loads and was slammed by the sharp drop in the price of oil after the pandemic hit.

A tally by Friends of the Earth, Public Citizen, and BailoutWatch has identified nearly \$100 billion in bonds sold by oil and gas companies since the Federal Reserve launched its unprecedented bailouts last March. The Fed's emergency measures have boosted the tattered dirty-energy sector, with companies taking advantage of lowered debt costs and extended loan terms. At the same time, the government's support for individuals and small businesses has been extremely limited.

The bailouts engineered by Treasury Secretary Steven Mnuchin and Fed Chairman Jerome Powell are just the latest example of how corporate-friendly Trump appointees have scrambled to help the fossil fuel industry. The dirty-energy sector has been a key source of support for Republicans as well as a consistent pipeline for Trump administration staffers.¹ Interior Secretary David Bernhardt² is a former lobbyist for fossil fuel companies, agribusiness and other corporate interests. Energy Secretary Dan Brouillette lobbied for Ford Motor Co.³ and served on the board of a Louisiana agency that oversees leasing of state lands to energy companies.⁴ “I’m proud to have been a small part of the incredible success we have seen in American energy,” Brouillette said at his confirmation hearing.⁵ Fossil fuel companies have enjoyed easy access to the Trump administration,⁶ and President Trump himself is an enthusiastic fossil fuel booster who has many friends in the industry. “We will never let the great U.S. Oil & Gas Industry down,” Trump tweeted in April.⁷

Key findings:

- A total of 56 oil and gas companies have issued \$99.3 billion of debt in U.S. markets since the Federal Reserve began its bailout of corporate debt markets in late March. Some said they might fail without the fresh financing.
- The Fed has purchased debt from a total of 19 oil and gas companies. Those companies have sold debt investors more than \$60 billion in new bonds since the Fed's intervention began, representing about 60 percent of energy debt issuance in that period. Of those 19 companies, 12 have received downgrades of their short-term debt, long term debt, credit or default ratings from major credit rating agencies since March.
- Oil and gas companies incorporated in the U.S. have issued \$129 billion in new bonds this year, according to Bloomberg data. This tally is a record for the year to date going back at least a decade. The first three quarters of 2020 represent the highest level of energy debt issuance for that period since at least 2010. This surge in borrowing was fueled by the Fed's promise to purchase large quantities of corporate debt.
- Of the 122 new bond issuances reviewed, 93 will be used at least in part to pay down or refinance a specifically named existing debt such as commercial paper, revolving credit lines, or other bonds. At least 15 companies are issuing new bonds to replace existing bonds that had higher coupon rates.



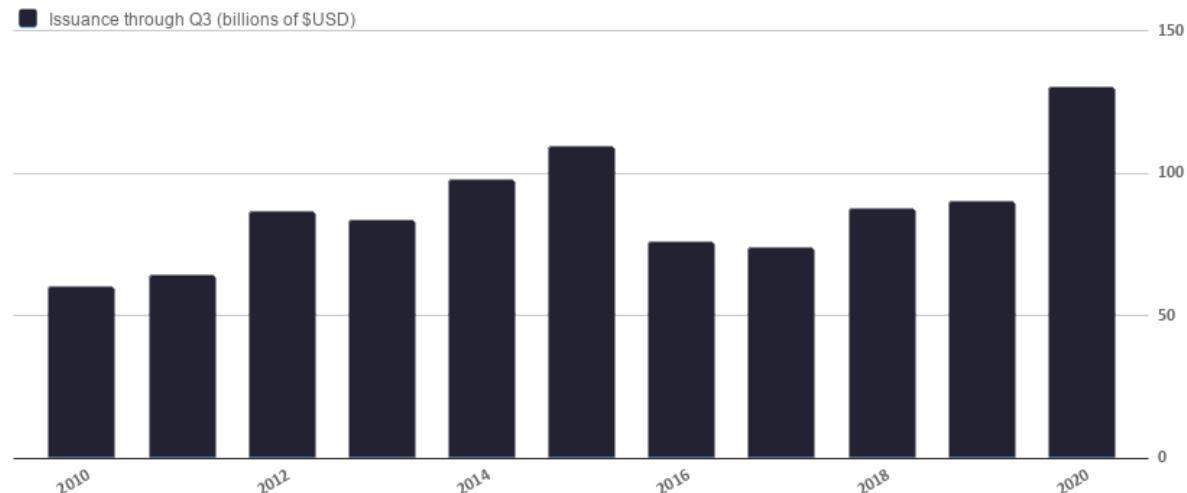
Introduction

One of the most consequential decisions in the history of U.S. economic policy happened on Monday, March 23, 2020. The Federal Reserve, responding to the crisis of COVID-19 and an emerging financial panic, announced⁸ a raft of unprecedented emergency measures to rescue financial markets. These actions would prop up stock and bond markets, but in the process have conferred enormous benefits on Corporate America, especially the struggling oil industry.

In deciding to buy corporate bonds for the first time, the Fed stepped in as a buyer of last resort for companies' risky debt. In the past, the Fed's crisis programs focused on ultra-safe government-backed securities such as Treasury bonds and mortgage debt. The new, broader purchases signaled that the Fed had the backs of corporate debt issuers and investors. The market responded with a surge of cash that pared borrowing costs for corporations. The Fed's historic move calmed markets and helped power a rapid stock market recovery but created aftereffects and distortions that are reverberating through the economy. "It is meaningfully changing the way investors are evaluating the risks for a swath of companies," Kathryn Judge, a law professor at Columbia University, told the *American Prospect*. While the Fed's support benefits large corporations that issue debt, Judge said, small and midsize businesses are struggling without a safety net.⁹

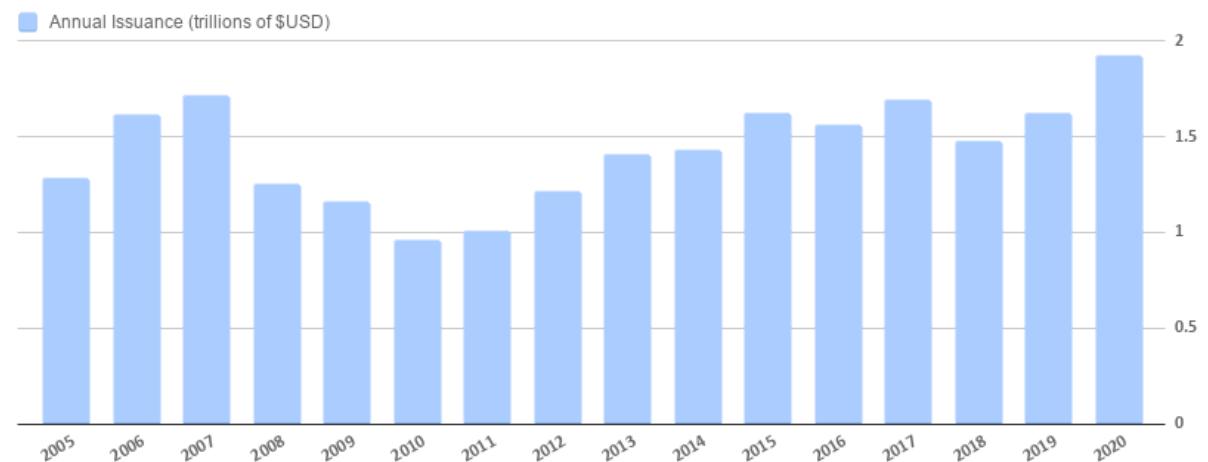
Five days after the Fed announced its bond-buying programs, President Trump signed the Coronavirus Aid, Relief, and Economic Security (CARES) Act into law. The biggest single expenditure in the bill was not for expanding unemployment benefits or even corporate tax cuts: It was \$454 billion in taxpayer funds the Treasury Department could use to absorb losses on the Fed's investments. Trump officials lauded the combined power of

US energy sector corporate bond issuance hits year-to-date record



*All years are through quarter 3 except 2020 which is through September 18.

US corporate bond issuance sets a new record



*All years are through Dec 31 except 2020 which is through Sept 18

Source: Bloomberg L.P.

Treasury funding and Fed borrowing: “We can lever up to \$4 trillion to help everything from small business to big business get through the next 90 to 120 days as we win this war,” Mnuchin said at the time.¹⁰

Months later, Mnuchin’s promises ring hollow as the rescues have mainly benefited corporations and stock market investors. Individuals, small businesses, and municipalities have continued to struggle in dire economic conditions resulting from the global pandemic.¹¹

The Fed programs’ favorable treatment for corporations – especially when compared to municipalities, small businesses, and individuals – faces growing scrutiny on Capitol Hill. Critics note that the Fed has been offering states and municipalities far more restrictive loan terms than what private companies are getting, even though municipal bonds are far less likely to default than corporate debt.¹² As Bharat Ramamurti, a member of the Congressional Oversight Commission examining the bail-outs, recently noted, the Fed purchased a Chevron bond, paying a rate of about 0.9% over four years. By contrast, a state such as Wisconsin, which has the same credit rating as Chevron, has to pay about 1.3% over three years under the Fed’s programs.¹³ “There seems to be no penalty rate for corporations, but there is a significant penalty rate for state and local governments,” Ramamurti said.¹⁴

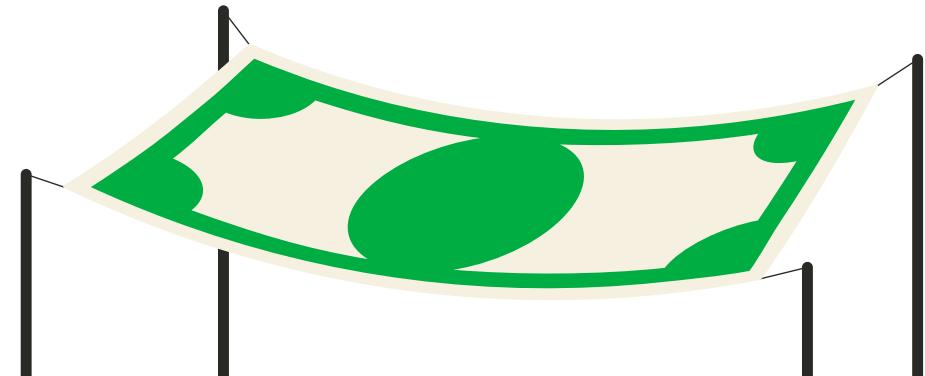
Despite its shortcomings, the Fed’s intervention did provide a safety net for corporate America, ensuring that companies could continue to borrow money and supporting record-breaking rallies by major stock indexes. The result was an immediate surge in bond issuance. According to Fitch Ratings, non-financial companies issued a record \$584 billion in investment-grade bonds from January through May, about 85% of which was issued March through May as the Fed intervened to support the market.¹⁵

The Fed’s unprecedented investments in corporate debt have so far occurred through a program called the Secondary Market Corporate Credit Facility (SMCCF). Treasury transferred \$25 billion for the facility to back \$250 billion in bond purchases by the Fed.¹⁶ This and other programs aimed to flood the debt markets with newly created funding, luring investors back into the market and easing borrowing for corpora-

tions during the crisis. The SMCCF was set up mainly to purchase safer, “investment-grade” debt issued by strong companies – and, in special cases, the riskier, “high-yield” debt often called “junk bonds.”

Even before the Fed started buying up corporate bonds, the mere promise that it would do so enabled companies to tap debt markets.¹⁷ Boeing Corp. sold \$25 billion worth of bonds in late April and said it did not intend to seek direct aid from the government, a milestone for bond markets.¹⁸ Oracle Corp. raised \$20 billion through a debt sale, Disney raised \$11 billion, and ExxonMobil raised \$9.5 billion.¹⁹ By the end of August, U.S. corporate debt issuance for the year to date had already edged above the record \$1.9 trillion raised in the entire year of 2017.²⁰

The Fed’s decision to buy risky corporate debt has drawn outrage as the depth of the pandemic-induced recession becomes clear. Early critics included Sarah Bloom Raskin, a former top Fed and Treasury official, and former top bank regulator Eugene Ludwig, who wrote in May that the program effectively protects wealthy investors from losses, offering them “all the upside that comes with a junk bond, but none of the risk that, before now, made it, well, junk.”²¹



In a July letter to the Fed, Americans for Financial Reform raised questions about whether the Fed is violating its ban on lending to insolvent companies when it buys bonds issued by troubled oil companies and failing companies owned by private equity firms.²² The Center for American Progress argued that “these highly leveraged, financially troubled firms should go through the traditional bankruptcy process – not receive a government lifeline. The bankruptcy process separates firms that are viable from those that are not.”²³ Some conservatives have also worried about the implications. The libertarian Cato Institute’s James Dorn wrote that the interventions “risk giving the Fed a permanent footprint in private credit markets.”²⁴

An analysis by Friends of the Earth, Public Citizen, and BailoutWatch sheds new light on how forcefully the Fed’s lending surge has affected the oil and gas sector. The industry, heavily indebted and struggling²⁵ long before the coronavirus, is now benefitting substantially from the central bank’s bailout of the corporate debt markets. An analysis of SEC filings and market data reveals troubled companies, some on the brink of insolvency, exploiting the federal response to COVID-19 to secure a lifeline. Weakened by plunging oil prices and a global supply glut, these companies are taking full advantage of the easy money afforded by the Fed’s intervention, issuing nearly \$100 billion in new bonds since March. The borrowing includes a wave of refinancing often resulting in later payment deadlines, substantially lower borrowing costs, or both. In effect, the Fed is forestalling the demise of an industry that has always relied on government largesse.²⁶

“An analysis of SEC filings and market data reveals troubled companies, some on the brink of insolvency, exploiting the federal response to COVID-19 to secure a lifeline.”

Crisis Upon Crisis For Big Oil

Before this spring's oil price war between Russia and Saudi Arabia²⁷ and the collapse in global demand sent the price of oil below zero in April, the oil and gas industry showed unmistakable signs of decline. Battered by persistently low commodity prices and competition with lower-cost renewable energy sources, these companies have long faced rising debt, sinking profits, and the reality that global oil demand may have passed its peak.²⁸

Five large, vertically integrated international oil giants including Shell, Chevron, and ExxonMobil spent \$216 billion more on shareholder payouts through dividends and stock buybacks over the last decade than they raised in revenue, effectively running deficits.²⁹ Struggling to adjust to a low-carbon future, these supermajors have staked their future growth on aggressive expansions into plastics and other petrochemicals, a dubious economic lifeline based on demand forecasts. These investments bring their own considerable set of environmental risks.³⁰

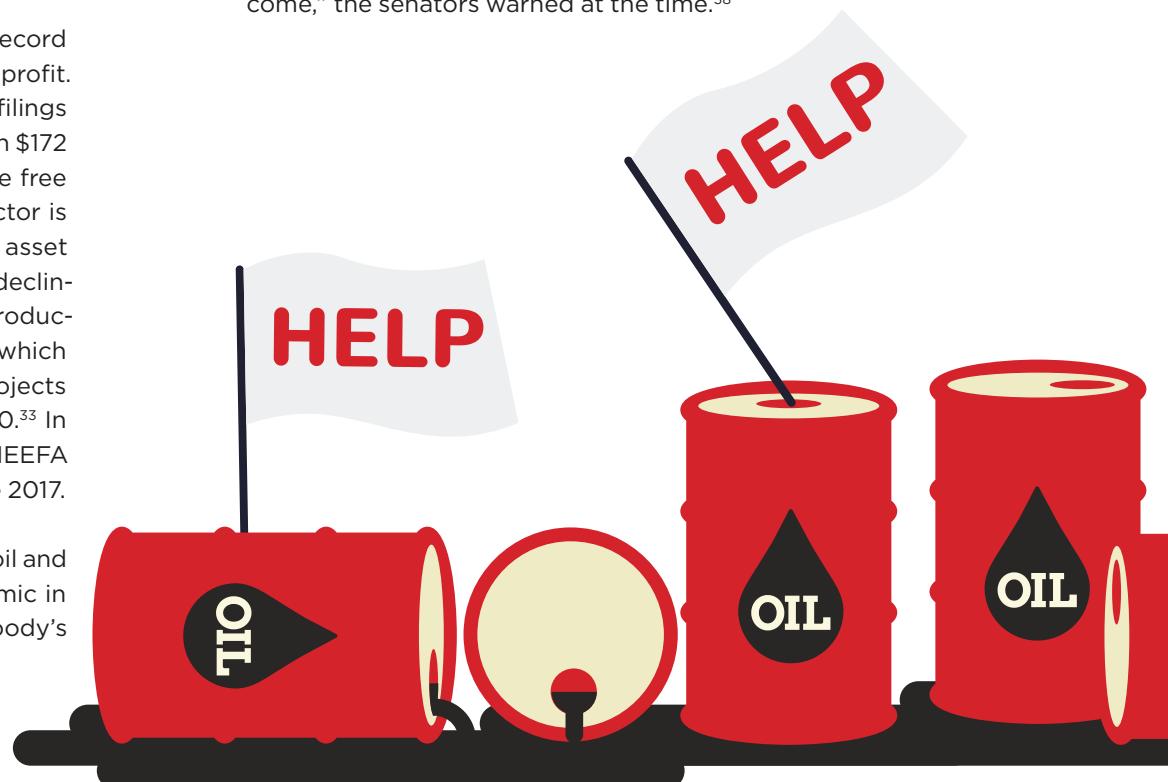
The domestic shale industry's position is even more precarious. Record growth in oil and gas production has largely failed to translate into profit. The law firm Haynes and Boone LLP has tracked 244 bankruptcy filings by oil and gas producers in the past five years, involving more than \$172 billion in debt.³¹ Deloitte found that the sector has seen negative free cash flow of \$300 billion since 2010, and at least 30% of the sector is "technically insolvent," with liabilities including debt exceeding asset values.³² The industry continues to struggle with low prices and declining sales, according to an analysis of 34 North American shale producers by the Institute for Energy Economics and Financial Analysis, which found that those producers' spending on drilling and capital projects exceeded revenues by \$3.3 billion in the second quarter of 2020.³³ In an especially ominous sign, the fracking companies analyzed by IEEFA have spent \$29 billion more than their operating cash flows since 2017.

By the beginning of 2020, these weak fundamentals weighed on oil and gas — unlike the rest of the economy, which entered the pandemic in good economic health. In February, the credit rating agency Moody's

forecast a higher risk of default and more difficulty borrowing for the oil industry. Drillers faced a "staggering" \$86 billion in debt coming due in the four years ahead, and 62% of it was rated as junk.³⁴

Then came COVID-19. Due to the coronavirus crisis and worldwide lockdowns, energy demand plummeted, and many smaller oil companies, especially domestic firms that rely on fracking, faced severe struggles. Colorado-based Whiting Petroleum filed for Chapter 11 bankruptcy protection in early April.³⁵ Chesapeake, an early fracking pioneer, followed suit in June.³⁶

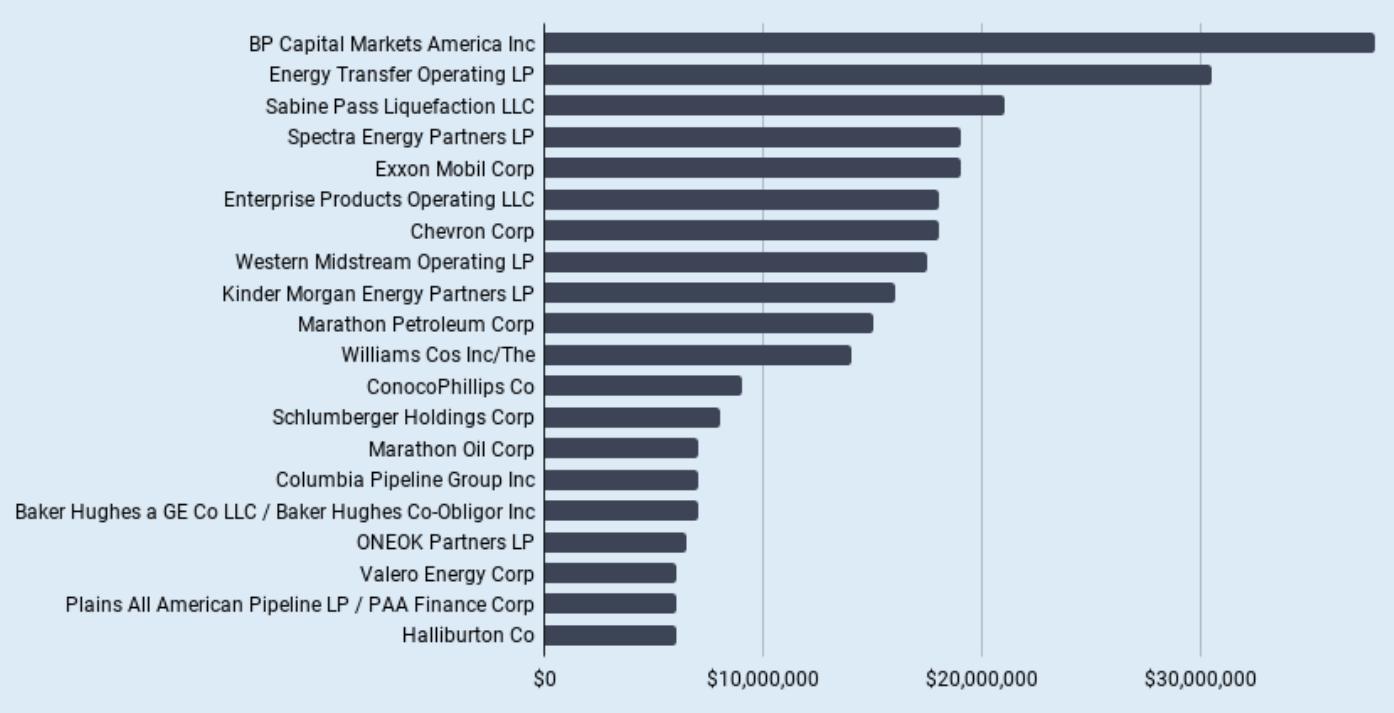
Industry-friendly lawmakers flew to the companies' aid. U.S. Sen. Ted Cruz, R-Texas, and 10 Republican colleagues pleaded for help in an April 22 letter³⁷ to Mnuchin and Powell, pushing the central bank to loosen a restriction that made it difficult for companies whose debt was recently downgraded, including Occidental Petroleum, to access Fed assistance. "We face a real and present danger of seeing hundreds, if not thousands of oil producers shuttering, an event that will profoundly and negatively impact the industry, its financial partners and consumers for years to come," the senators warned at the time.³⁸



Anatomy of a Lifeline

The Fed has injected money into the corporate bond market through the SMCCF with purchases of already-issued bonds and exchange-traded funds, which are broad baskets of stocks or bonds that trade on public markets. At the end of August, the Fed held \$355.5 million in fossil fuel bonds, an increase of \$40 million from the prior month, accounting for 9.4% of the \$3.8 billion portfolio. The SMCCF holds bonds issued by more than 40 fossil fuel companies, including giants like ExxonMobil and BP, frackers like Apache and Continental, and pipeline companies like Enterprise Products and Williams. The Fed also has purchased \$1.1 billion of seven high-yield exchange-traded funds, which contain riskier corporate debt investments, including some issued by oil and gas companies. For example, the Fed owns about \$555 million of the SPDR Bloomberg Barclays High Yield Bond ETF, about 11% of which is invested in corporate energy bonds.³⁹ Additionally the Fed has purchased more than \$8 billion in investment-grade exchange-traded fund holdings, which also contain energy company debt.

Top Issuers of Energy Bonds Purchased By Federal Reserve



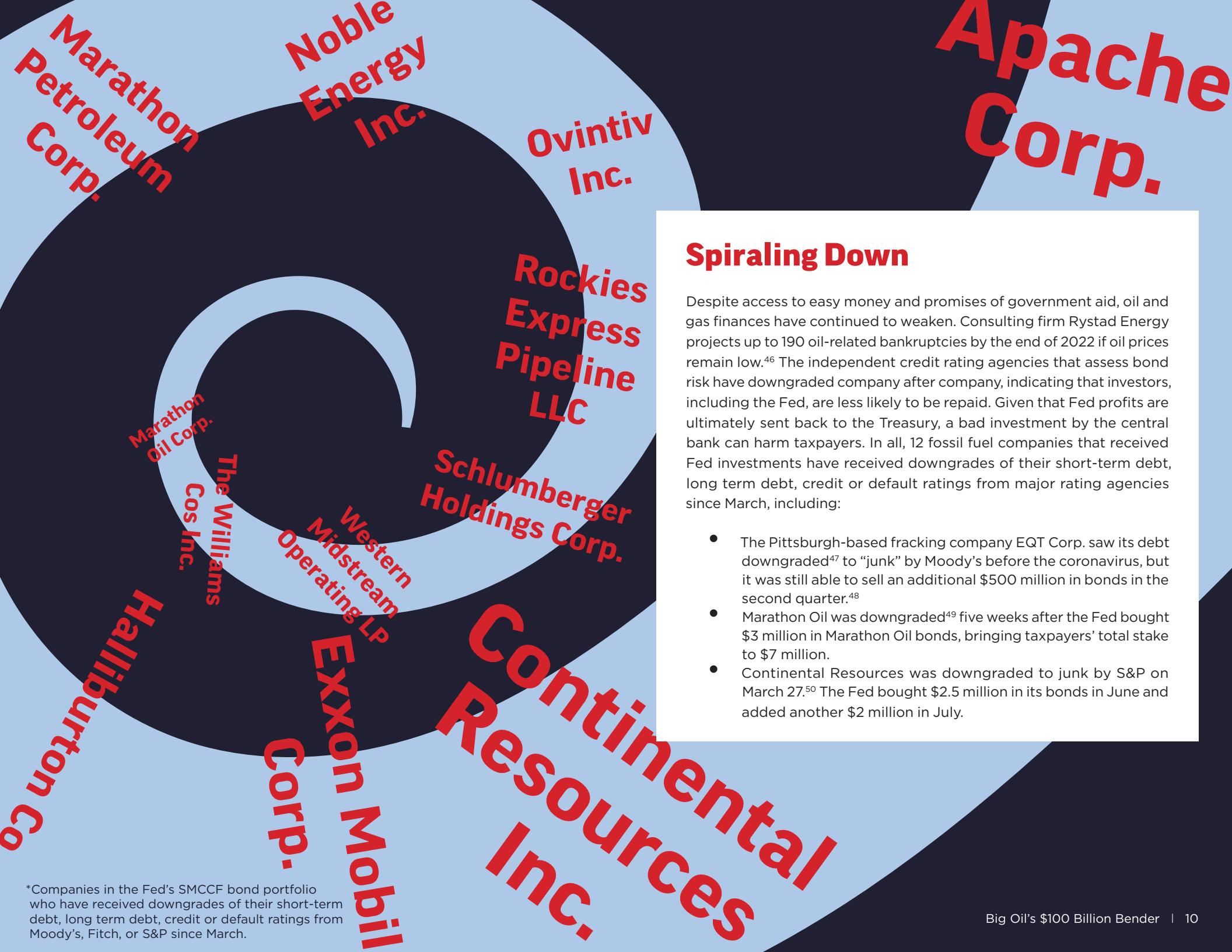
These interventions have put a floor under the debt markets so successfully that no companies have had to tap a separate Fed program designed to help companies issue new bonds. "Those that can get out into the bond market are doing it. It secures liquidity, but it also demonstrates that they have access to funding," Brendon Moran, a senior energy banker at Société Générale, told the *Financial Times* in early April.⁴⁰

Among companies with a share of the \$100 billion in new oil and gas debt, some have benefited more than others. For example, ExxonMobil issued 10-year notes in March, days before the Fed's announcement, and again in April. The later issuance cut Exxon's borrowing rate by 0.9 of a percentage point, likely resulting in tens of millions in savings.⁴¹ At least seven pipeline companies, including Williams and Plains All American, similarly have been able to refinance at lower rates.

Some companies might not have survived had the Fed failed to restore market liquidity. If its proposed financing was not successful, oilfield service company Forum Energy Technologies told investors in July, "the Company will need to consider other restructuring alternatives, including bankruptcy."⁴² Martin Midstream, a gas pipeline operator, raised nearly \$400 million as part of a debt restructuring designed to avoid seeking bankruptcy protection.⁴³ Two weeks later, it awarded three top executives "retention bonuses" of \$100,000 each.⁴⁴

Others have paid a steeper price for lifelines from the bond market. Drillers like Occidental, Range Resources, and SM Energy have all swapped out debt that was about to come due for longer-term debt at higher interest rates. While some companies have certainly benefited, the sector as a whole has nevertheless been wracked with bankruptcies involving \$50 billion in debt so far in 2020.⁴⁵ Even with the substantial back-stopping of corporate debt markets from the Fed, there is no denying that many companies are going bust.

Source: Par value of energy bonds purchased by SMCCF as disclosed by Fed on 9/8.



*Companies in the Fed's SMCCF bond portfolio who have received downgrades of their short-term debt, long term debt, credit or default ratings from Moody's, Fitch, or S&P since March.

Conclusion

“Climate change is a tragedy of the horizon which imposes a cost on future generations that the current one has no direct incentive to fix. The catastrophic impacts of climate change will be felt beyond the traditional horizons of most actors. Once climate change becomes a clear and present danger to financial stability, it may already be too late.”

-Mark Carney, former Bank of England Governor⁵¹

The Fed's actions have exacerbated the already dire threats of climate change by prolonging the ability of oil and gas companies to borrow money at lower rates than investors were willing to offer before the pandemic. Besides the costs associated with direct emissions, climate change poses broad risks to financial stability.⁵² Events such as wildfires, flooding, and other natural disasters are already having an impact on real estate values and businesses. The 2019 bankruptcy filing of California utility PG&E Corp. after massive losses from wildfires was widely labeled the first climate change bankruptcy. "Few people expect it will be the last," *The Wall Street Journal* wrote at the time.⁵³ Prominent investors and real estate experts⁵⁴ are already taking stock of the future impact of climate change on the housing and insurance sectors.⁵⁵ If losses from a climate-related disaster cause an insurance company to fail, it could have dire ripple effects through the deeply interconnected global financial system.⁵⁶ And eventually, the so-called "carbon bubble" – the valuation of fossil fuel assets – will burst, causing a price shock throughout the financial system.⁵⁷

The Federal Reserve has a broad mandate to promote employment and price stability, but the central bank and other financial regulators have historically eschewed the idea that these mandates can include climate policy. Regulators do not require banks to assess climate change in their risk management analysis, dismissing such risks as too distant in the future.⁵⁸ Doing so seriously understates the mounting risks resulting from climate change and allows banks to finance oil and gas drilling, despite the risks to the planet and financial system. Ironically, under the guise of providing emergency economic stability to confront the global pandemic, the Fed is creating a greater risk for humanity and eventually, financial markets.

Even setting aside the Fed's responsibility to evaluate how the climate crisis will affect the economy and financial system, it certainly should avoid purchasing the debt of companies on the brink of failure. As Raskin, the former Fed official, wrote in *The New York Times*, the Fed's decision to buy energy bonds "sends a false price signal to investors about where capital needs to be allocated. It increases the likelihood that investors will be stuck with stranded oil and gas assets that society no longer needs. It also forestalls the inevitable decline of an industry that can no longer sustain itself."⁵⁹

This year's devastating wildfires and hurricanes should be a reality check for the Federal Reserve and other regulators: Helping to mitigate these risks should remain a core component of Fed policy.⁶⁰ Yet the Fed has been far slower than other central banks, especially the Bank of England, in recognizing the importance of climate change to financial regulation.⁶¹ In 2017, eight global central banks established the Network for Greening the Financial System to consider ways to incorporate climate change risks into their functions. The U.S. has yet to join this group, with Chairman Powell saying, "we probably will do that at some point."⁶² Ignoring the existential threat of climate change is not an option. As the implementation of coronavirus aid continues, urgent reforms to its existing emergency programs are needed.



Policy recommendations:

- The Fed's SMCCF must exclude bonds from oil and gas companies and fossil-heavy utilities.
- The Fed must begin selling off the fossil fuel bonds already accumulated on its balance sheet, as opposed to holding them to maturity as currently planned.
- The Fed must modify the other existing stimulus programs, including the Main Street Lending Program and the Primary Market Corporate Credit Facility, to eliminate or heavily condition aid to fossil fuel companies.
- The Fed must immediately join the Network for Greening the Financial System, measure banks' vulnerability to climate risks, and work with all federal financial regulators to incorporate climate risk into the supervision of banks and other financial companies.
- Congress must exclude further aid to the fossil fuel industry from any future coronavirus relief packages.

Methodology

This analysis includes all bonds issued by oil and gas companies since the Federal Reserve's announcement on March 23. Oil and gas companies were selected using the Bloomberg Industry Classification System; classifications included are Exploration & Production, Integrated Oils, Oil & Gas Services and Equipment, Pipeline, and Refining and Marketing. Additional data were drawn from SEC filings, corporate press releases, and rating actions by major agencies. The downgrades associated with companies benefitting from the SMCCF encompass all companies who have received downgrades of their short-term debt, long term debt, credit or default ratings since March. The full list of bonds, their coupons, maturities, and intended uses of proceeds, is available with hyperlinks to the original sources [here](#).⁶³



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