

2017 Energy Investment Roundtable

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Back to the Future: The Impact of Regulatory Changes on Energy Investment Opportunities

Speakers

Robert Seber, Partner, Vinson & Elkins LLP.

Paul Perea, Managing Director, Co-Head of M&A Investment Banking, Tudor, Pickering, Holt & Co.

Stephen Richardson, Senior Managing Director, Head of Oil and Gas, Exploration and Production Research, Evercore ISI.

Richard Kauffman, Chairman of Energy and Finance for New York.

Moderator

Greg Radner, Chief Marketing Officer, RANE

The energy sector's recovery from a historic decline in oil prices in 2016 has driven renewed interest in the industry's investment opportunities. Further fueling this interest is rising demand and advances in technology that are yielding significant cost reduction in the way oil and gas are developed and produced.

In a volatile industry already subject to multiple supply and demand factors, what will be the implications of the new U.S. administration's proposed regulatory changes? Most business leaders expect a dramatic rollback in regulations impacting arctic and offshore exploration, oil and gas drilling and coal mining on Federal lands, pipelines, power plants, trade, and international climate change initiatives. How would these changes impact investment opportunities in the oil and gas industry, which only recently emerged from a cycle of oversupply? And what is the fate of future investments in renewable energy?

At a recent RANE roundtable in New York City, presented in partnership with Vinson & Elkins LLP, a panel of energy investors, analysts, regulators and leading experts discussed investment opportunities and associated risks in the rapidly changing energy sector. Key takeaways from the discussion follow.

A New Era for Energy? First Impressions and Long-Term Expectations

- **Robert Seber** pointed out a number of factors that need to be taken into account when forecasting the future of energy under the new administration. “In the short-term, the industry is much more influenced by geopolitical factors than it is by policy. The reason why so many long-term energy forecasts have turned out to be fundamentally wrong is because they underestimated the impact of future technological innovation. In making such predictions, I would argue for the pragmatic view that appreciates the geopolitical factors, market forces, and technological changes that influence the industry much more so than the policy forces.”
- **Paul Perea** said that while we can expect to see some *changes*, they may not be as all-encompassing as some forecasts are saying. “We believe CEO sentiment is a key driver of activity in our space—and that sentiment is very good right now. There are two drivers of the current CEO sentiment: One, a belief that the OPEC accord will hold, and two, a sense that the Trump Administration will be generally positive for the industry. So, unless there is some kind of change in either of these two areas, I would say the industry feels as though it is headed in a rather positive direction.”
- **Stephen Richardson** added to Perea’s comments on CEO sentiment, saying that although CEOs are optimistic under the new administration, they are not really able to say why. “When I ask CEOs if they can tell me something specific about their business that will change in the next six months, they don’t seem to have a tangible answer at their fingertips. It just ‘feels like a better operating environment.’”
- **Richard Kauffman** agreed with Seber, saying that the power of the market should not go overlooked when looking at the key influencers of industry activity. “The biggest impact has probably come from fracking and the impact of lower natural gas prices, which effectively shut down a number of coal plants, proving that it is not so much regulations, but more so about the market and market prices.”

“We believe CEO sentiment is a key driver of activity in our space—and that sentiment is very good right now,” said Paul Perea.

The Impact of Regulations & Tax Reform

- Though there has been a fair amount of discussion in the nation’s capital of a Border Adjustment Tax (BAT), **Seber** said the probability of such a radical change actually being implemented is very low. “To implement the BAT, and do so in a revenue neutral way, there needs to be an offset—and there isn’t one. If it were to go through, and if it were to capture crude oil, it would have a fundamental structural impact on the industry. However, based on the current proposal, as far as I can tell, there has not been as much coming out of the administration that would indicate that they want to make this a priority.”

- **Perea** agreed with Seber, saying that “if the BAT went through, and if it were applied to crude oil, it could be a real negative for US refiners.” However, Perea noted that there are “lots of other levers in the BAT plan that are potentially offsetting factors for both the upstream and downstream.”
- In the face of possible regulations or reforms, **Richardson** noted industry executives’ ability to act pro-cyclically, adjust their cost structures, and work with flexibility – just as they did in a \$30 a barrel market.
- **Richardson** also echoed Seber’s comments on the debatable impact of policy, referencing past EPA regulations on capturing methane from the industry. “Yes, it was a serious regulation, but no producer really changed the way in which he/she was developing a gas reservoir, nor did it really impose much of a cost on the industry overall. I don’t want to say that there are no really relevant impacts here, but generally speaking—it is good to be a producer of oil and gas in North America right now.”

“When the Obama Administration came into office, it was not known for being a friend of the oil and gas industry,” said Robert Seber. “Yet, it was during that administration that the country came to reach the highest level of oil and gas production ever.”

Environmental Policy and State vs. Federal Power

- According to **Perea**, environmental policy may be one area in which the Trump Administration could effectuate more immediate change, relative to tax and other reforms requiring congressional action. “Just based on the way the government is structured, this is an area where things can be done quite quickly at the administrative level, through the executive order, and so forth. Given Scott Pruitt’s appointment [as head of EPA], we can expect to see a shift.”
- **Kauffman** noted that states have played a huge role in terms of enacting their own environmental policies. “The Supreme Court has held that states have an authority to implement environmental policy—even if affects prices of wholesale power markets, for example.”
- **Seber** added that there will likely be an increase in the amount of influence that states hold over energy and environment-related policy concerns. “The question is, ‘Will the Republican Administration object to it?’ If you take them by their word, then the answer is no. This administration, and the party as a whole, is all about giving power back to the states, so we will probably see a continuation of this already ongoing trend.”
- As for Trump’s campaign promise to grow jobs in the coal sector, the panelists agreed that revival of the industry seems almost impossible. “If there was a war on coal, it was not fought by the government; natural gas prices are the enemy here, and that is not going to change,” said Seber.

Assessing Tomorrow's "Energy Mix:" A Focus on Renewables

- According to **Kauffman**, it is not as simple as "the blue states are pursuing energy and the red states are not." While it is true that a number of senior energy executives or government officials from red states do not want to discuss climate change, Kauffman said that they are more than happy to discuss renewable energy. "Even the states which are not originally "climate-focused" sort of end up becoming "climate-focused" simply because they have overlapping policies on things like energy efficiency, wind, and so forth."
- **Seber** said that when it comes to federal regulatory oversight, it is important to remember that the government holds significant land responsibilities. On the topic of environmental policy, pipelines, coal, and the like, he pointed out, it should be noted that 28 percent of all land in the US is owned by the federal government, and 42 percent of all coal in the country is produced on federal land.
- "From an investment perspective, the market took this election as though it would be negative for renewables," said **Richardson**. In spite of that, he expects renewables to pick up. "I do think global oil demand growth will reach a peak within the next five years. Despite conversations about climate, I think renewables is just an area that people will continue to be interested in and continue to put money towards."
- **Richardson** also noted that 2016 was the first year in the history of the US in which renewable new starts were bigger than coal plant retirements.
- **Seber** said that in order to assess what the broader energy mix will look like 10 years from now, it is important to reflect on what it was 10 years ago. "Comparing the US's sources of energy today to those from 10 years ago, we find that: Oil is about the same share. Today's falls somewhere around 36 percent, while 10 years ago it was around 38. Nuclear is also about the same today as it was ten years ago. The only area where we have seen real change has been in coal. Ten years ago, coal was around three percent. Today, that number is closer to 16 percent. Looking 10 years out from today, I would suspect the coal to gas shift will continue, but then plateau at a fairly low point. Renewables will increase, but not dramatically, nuclear will be about the same as it is now, but could see a slight decline, and I think oil will more or less remain the same."

"Despite conversations about climate, I think renewables is just an area that people will continue to be interested in and continue to put money towards," said Stephen Richardson.

2017 Investment Outlook on Energy

- **Seber** reminded investors of the industry's experience with the Obama Administration. "When the Obama Administration came into office, and on its

way out, it was not known for being a friend of the oil and gas industry. Yet, it was during that administration that the country came to reach the highest level of oil and gas production ever, and that the export ban on oil was lifted. The point is, there is room for surprises—and those surprises usually come out of the market and out of Washington.”

- **Perea** echoed Seber’s comment on the potential for surprises in 2017, using last year as an example. “2016 started off incredibly slowly, with a lot of angst in the system, but mid-year things just flipped. As far as the dollar value of energy M&A goes for North America, 2016 ended up being a record year.”
- **Richardson** said not to underestimate the amount and significance of natural gas production in the continental United States. “We don’t have a world class oil reservoir in the lower 48, we have world class gas reservoirs in here in the US. The industry’s ability to deliver massive amounts of this particular commodity in a relatively short period of time is unprecedented, and will probably just continue to get better.”
- Finally, **Richardson** noted that when it comes to shale and other unconventional resources, there is a lot of room for technology improvements. “There’s clearly been a gap, so I think there’s a need and an opportunity to apply better technology, especially on the data side, that could be used across the entire upstream.”

“Fracking and lower natural gas prices, which effectively shut down a number of coal plants, have proved that it is not so much regulations, but the market” which drive industry activity, Richard Kauffman pointed out.

About the Speakers

Robert Seber, Partner, Vinson & Elkins LLP.

As a Partner at Vinson & Elkins LLP, Robert Seber’s principal areas of practice are private equity and privately negotiated mergers and acquisitions. Seber has represented numerous investment funds and corporate clients in different sectors of the energy industry and a wide spectrum of other industries, including technology and financial services. His extensive private equity experience covers the full transactional cycle of investment funds, ranging from fund formation to acquisitions, recapitalizations, minority investments, complex equity arrangements, and exits. Seber also teaches classes on “Oil and Gas Law and Governance” and “Energy Deals” at New York University.

Paul Perea, Managing Director, Co-Head of M&A Investment Banking, Tudor, Pickering, Holt & Co.

Before joining Tudor, Pickering, Holt & Co., Paul Perea was a partner at Baker Botts LLP, where he spent over 15 years advising clients and their boards of directors on mergers and acquisitions, joint ventures, proxy contests and capital markets transactions in the energy space. Perea holds a BA in Government with high honors from The University of Texas at Austin and a JD from Vanderbilt University School of Law, where he served on the Law Review.

Stephen Richardson, Senior Managing Director, Head of Oil and Gas, Exploration and Production Research, Evercore ISI.

Stephen Richardson ranked #3 on the 2014 Institutional Investor's All America Research Team for Oil and Gas Exploration and Production, and has been ranked for the last two years. Prior to joining Evercore ISI, he was at Deutsche Bank. In addition, Richardson has held positions at Morgan Stanley and Bombardier. Richardson is a graduate of McGill University and holds an MBA from École des Hautes Études Commerciales.

Richard Kauffman, Chairman of Energy and Finance for New York.

Richard Kauffman joined the administration of Governor Andrew M. Cuomo as New York State's first "energy czar" in February 2013. Kauffman oversees and manages New York State's entire energy portfolio, including the New York State Department of Public Service, the New York Power Authority, the Long Island Power Authority, and the New York State Energy Research and Development Authority (NYSERDA). He was appointed chair of NYSEDA's Board on June 19, 2013, and also leads New York State's comprehensive Reforming the Energy Vision (REV) initiative.

ABOUT VINSON & ELKINS LLP

Vinson & Elkins' New York office provides high-quality legal services to an array of blue-chip clients, including leading private equity firms, investment banks, and other financial institutions, as well as public and privately held companies in such areas as energy, infrastructure, media and entertainment, and pharmaceuticals. The Lawyers in V&E's New York office focus on capital markets and securities, private equity, mergers and acquisitions, commercial litigation, securities litigation, intellectual property, finance, tax, and restructurings.

ABOUT RANE

RANE (Risk Assistance Network + Exchange) is an information and advisory services company that connects business leaders to critical risk insights and expertise, enabling risk and security professionals to more efficiently address their most pressing challenges and drive better risk management outcomes. RANE clients receive access to a global network of credentialed risk experts, curated network intelligence, risk news monitoring, in-house analysts and subject matter experts, and collaborative knowledge-sharing events.