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PXD/XOM, HES/CVX: Second requests likely, but deals seen clear of major obstacles

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The US Federal Trade Commission's upcoming reviews of Pioneer/Exxon and Hess/Chevron are likely to draw lengthy second requests, but the theories of harm presented and the likelihood of an eventual lawsuit being issued by the FTC were questioned by several consultants, industry participants and antitrust attorneys interviewed by *CTFN*.

Jeffrey Oliver, a partner at Baker Botts, said the FTC has traditionally not found antitrust problems when reviewing deals involving exploration and production (E&P) of oil and gas.

Chevron's acquisition this year of PDC Energy, which did not even receive a second request, stands as a recent example, *CTFN* notes.

Oliver explained that typically it is difficult for the agency "to make an argument that these deals are anticompetitive, because it is a crowded, fractured, competitive environment for crude oil these days". US crude tends to compete with crude from all over the world, he noted.

Even so, Oliver said, there is "a long tradition of looking very closely at oil and gas deals" since energy is vital to the broader economy. He noted that the FTC brought an enforcement action last year against an upstream-production deal, EP Energy/EnCap. That case involved "a very specific circumstance in which there was a particular type of crude" the agency was concerned about, he said, in reference to the settlement in the deal.

Hess/Chevron and Pioneer/Exxon are certainly "going to get some scrutiny", and "no one will be super surprised if they draw a longer review", Oliver said.

As per the Pioneer/Exxon merger agreement, the parties had until November 7 to file HSR, which is anticipated to expire on December 7 and the proxy statement shall be filed by November 24. Hess/Chevron had to file HSR by November 3, which would give the agencies until December 3 to come up with a decision on a second, unless the parties pull and refile.

Oliver suggested that issues the FTC would likely investigate in its review of each deal would center around whether refineries believe their supply or the price they pay for crude could be affected. "If they've been benefiting from Exxon competing with Pioneer to some degree in crude," he said, then the refineries might contact the FTC, or the agency would call them.

The interplay of pipelines with refineries makes the analysis "a little more complicated", Oliver added.

A second attorney with significant industry experience said that in the end he does not see a specific case that could be brought against either deal, but he still cautioned that the FTC will examine both closely. The reviews will parse every layer of the companies' supply chains, he said, and every vertical relationship will be examined.

One angle for inquiry could involve the impact on landholders. In essence, those seeking to sell their land to E&P companies could have fewer potential buyers in the Permian, at least theoretically, with the combination.

Art Berman, a petroleum geologist at Labyrinth Consultants, pointed out that Exxon operates more in the western Delaware basin of the Permian, where Pioneer CEO Scott Scheffield has been reluctant to seek plays, focusing instead on the Midland basin, which might mitigate such concerns.

In terms of process, the second attorney suggested the companies should hope to comply with their second requests and certify as quickly as possible, given the likelihood of increasing pain at the pump and the hotting up of next year's presidential election.

The two mergers will be reviewed by staff in the Bureau of Compeititon's Mergers III unit, under FTC veteran Peter Richman. Richman was described to *CTFN* as a professional and competent attorney who plays it down the middle of the fairway, but with the litigation background and ability to win cases. Staff at the FTC will take the review in whatever direction the front office calls for, the second attorney added.

Political risk

A November 1 letter to FTC chair Lina Khan from 23 US senators called for action on Pioneer/Exxon and Hess/Chevron, detailing various theories of harm that the agency could explore during its investigations.

Such political pressure, according to the second attorney, is impetus enough to open a second request. With two ongoing wars that may drive up prices at the pump, he said, the Biden administration and the FTC could feel they must show they are trying to mitigate cost, despite an empirical disconnect between mergers of this nature and the prices paid by consumers.

Worryingly for Pioneer/Exxon and Hess/Chevron, the senators said the Mobil/Exxon merger of 1999 and the Texaco/Chevron merger of 2001 should not have been approved — and should be investigated anew — as they harmed consumers. The letter cited a GAO study from 2007, which concluded that an increase in consumers' gasoline prices was the result of E&P mergers.

The supermajors' further integration of their "extensive operations into important oil-and-gas fields", according to the letter, will harm competition, risk increasing consumer prices and reduce output.

Calling out the vertical-integration angle, the senators suggested that competing E&Ps could find it difficult to operate without access to Exxon's and Chevron's "networks" after the mergers, which the letter said would create "new abilities and incentives" to engage in anti-competitive tactics.

Ownership of midstream assets — storage, refining and transportation — were noted in the letter, with the suggestion that the supermajors could "redirect Pioneer's and Hess's crude supply to themselves" to the detriment of their midstream competitors.

The senators also highlighted the potential impact, particularly of Pioneer/Exxon, on the labor market for geologists and engineers. The second attorney envisioned a labor component to the review, or at least a deep investigation into that aspect of Pioneer/Exxon, where both operators are active in the Permian.

Call for calm

Despite the number of issues the FTC could examine, voices with experience in the industry counseled for optimism on both deals.

The senators specifically called out potential harm to the midstream segment of the market — those that run pipelines that connect wells with refiners. However, *CTFN* spoke with a representative from Plains All American who offered a view of the transaction different from other voices within the Beltway.

Plains has a strong relationship with both Exxon and Pioneer, and it sees the consolidation as a potential positive for its business, the Plains All American representative said.

In his view, the combined entities could produce higher volumes than the two entities on a standalone basis. If Exxon were successful at enhancing recovery rates in the Permian, these improved drilling and completion techniques along with technological advancements could have others following their lead, resulting in higher production volumes for the basin as a whole.

These volumes would benefit midstream companies like Plains that have capacity to move incremental Permian volumes to market.

Further, supermajors like Exxon and Chevron are strong counterparties given their better credit ratings and ability to drill throughout commodity cycles. Smaller producers tend to react more to pricing signals, leading to more volatility in production trends. Supermajors take a longer-term approach to developing resources and should ultimately lead to a more stable production profile from the basin over time, benefiting operators of long-term midstream infrastructure.

Specifically referring to Pioneer/Exxon, Hinds Howard, an investor in energy, infrastructure and transportation at CBRE Investment Management, said it is difficult to see “an issue of losing bargaining power” for midstream players.

“There are contracts in place with both companies, and over time as those contracts roll, there will be healthy competition across the major midstream players to provide services, whether it’s processing [or] transportation of gas, oil and [natural-gas liquids],” Howard said.

He added that the consolidation trend exists in the midstream segment as well, such that there are only three or four players capable of servicing the large producers in the Permian. A second consultant in the sector said the midstream segment has more players in the US than in many other geographies, and more investment capital available, potentially reducing barriers to entry.

Pipelines are a constraint for Permian oil, Berman said. There are two “sensible” places for Permian production to flow, he said: Corpus Christi which is near capacity and Houston.

Berman said the system is limited by pipeline capacity to Corpus Cristi, so additional production from the merger would logically either have to go to spare capacity or to the Gulf of Mexico by way of Houston. This should work well for Exxon, as its own refineries are in North Houston, and according to Berman there is unused capacity in the pipeline system to Houston.

He also said the US has ample supply of the type of oil coming out of the Permian, suggesting that even if somehow Exxon were able to restrain this supply, refineries could source oil elsewhere. Permian oil is low in sulfur, meaning there is no need to process it before it enters pipelines.

On the potential impact on third parties such as service providers, Berman said at the scale of Pioneer, most such work is already done internally, likening this to a manufacturing process.

Chevron declined to comment. Exxon, Pioneer and Hess did not respond to requests for comment.

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