# NM oil and gas industry wary of regulatory future

BY KEVIN ROBINSON-AVILA / JOURNAL STAFF WRITER
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A pump jack operating north of Carlsbad in 2019. (Eddie Moore/Albuquerque Journal)

ALBUQUERQUE, N.M. — New Mexico's oil and gas industry survived the worst disruption in its history during the coronavirus, but operators now face an uncertain regulatory environment that's clouding post-pandemic recovery.

With oil prices rebounding beyond pre-pandemic levels as vaccination campaigns gain force in the U.S. and elsewhere, market conditions are ripe for a return to robust activity in the Permian Basin in southeastern New Mexico. But while oil rig activity is up significantly after reaching bottom last September, new drilling and investment remains markedly sluggish.

President Joe Biden

In part, that reflects ongoing uncertainty over the pace at which society will return to normal. Governments are still striving to reach herd immunity, demand for oil is only slowly recovering after reaching record lows last year, and prices continue to fluctuate alongside the ebb and flow of coronavirus infections, boosted largely by the willingness of world producers to hold back on fully reopening the spigots to avoid flooding the markets with a new wave of oil.

Producer restraint also reflects what may be a “new normal” in the U.S. shale-oil industry, as most companies concentrate on paying down debt and returning profits to shareholders rather than pursuing the wild-west-like hyper growth that reigned prior to the pandemic.

But alongside those constraints, New Mexico operators say regulatory uncertainty at the federal level under President Joe Biden’s administration, plus the prospect of new, adverse regulations pursued by legislators in Santa Fe, is slowing recovery even more on New Mexico’s side of the Permian.

**Federal stays**

Biden’s order in January to temporarily halt all new oil and gas leasing on federal lands, combined with the U.S. Interior Department’s 60-day suspension of new drilling permits for federal leases, is driving a lot of potential activity and investment into West Texas, said Raye Miller, mayor of Artesia and president of oil company Regeneration Energy Corp.

That’s because the majority of New Mexico production takes place on federal land, compared with Texas, where nearly all activity is on private land.

“Despite the upswing in prices, we’re not seeing any resurgence of large capital expenditures here,” Miller told the Journal. “I believe that reflects concerns about the federal land issues and uncertainty about what producers will be allowed to do in the future, as well as numerous legislative initiatives in Santa Fe that don’t seem reasonable to people in the industry. As a result, since most larger companies in southeastern New Mexico also have property in West Texas, they’re putting their money there, where they see better opportunities to operate and earn a return.”

Raye Miller

Investors have adopted a “wait-and-see” position on how federal and state regulations will evolve before making any major new commitments in New Mexico, said Gregg Fulfer, a former Republican state senator and owner of Fulfer Oil and Cattle Co. in Jal.

“One private equity group and some bankers who were talking with me about investments here immediately backed out after Biden’s order on halting new leases,” Fulfer said. “Most new investments are on hold now. The people who are spending money are generally operators who are already here with permits and right of ways in hand that they’re moving forward on, but if it weren’t for that, we might not have any new activity going on in southeast New Mexico.”

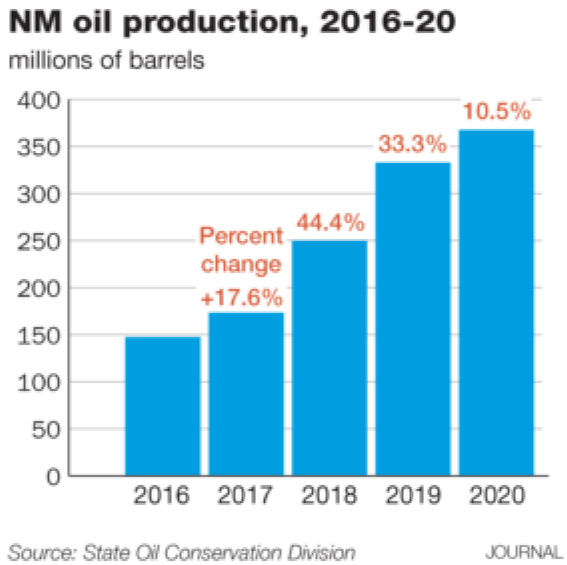
**Flight to Texas**

Industry flight to Texas is best reflected in rig counts along the border, Miller said.

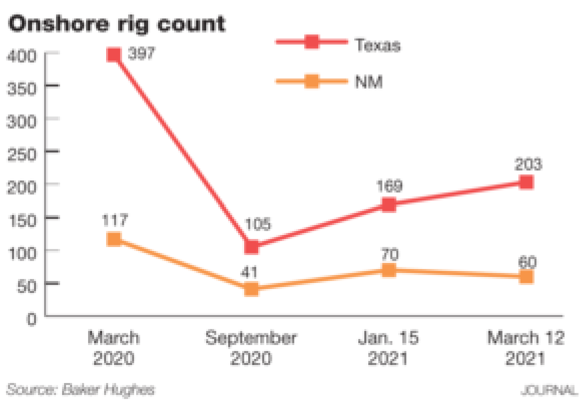
Before the pandemic hit in March 2020, New Mexico reached a record-high of 117 active rigs. That dropped to just 41 rigs by September, after global oil demand plummeted by more than 20% in the wake of coronavirus lockdowns as people stopped driving and airline travel practically ground to a halt. Oil prices plunged from about $60 per barrel for U.S. benchmark West Texas Intermediate in January 2020 to the low teens by May, bringing oil and gas production to a near standstill.

A tank battery that’s used to separate the water, gas and crude oil in Eddy County late last year.

But when the economy began to reopen in summer and fall, prices starting climbing again, hovering in the low $40s per barrel through the second half of 2020. Then, in early January, prices shot above $50 per barrel for the first time since the pandemic started. And, by early March, they climbed to about $65 a barrel.




That reflects, in part, renewed confidence on commodity markets that the pandemic is winding down as vaccination efforts move forward. But the key catalyst is an ongoing agreement among members of the Organization of Petroleum Exporting Countries and allied producers led by Russia to continue suppressing world production by nearly 7 million barrels per day through at least May to allow supply and demand to balance out before reopening the spigots.




The rise in prices over the past six months did trigger an initial rebound in local activity. Active rigs rose fairly consistently through the fall to reach 70 by Jan. 15, the week before Biden took office.

But immediately after Biden ordered the moratorium on federal land leases, the rig count started falling again, declining to 65 by Jan. 22, and then to 60 as of mid-March.

In contrast, the rig count in Texas has climbed nonstop since September, from 105 on Sept. 11 to 169 by Jan. 15, and then to 203 as of March 12.

Gregg Fulfer

“The rig count is only up a small amount relative to a year ago, but oil prices now are even higher than they were before the coronavirus,” Miller said. “I believe we’d be on a strong road to recovery right now with the pandemic moving to the rear view mirror in the next few months if not for the regulatory environment. Industry is completely focused on what’s happening in Washington and Santa Fe, not on the coronavirus.”

For every one rig added in New Mexico since September, five have been added in Texas, Fulfer said.

“That reflects all the uncertainty around the regulatory environment,” he said.

**Market forces**

Market factors are also restraining growth, said Raoul LeBlanc, vice president for nonconventional oil and gas at global consultant IHS Markit. Most U.S. producers are much more focused now on earning a significant return on investment for shareholders and paying down accumulated debt than on the pre-pandemic mindset of growth at all costs.

That reflects fundamental problems in the shale-gas revolution that began before the coronavirus started. For years, companies borrowed substantially to acquire extensive land leases, build infrastructure and ramp up production.

Raoul LeBlanc

The problem is, shale oil wells produce huge gushers when they first come online, but the flow rapidly declines over the next 18 months, forcing the industry into a constant cycle of “drill, baby, drill.” As a result, in previous years, operators continually pumped most returns back into production to keep output up, racking up huge debts and greatly adding to a global supply glut. That kept prices from rising significantly before the pandemic, and then helped accelerate the price crash after the coronavirus hit.

Investors grew tired of the cycle by 2019. Stock prices plummeted for large publicly traded companies and creditors tightened up lending policies, leading to major declines in market valuation even for major players like ExxonMobil and Chevron.

### Looking ahead

Now, as the industry emerges from the depths of coronavirus, a “new normal” has set in that emphasizes operational discipline to produce increased profits with lower investment and slower growth, LeBlanc said.

“Today’s prices are looking good, which puts companies in a strong position to perform well this year,” LeBlanc said. “But the industry has absolutely re-focused on pulling back capital outlay and returning more money to shareholders. … Private companies may be more aggressive about investing, but most public companies will remain disciplined and hold the line to regain investor credibility.”

Daniel Fine

Price volatility also remains a chronic concern. The pandemic is still not over, with new coronavirus mutations emerging and slow vaccination rollouts in Europe and many other places, which could slow economic recovery.

In addition, OPEC and its allied producers are expected to begin ramping up production again in May. And with the Biden administration seeking to reinstate agreements with Iran over its nuclear ambitions, Iranian oil production could significantly increase later this year, further flooding world markets, said Daniel Fine, a longtime oil expert with New Mexico Tech in Socorro.

Between OPEC and Iran, about 3.25 million more barrels per day could be added back into the global market by summer, Fine said.

“Can market demand absorb that in the second half of the year? The answer is ‘no,'” he said. “Demand won’t adjust to it and the price will fall.”

Many market consultants have recently speculated about a post-pandemic boom in demand that could push prices well above $70 per barrel in the next few months. But Fine projects prices declining back to $50 a barrel and possibly lower by mid-summer.

New Mexico State University economics professor emeritus Jim Peach said demand is still “shaky,” and the pace of economic recovery remains uncertain.

Jim Peach

“We’re still far from being out of this,” Peach said. “… We don’t yet know where it’s all going. Some say we’ll see $75 a barrel by the end of the summer – and that could happen – but we could also see it fall back to $40 a barrel.”

Notwithstanding market ups and downs, industry leaders say regulatory uncertainty remains the critical factor that’s generating investment restraint now in New Mexico – not oil prices or the pandemic.

As the coronavirus recedes and the global economy regains momentum, the pace of oil and gas recovery here will largely depend on policies mandated by the state and federal governments, said Ryan Flynn, who until Saturday served as


Ryan Flynn

executive director of the New Mexico Oil and Gas Association.

“Our future as an industry is squarely in the hands of policymakers now,” Flynn said. “The natural resources are there, industry interest to develop it is there, and the infrastructure is in place. … For New Mexico, the question is, will policies be put in place to continue growing the industry, or to inhibit future production?”