



THE BIG OIL MONEY PIT:

How \$750 billion in new stimulus spending could prop up failing polluters

- 💰 The Federal Reserve has just announced \$750 billion in corporate debt-buying as part of funding made available through the stimulus.
- 💰 ExxonMobil, Chevron and Conoco are together eligible for a maximum **\$19.4 billion** in benefits, based on their credit ratings and outstanding long-term debt,
- 💰 There are 12 fracking-focused oil and gas companies that could potentially qualify for the new program. Together, they may be eligible for over **\$24.1 billion** in potential benefits.
- 💰 Major fracking company Continental Resources, whose debt was recently downgraded to below investment grade by S&P, is potentially eligible for as much as **\$1.5 billion** under new, weaker standards announced by the Federal Reserve.
- 💰 As BlackRock begins purchasing “high yield” exchange-traded funds (ETFs) to bolster corporate debt markets, energy companies (predominantly oil and gas) stand to benefit disproportionately as the largest single issuer of junk bonds, at 11% of the entire US market.

INTRODUCTION

Last month, as the COVID-19 pandemic gained speed and the economy ground to a halt, Congress rushed through a \$2 trillion economic stimulus package. It passed 96-0 in the Senate and by a unanimous voice vote in the House. As he signed the legislation into law, Donald Trump publicly promised to ignore key safeguards supervising how the money would be spent.¹

The largest single expenditure was a \$500 billion corporate slush fund. Of that amount, Treasury Secretary Steven Mnuchin enjoys direct control over a comparatively small \$46 billion reserved for aviation and industries deemed essential to “national security.” But the remaining \$454 billion went to the Federal Reserve, which will use the money to implement emergency lending programs for corporations and municipalities. Secretary Mnuchin must approve these lending programs and wields considerable power over their design, but the money itself will move through the Fed.²

After weeks of unprecedented human suffering and an ongoing failure to support frontline workers, the Fed announced on April 9, 2020 how it would spend the first \$195 billion of the slush fund. A full \$75 billion would go to buy corporate debt. But because the Fed can leverage money appropriated by Congress, the real size of this program is \$750 billion.³ Considering that a majority of the money from the first stimulus still unspent, there is plenty of room for this program to grow.

There are strong indications that as these programs are deployed, they will function as a bailout for the fossil fuel industry.

BONDS 101

One of the most common ways for large corporations to raise capital is by issuing bonds. Bonds are essentially long-term debt obligations that promise a fixed return on investment. The company issuing the bond pays interest to the bondholder over the course of the loan, and then pays the full amount when the bond comes due. Like many other financial products, the value of bonds can fluctuate as they are traded back and forth on secondary markets.

Not all bonds are created equal. Some companies are financially healthier than others, which affects their ability to borrow and the value of their existing debt. Making these determinations about financial health are credit rating agencies, which score companies on whether their debt is “investment grade” or more speculative “junk.” The so-called Big Three credit rating agencies are Moody’s, S&P and Fitch, and these are how they rate companies:

1. <https://www.whitehouse.gov/briefings-statements/statement-by-the-president-38/>

2. See CARES Act, Section 4003.

3. <https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200409a5.pdf>

Investment grade	Moody's	Standard & Poor's	Fitch
Strongest	Aaa	AAA	AAA
	Aa1	AA+	AA+
	Aa2	AA	AA
	Aa3	AA-	AA-
	A1	A+	A+
	A2	A	A
	A3	A-	A-
	Baa1	BBB+	BBB+
	Baa2	BBB	BBB
	Baa3	BBB-	BBB-
Non-investment-grade	Moody's	Standard & Poor's	Fitch
	Ba1	BB+	BB+
	Ba2	BB	BB
	Ba3	BB-	BB-
	B1	B+	B+
	B2	B	B
	B3	B-	B-
	Caa1	CCC+	CCC+
	Caa2	CCC	CCC
	Caa3	CCC-	CCC-
	Ca	CC	CC
Weakest	Moody's	Standard & Poor's	Fitch
	C	C	C
		D	D

(Source: Fidelity Learning Center)

ENTER THE FED

The \$750 billion available through the Fed is meant to support the economy by purchasing massive amounts of corporate debt. The total amount of money is technically shared between two separate programs: **the Primary Market Corporate Credit Facility (PMCCF) and the Secondary Market Corporate Credit facility (SMCCF).**

The PMCCF allows companies to issue new bonds that the Fed then directly purchases. This is a novel way of injecting corporations with emergency money. A company gets cash and the Fed gets debt, to be repaid in at most four years.

The SMCCF allows bonds to be purchased from secondary markets and stored in the relative safety of the Fed's balance sheet. It also allows the purchase of shares in so-called "high yield" exchange-traded funds, or ETFs. These are basically investment funds that pool together the debt of comparatively risky companies. They are designed to provide investors with broad exposure to bonds that fall below the standard of investment grade. This piece of the program is being administered by BlackRock, the largest asset manager on earth, the largest player in the ETF market, and the largest owner of fossil fuels on the planet.

Here are some of the most important conditions associated with PMCCF and SMCCF:

- 💧 No company may issue bonds for the Fed to purchase that exceed 130% of their outstanding debt obligations.
- 💧 No company may have more than 10% of its outstanding debt purchased from a secondary market by the Fed.
- 💧 No ETF may have more than 20% of its outstanding shares purchased by the Fed
- 💧 No single company is allowed to account for more than 1.5% of the total \$750 billion combined size of the PMCCF and SMCCF.

Perhaps most important of all, the Fed has stipulations about the financial health of individual companies allowed to participate. It cannot use stimulus funds to purchase bonds unless they are considered investment grade by at least two major ratings companies. However, there is an exception. Companies that were investment grade on March 22, 2020 and subsequently downgraded can still benefit if at the time of purchase they hold at least two ratings no lower than BB- or Baa3. This is essentially a loophole allowing for the purchase of junk.

It is important to note that this exception for junk bonds already represents a relaxing of the Fed’s original standards. Although the PMCCF and the SMCCF programs have been super-charged with money from the stimulus, they were both technically established by the Fed and the Treasury Department in March before the stimulus even became law. The original terms for both programs were considerably more strict. There was no exception for companies that had fallen into the junk range, and instead of allowing companies to issue bonds up to 130% of outstanding debt, there was a sliding scale that allowed companies on the lower end of investment grade to qualify for only 110%. Purchases of bonds below BBB- or Baa3 were expressly forbidden.⁴

STIMULATING BIG OIL?

Long before the coronavirus, the oil and gas industry was struggling. The five largest supermajor oil companies have been living beyond their means, spending a massive \$216 billion more on their shareholders through dividends and buybacks than they managed to raise in profits over the last decade.⁵

Although the climate and environmental risks of hydraulic fracturing have long been known to grassroots activists, Wall Street is becoming slowly aware that the practice is also financially ruinous. According to an analysis of 34 major fracking companies conducted by the Institute for Energy Economics and Financial Analysis, the sector has almost never generated positive cash flow. Between 2017 and 2019, it was spending more than it was bringing in to the tune of \$25.9 billion.⁶

The economics of fossil fuels have never looked worse. And yet, just as Wall Street may be finished with fracking, the new stimulus programs from the Trump Administration could be a massive lifeline. Here’s how:

BIG OIL WINS BIG

The biggest potential beneficiaries of the Fed’s programs are unsurprisingly the biggest companies who entered the crisis with the most stability. ExxonMobil, Chevron and Conoco all had investment grade ratings across the board and have so far maintained them as the crisis unfolds. Using their long-term debt as a proxy, Friends of the Earth estimates that ExxonMobil potentially qualifies for \$7.9 billion, Chevron qualifies for \$7.1 billion, and Conoco qualifies for \$4.4 billion. That means that taken together these large companies are potentially eligible for a combined total of \$19.4 billion in benefits.⁷

A FRACKING BAILOUT?

In spite of the fracking industry’s considerable economic headwinds, there are still at least 12 oil and gas companies heavily invested in fracking that could potentially qualify for debt purchases under the new Fed program. Using the long-term debt of these companies as a proxy for their total debt obligations, Friends of the Earth estimated their total potential benefits. The companies, their credit ratings, their long-term debt as reported to investors, and their maximum eligibility for Fed support are listed below:

Company	S&P Rating	Moody	Fitch	Total Long-Term Debt 31 December 2019	Total eligible amount
Apache	BB+	Baa3	BBB	8,555,000,000	\$2,566,500,000
Cimarex Energy Co.	BBB-	Baa3	N/A	2,000,000,000	\$600,000,000
Concho Resources Inc.	BBB-	Baa3	BBB	3,955,000,000	\$1,186,500,000
Continental Resources Inc.	BB+	Ba1	BBB-	5,326,514,000	\$1,597,954,200

⁴ <https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200323b1.pdf>

⁵ <https://ieefa.org/ieefa-update-oil-majors-paid-216-billion-more-to-shareholders-than-they-earned-directly-from-business-over-the-past-decade/>

⁶ https://ieefa.org/wp-content/uploads/2020/03/Shale-Producers-Spilled-2.1-Billion-in-Red-Ink-Last-Year_March-2020.pdf

⁷ This calculation for the total PMCCF cap was calculated from their long-term debt reported in SEC filings. Chevron, ExxonMobil, and Conoco had \$23.691 billion, \$26.342 billion, and \$14.790 billion respectively.

Devon Energy Corporation	BBB-	Ba1	BBB	4,294,000,000	\$1,282,200,000
Diamondback Energy Inc.	BBB-	Ba1	BBB	5,371,000,000	\$1,611,300,000
Encana/Ovintiv	BBB-	Ba1	BBB-	6,974,000,000	\$2,092,200,000
EOG Resources Inc.	A-	A3	N/A	4,160,919,000	\$1,248,275,700
Hess Corporation	BBB-	Ba1	BBB-	7,142,000,000	\$2,142,600,000
Noble Energy Inc.	BBB-	Baa3	BBB	7,477,000,000	\$2,243,100,000
Marathon	BBB-	Baa3	BBB	5,501,000,000	\$1,650,300,000
Pioneer Natural Resources Company	BBB	Baa2	BBB	1,839,000,000	\$551,700,000
					\$24,172,629,900

One company to note is fracking pioneer Continental Resources. It was affirmed by Fitch as BBB- on March 20, 2020, putting it barely within investment grade. But it is currently rated by S&P at BB+, or just barely below investment grade. Together with its recently confirmed Ba1 from Moody's,⁸ the company should be ineligible for Fed support because it has two junk ratings from two major rating agencies. However, because it was only downgraded to junk by S&P on March 27, 2020,⁹ it qualifies as an exception to the Fed's rule.

For a company like Occidental, the shoe is on the other foot. Still one of the largest oil producers in the country, it assumed massive liabilities last year to acquire fellow oil giant Anadarko. But it was downgraded to junk by both Fitch and Moody's before the March 22, 2020 cutoff, with S&P following suit not long after the deadline.¹⁰ Unless the Fed and Treasury modify the standards of the program, Occidental cannot issue bonds for the Fed to buy and the Fed cannot buy Occidental's bonds from secondary markets.

One thing to keep in mind is that companies benefitting from these debt purchases are exempt from a key provision of the stimulus. In theory, companies receiving direct loans from the Fed cannot engage in stock-buybacks until one year after the loan is repaid. Although Secretary Mnuchin always had the authority to waive this requirement, this condition apparently does not apply at all to the bond-buying programs.¹¹ That means that a company could issue bonds for purchase by the Fed, plow the resulting cash into stock-buybacks that enrich shareholders, and not be outside of the law.

BLACKROCK'S BIG BAILOUT?

Many companies involved in fracking are still too risky for a bailout from the Fed. For example, major mid-size drilling companies like Antero, SM Energy, Highpoint, Callon and EQT were all downgraded by Moody's in March or early April of 2020, but these cuts dropped them from junk to even deeper junk.¹²

Unfortunately, there is another way for these cash-strapped drillers to receive help from the Fed, albeit indirectly. Because the junk bond market is now 11% energy companies (predominantly oil and gas),¹³ any attempt to bolster the entire sector is going to benefit heavily indebted frackers. So now that BlackRock has broad authority to purchase junk or "high yield" ETFs to back-stop the market, the owners and issuers of that junk potentially stand to benefit -- even if they are currently ineligible for the Fed's other debt buying programs.

Take a particularly large high yield ETF managed by BlackRock -- for example, iShares iBoxx \$ High Yield Corporate Bond ETF, which can be found using the ticker HYG for short.¹⁴ This is a financial product designed to approximate exposure to the

8 <https://markets.businessinsider.com/news/bonds/continental-resources-inc-moody-s-affirms-continental-s-ba1-ratings-outlook-stable-1029028812>

9 <https://www.marketwatch.com/story/continental-resources-suspends-dividend-to-cut-production-by-about-30-2020-04-07>

10 <https://finance.yahoo.com/news/occidental-becomes-biggest-fallen-angel-133028380.html>

11 <https://www.brookings.edu/research/explaining-the-new-fed-treasury-emergency-fund/>

12 https://www.moody.com/research/Moodys-downgrades-Antero-Resources-CFR-to-B3-notes-to-Caa1--PR_421782

https://www.moody.com/research/Moodys-downgrades-SM-Energys-CFR-to-B3-outlook-negative--PR_422239

https://www.moody.com/research/Moodys-downgrades-HighPoints-CFR-to-Caa2-outlook-negative--PR_422357

https://www.moody.com/research/Moodys-downgrades-Callon-Petroleums-CFR-to-B3-negative-outlook--PR_420376

https://www.moody.com/research/Moodys-downgrades-EQT-to-Ba3-outlook-remains-negative--PR_422015

13 <https://www.ft.com/content/c048d870-6138-11ea-a6cd-df28cc3c6a68>

14 See <https://www.ishares.com/us/products/239565/ishares-iboxx-high-yield-corporate-bond-etf>. Outstanding shares and values for HYG are current as of April 9, 2020

entire universe of junk bond debt issued by US companies. Unsurprisingly, many fracking companies are well represented.

There is thus considerable risk that this strategy to support junk debt ETFs could function as a back-door bailout for the accumulated bad debts of the fracking industry. For example, Chesapeake, which Moody's confirmed at a perilous Caa1 in January,¹⁵ has \$6.9 million worth of bonds contained within this ETF maturing in 2024 and 2025. Range Resources, which was downgraded in early April by S&P to a very risky B2,¹⁶ is represented with \$37.4 million in bonds maturing over the next six years.

Curiously, BlackRock could technically begin buying the 196 million current outstanding shares of this ETF to help bolster the corporate debt market overall. It would theoretically be limited by the 20% cap on the ownership of any single ETF. Although the shares would be stored on the Fed's balance sheet and BlackRock would waive its normal fee,¹⁷ there is no escaping the fact that the world's largest asset manager is now empowered to use taxpayer funds to purchase its own products. This is a role similar to the one it played as a purchaser of toxic assets during the 2008 financial crisis.

CONCLUSIONS AND RECOMMENDATIONS

The danger that Big Oil could benefit from existing stimulus programs is considerable. Unfortunately, it would not take additional legislation from Congress to super-charge the risk of a dirty energy bailout. The Treasury and the Fed already have broad discretion over the implementation of the stimulus, and could modify it to better suit polluters. For example, the Fed and Treasury could:

- 💧 Further loosen standards to support junk-rated companies, including fracking companies not currently eligible for aid.
- 💧 Create an entirely new Fed program with still unspent stimulus funds tailored to support either junk-rated companies in general or the oil and gas sector in particular.

The original coronavirus stimulus was passed quickly in an emergency. As additional legislation to address the crisis is considered, it is important for Congress to both prioritize still unmet human needs while correcting previous mistakes.

Much more work needs to be done, both to support workers and families in the face of COVID-19 and to prevent a runaway bailout of the fossil fuel industry. Congress cannot afford to wait. It must:

- 💧 Prioritize direct aid to still neglected workers and communities on the frontlines of the crisis.
- 💧 Engage in aggressive oversight to ensure BlackRock does not benefit unfairly from purchasing its own products or needlessly bolster fossil fuel assets.
- 💧 Eliminate Secretary Mnuchin's authority to waive crucial protections banning companies receiving bailouts stock buybacks.
- 💧 Make future stimulus aid conditional on new and binding protections for workers and the environment.
- 💧 Make oil, gas and coal companies ineligible for support from existing stimulus programs, unless it is conditioned on a phaseout of existing production and an iron-clad commitment to existing pension and environmental liabilities.

15 https://www.moodys.com/research/Moodys-changes-Chesapeake-Energys-Probability-of-Default-Rating-to-Caa1--PR_416663

16 https://www.moodys.com/research/Moodys-downgrades-Range-Resources-to-B2-outlook-negative--PR_421834

17 https://www.newyorkfed.org/medialibrary/media/markets/special_facilities/SMCCF_Terms_BlackRock.pdf

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