OPEC Production Cut Primes Pump For More Energy Deal
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The agreement reached Wednesday by the Organization of Petroleum Exporting Countries to temporarily curb oil production will help stabilize global oil prices, and experts say that will allow more deals to get done and encourage more U.S. shale developers to start drilling again, though large, expensive energy projects will likely remain on the shelf for the time being.

OPEC members agreed in Vienna to cut their oil production from 33.6 million barrels a day to 32.4 million barrels a day for at least six months starting in January 2017. It's the first production cut by the cartel in eight years and immediately sent U.S. oil prices toward the $50-a-barrel mark and global oil prices above the $50-a-barrel-mark.

Oil prices have seemingly leveled off between $40 and $50 a barrel in recent months after going as low as the mid-$20s, and even if Wednesday's OPEC deal doesn't send prices skyrocketing, it will further assure oil and gas firms that they won't see a similar price plunge in the near future, experts say.

"I think it would be fair to say that if this deal looks real when everyone looks under the hood and sees the actual details, it will allay a lot of the remaining fears in the market in the short term that prices could drop back down into the $30s and $20s," said David Asmus, who leads Morgan Lewis & Bockius LLP's energy transactions practice.

That could further accelerate a nascent recovery in deal-making as more buyers and sellers will be able to agree on a fair price for oil and gas assets, experts say.

"There's been a lot of capital that's been earmarked for the sector but hasn't been used because of the volatility in price," said George Koutsonicolis, managing director and co-head of the energy practice at investment and restructuring bank SOLIC Capital Advisors. "I think both the financial and strategic buyers were holding off, not wanting to catch a falling knife. There's always buyers for the right prices, and as long prices are stable, I think you'll see more buyers willing to put capital to work."

Meanwhile, the OPEC deal could reassure sellers that there won't be any significant oil price swings after they ink an agreement with a buyer.

"If you're a seller, now might be the time to put your properties on the market and see what you can get for them," Orrick Herrington & Sutcliffe LLP partner Jonathan Ayre said.

The OPEC deal will also convince some companies to ramp up their production in order to cash in on potentially higher prices, though experts say it won't move the price needle high enough to restart the billions of dollars worth of large conventional oil and gas projects that have been mothballed by global oil supermajors and large independents in the wake of the price plunge.

"A lot of the projects being put on hold by the majors are not shale projects. They're conventional, deepwater projects, LNG projects, very capital-intensive projects that will not resume quickly," Asmus said. "The type of boost we get in the short term for the OPEC agreement isn't going to get everyone to suddenly dust off their big deepwater projects."

For U.S. shale operators, it's a different story. Unlike large, conventional drilling projects, shale drilling can be ramped up quickly and done incrementally, as they're not as capital-intensive.

"There are a lot of formations in the U.S. that can be economically produced even before the OPEC deal," Ayre said. "If you assume a higher price, then that could open up more U.S. shale formations to transactions because the break-even costs are down across the U.S."

The oil-rich Permian Basin of west Texas, with some of the lowest drilling costs in the U.S., has been a hotbed of multibillion-dollar deal activity in recent months as oil prices have stabilized between $40 and $50 a barrel. A price bump as a result of the OPEC deal will only intensify interest in the region, and that interest could spill over into other shale regions that might not have been as economical to develop at lower prices, experts say.

"I would expect the Permian Basin to get even more frenetic than it has been, and you'll probably see more interest in the next-tier shale plays, like the Eagle Ford [in south Texas]," Asmus said.

But increased U.S. shale activity carries a potential downside: production increases that could send oil prices back down again, blunting the impact of the OPEC deal.

And the deal itself is far from a sure thing, experts say. For starters, there's the question of whether OPEC members will actually follow through on their pledged production cuts.

"OPEC is a cartel. You may have some of its members paying lip service to an output cut," Koutsonicolis said.

The deal is also contingent on commitments of major non-OPEC nations to reduce their production by 600,000 barrels a day. One of those non-OPEC nations, Russia, has reportedly pledged to cut their production by 300,000 barrels a day.

Combine that with the short-term nature of the agreement and additional political uncertainty following the election of Donald J. Trump as president of the United States, and Ayre says it's likely that deal makers will take a wait-and-see approach, at least in the short term.

Still, after two-plus years of oil price volatility that froze a lot of deal-making activity, the fact that OPEC was able to agree to a production cut is in itself a reassuring sign for oil and gas firms looking to make a deal, he said.

"There was uncertainty about whether OPEC was ever going to be able to come to a deal, given the difficulties they had in the past," Ayre said. "The deal shows they're going to be willing to act going forward."

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