

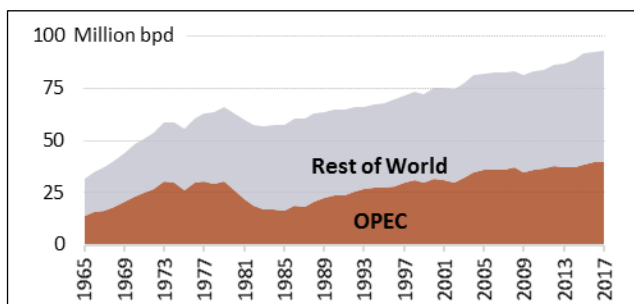


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No Oil Producing and Exporting Cartels (NOPEC) Act of 2019

Since the beginning of the oil industry, there have been multiple periods when a supply manager has influenced production and price levels. Generally, a supply manager has the capacity to adjust production rapidly in order to respond to changing market conditions. The limited ability of oil production and consumption to adjust in the short term, coupled with long development cycles for most oil production assets, a desire for price stability, and volatile price movements when the market is imbalanced by as little as 1% to 2% are some stated justifications for supply management. In the past, the Standard Oil Company, the Texas Railroad Commission, and international oil companies have functioned as supply managers. Today, the 14-member Organization of the Petroleum Exporting Countries (OPEC)—representing approximately 40% of the nearly 100 million barrels per day (mbpd) of world liquid fuels supply (see **Figure 1**)—makes crude oil production decisions that can affect global petroleum prices.

Figure 1. World Oil Production
1965 - 2017



Source: BP Statistical Review of World Energy, 2018.

Notes: Oil production includes crude oil, shale oil, oil sands, and natural gas liquids.

Following a period of petroleum oversupply and rapidly declining prices in 2014 and 2015—a situation some analysts attribute to OPEC not intervening in the market—OPEC, led by Saudi Arabia, along with 11 non-OPEC countries, led by Russia, entered into an agreement (the “Declaration of Cooperation” or DoC) in December 2016 to collectively reduce crude oil production by approximately 1.8 mbpd from October 2016 levels. Implementation of the agreement contributed to the benchmark U.S. crude oil price—West Texas Intermediate or WTI—rising from \$52/barrel to \$76/barrel between January 2017 and October 2018. As prices were increasing, the No Oil Producing and Exporting Cartels (NOPEC) Act of 2018 was introduced in the 115th Congress. The DoC expired at the end of 2018 and was modified to collectively reduce crude oil production 1.2 mbpd compared to October 2018 levels—for most countries—for the first six months of 2019. The NOPEC Act of 2019 was introduced in February 2019 (116th Congress).

NOPEC Overview

The NOPEC Act of 2019 (H.R. 948 and S. 370) would modify the Sherman Antitrust Act (15 U.S.C. 1 et seq.)—an act that led to the dissolution of the Standard Oil Trust in 1911 and prohibits U.S. oil companies from engaging in collective market management—to criminalize actions by a foreign state, collectively or in combination with other foreign states or persons, that limit the production or distribution, maintain the price, or restrain trade of oil, natural gas, or petroleum products (e.g., gasoline) in a way that affects markets and prices for these commodities. The bills would also eliminate the application of sovereign immunity and Act of State doctrines to foreign nations found to be in violation.

Potential Countries Affected

The current DoC production agreement includes 21 of 24 countries in the collective group (OPEC members Libya, Iran, and Venezuela are exempted). For reference, OPEC and non-OPEC countries currently engaged in supply management activities are listed below.

OPEC Countries: Algeria, Angola, Congo, Ecuador, Equatorial Guinea, Gabon, Iran, Iraq, Kuwait, Libya, Nigeria, Saudi Arabia, United Arab Emirates (UAE), and Venezuela. Qatar, an OPEC member since 1961, withdrew from OPEC effective January 2019.

Non-OPEC Countries: Azerbaijan, Bahrain, Brunei, Kazakhstan, Malaysia, Mexico, Oman, Russia, Sudan, South Sudan.

Combined petroleum production of OPEC and non-OPEC countries—hereinafter referred to as OPEC+—represents approximately 60% of world supply.

Consideration of Possible Oil Market and Price Effects

Exactly how enactment of the proposed NOPEC legislation might affect the oil market is uncertain. The perceived potential risk to affected countries of the United States imposing Sherman Act penalties, which could be severe, would likely determine the extent to which the NOPEC legislation might affect oil markets and prices. However, potential impacts would likely be within a spectrum of possible outcomes that might range from marginal to highly impactful. The following discussion is focused on market impacts but does not discuss potentially significant retaliatory measures, risks to seizure of U.S. assets abroad, or other potential U.S. foreign policy or military impacts.

Marginal Impact: OPEC+ continues supply management role and U.S. has a negotiating lever

At one end of the outcome spectrum is a scenario where OPEC+ continues its oil market-influencing role. The

NOPEC Act would provide the Department of Justice with sole enforcement authority for any violations. The bills do not expose foreign countries to broader civil litigation. It may be possible for affected countries to manage the proposed Sherman Act modification diplomatically, should these countries determine that their collective supply management role is more valuable than the risks associated with potential legal actions. If this were the approach employed by the affected countries, then OPEC+'s role in the oil market may not substantially change and supply management would potentially continue. However, the U.S. executive branch could possibly use the NOPEC Act, if enacted, as a diplomatic negotiating lever to motivate market intervention when oil prices are deemed to be too high for U.S. consumers, too low for U.S. producers, or to perhaps support broader geopolitical objectives.

Even if managed diplomatically, enactment of proposed NOPEC legislation could potentially affect economic reform efforts in some OPEC+ countries. For example, Saudi Arabia is embarking on several programs to restructure its economy to be less dependent on oil-related revenues. In order to finance some of these efforts, Saudi Arabia's leadership is looking to raise capital via the bond market and possibly through selling shares of Saudi Aramco, the national oil company. If the NOPEC Act were passed, the potential for the United States to pursue Saudi Arabia for Sherman Act violations could be viewed as a significant risk by the financial community and could possibly affect the Saudi Aramco valuation and/or result in increased borrowing costs for the country. Saudi Aramco's April 2019 bond prospectus lists U.S. antitrust litigation as a risk factor that could adversely affect Aramco's business.

High Impact: OPEC+ ceases supply management role and produces at full capacity potential

At the other end of the outcome spectrum is a potential scenario where the NOPEC legislation achieves its intended objective of eliminating the collective actions of OPEC+ countries to influence the world oil market. If the affected countries perceive the litigation and financial risks associated with NOPEC to be high, OPEC+ ceasing its supply management activities might be the result.

Under this scenario, OPEC+ countries might choose to produce at their full capacity potential, thereby eliminating the International Energy Agency (IEA)-estimated OPEC spare production capacity of 3.3 mbpd in March 2019 (IEA does not estimate spare production capacity for non-OPEC countries). Most of this spare capacity (67%) is in Saudi Arabia. Additional oil production entering the market would likely result in downward pressure on oil prices over the short term. Lower prices could benefit U.S. consumers, but could potentially have a negative impact on U.S. oil producers. OPEC representatives have indicated that the U.S. oil sector will likely be damaged—from an oversupplied market and low prices—if the NOPEC Act becomes law. Downward price pressures would likely be counter-balanced to some degree by the elimination of spare production capacity that may be needed in the event of unplanned outages resulting from a variety of world events (e.g., geopolitical unrest or sabotage). Spare production capacity is one of many factors identified by the

U.S. Energy Information Administration (EIA) that can influence global oil prices.

An oil market without spare capacity and a supply manager would simply respond to price movements. Since the ability of oil supply and demand to respond to price is limited in the short term, and since a relatively small market imbalance—either surplus or deficit—can translate into large price movements, the oil market could potentially enter a period of price volatility. Prices could reach high levels when the market is undersupplied and prices could be very low when the market is oversupplied. Academic research suggests that the presence of a market-intervening supply manager can reduce crude oil price volatility. However, this research also suggests that an oil market without a supply manager could have periods—the trough portion of price movements—when price levels could potentially be lower when compared to an oil market where a supply manager is present. Furthermore, oil price volatility may also affect the fiscal health and political stability of producing countries, which arguably might affect broader U.S. interests in certain regions.

Alternatively, some analysts suggest that a functioning oil futures market combined with the price-responsive and short-cycle development attributes of U.S. tight oil (also referred to as shale oil) production could possibly smooth volatile price movements and provide supply management functions. However, when considering the relatively recent development of U.S. tight oil, crude oil quality, and possible infrastructure bottlenecks that can limit the ability of crude oil being transported to global buyers, the potential for U.S. tight oil to smooth price volatility is uncertain.

Legislative History and Recent Action

NOPEC legislation was first introduced in 2000 and a version of the bill was introduced in each Congress from the 106th to the 112th. In 2005 (109th Congress), the Senate passed a version of the bill in the Energy Policy Act of 2005, but it was not included in the enacted legislation. In 2007 (110th Congress), the House of Representatives passed NOPEC legislation (H.R. 2264) by a vote of 345-72. The committee report (H.Rept. 110-160) on H.R. 2264 includes supplemental views that express concern about the potential for retaliatory measures from affected countries. The report mentions the ability to station U.S. troops in the Middle East, an oil export embargo, and the potential for seizing U.S. assets abroad as possible unanticipated outcomes associated with enacting NOPEC legislation.

Versions of the bill have also been introduced in the 115th and 116th Congresses. The House version of the NOPEC Act of 2019 (H.R. 948) was ordered to be reported by a Judiciary Committee voice vote in February 2019. In a book published in 2011, President Trump indicated support for passage of similar NOPEC legislation. However, Secretary of Energy Rick Perry has expressed concerns about the impact to U.S. oil producers and price volatility that might result from enacting NOPEC legislation.

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