

THE BIG SPILL, ECONOMIC STANDSTILL AND POLITICAL WILL
PRESENTATION TO THE U.S. ASSOCIATION FOR ENERGY ECONOMICS
NATIONAL CAPITAL AREA CHAPTER

SEPTEMBER 17, 2010

Kevin Book

Managing Director, Research
Book@CVEnergy.com

SPILLING IT

- **Political dynamics:** energy policy and the Zone of No Accountability
- **The 10th Amendment can be a BOEMRE:** the rich history of U.S. offshore drilling policy
- **Scenario analysis:** regulatory reform, fixed/variable cost changes and ... STAMPEDE?
- **Implications:** slower permit throughput and risk washes ashore
- **Discussion**

DRY VERSION: DISCONNECTS BETWEEN ECONOMIC REALITY AND U.S. ENERGY POLICY

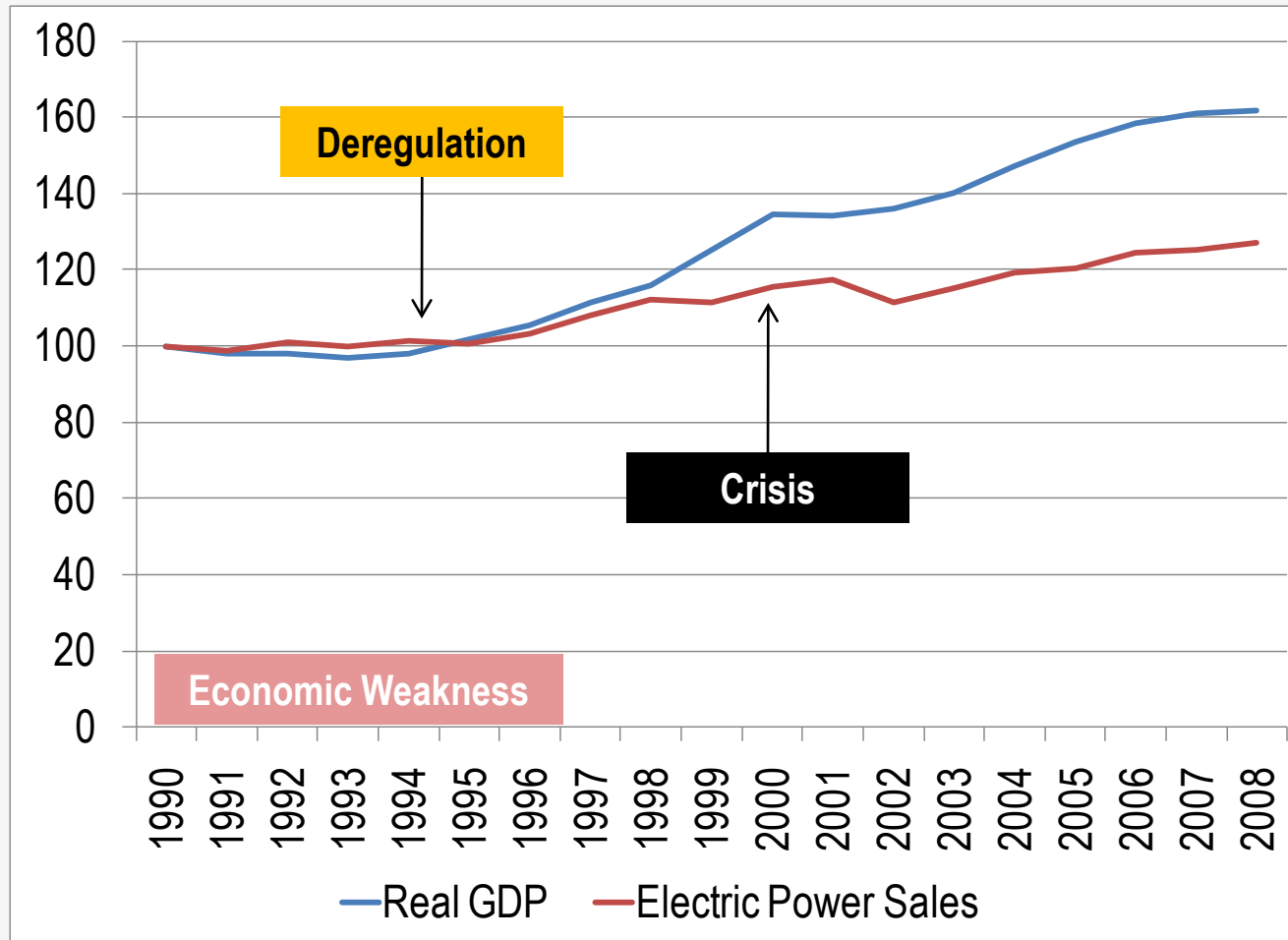
	Economic Reality	U.S. Energy Policy
Supply	<ul style="list-style-type: none"> • Slow: Years or decades for supply to come on-stream • Sticky because of debt service obligations • Assets typically produce for decades 	<ul style="list-style-type: none"> • Budget: 1Y; Congress: 2Y; President 4Y; “future”: 10Y • Sticky due to political sentiment governing access • Political value of energy strategy expires at next election
Demand	<ul style="list-style-type: none"> • Long-term link to industrialization and structural efficiency • Short-term link to end-user economic capabilities • Policy-adjusted price per Btu is ultimate determinant 	<ul style="list-style-type: none"> • Long-term link to infrastructure and standards • Short-term link to fiscal policy (rates, taxes, “Clunkers”) • Cheap energy is a political imperative
Dynamics	<ul style="list-style-type: none"> • Perspective: Forward-looking and opportunistic • Fixed cost amortization turns scarcity into profit • Companies choose sovereigns based on economics 	<ul style="list-style-type: none"> • Backward-looking and defensive • End-user frustration turns scarcity into political disaster • Sovereigns need companies to monetize resources

ANOTHER WAY TO FRAME IT: THE “TOMMY BOY” PROBLEM



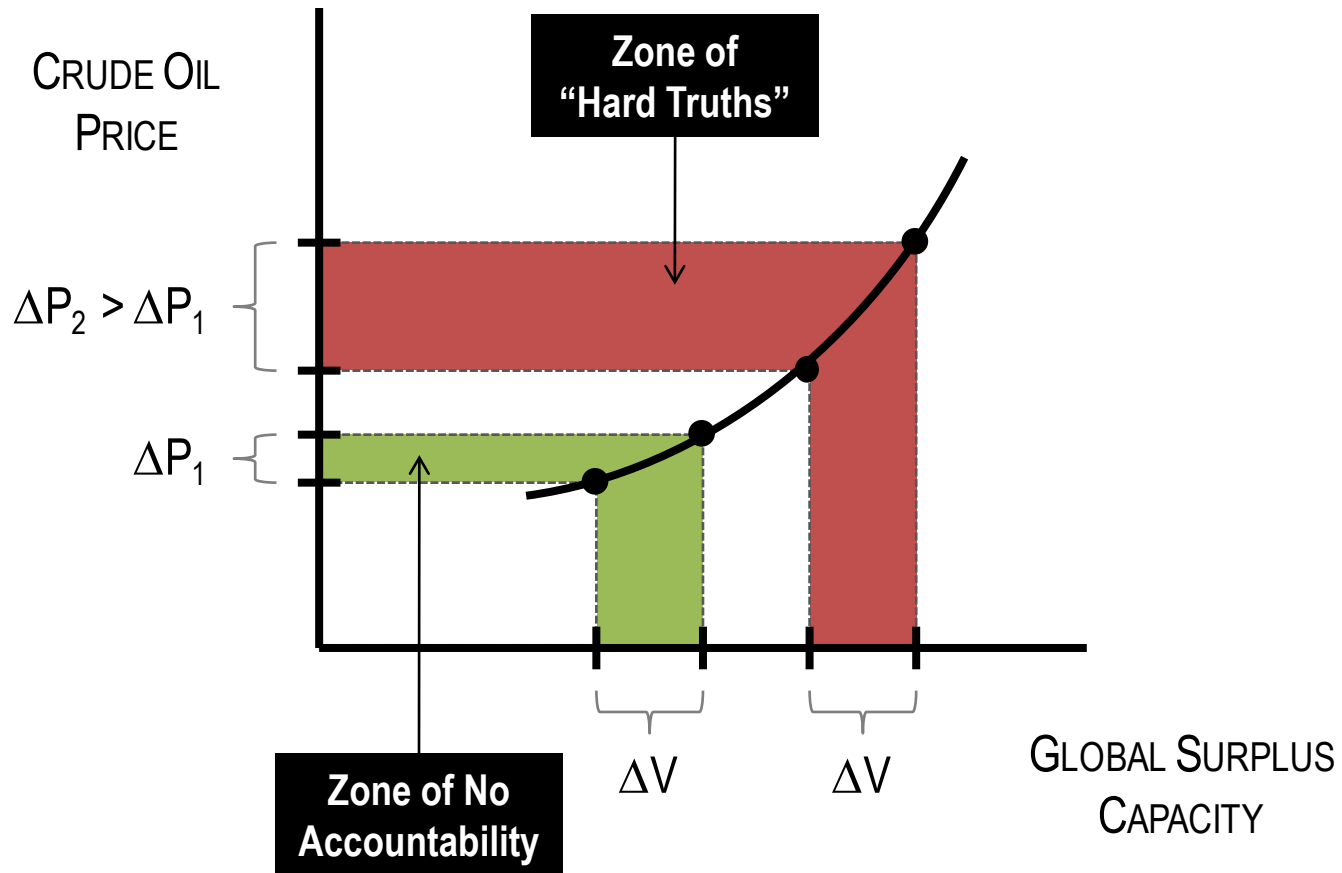
Source: Internet Movie Database

CASE STUDY: CALIFORNIA: PAST PERFORMANCE DOES NOT EQUATE TO FUTURE RESULTS



Source: ClearView Energy Partners, LLC, using data from BEA and EIA

COMMODITY PRICING DYNAMICS AND POLITICAL CONSTRAINTS



Source: ClearView Energy Partners, LLC

9.29.2008: **THIS** IS MARKET-BASED POLITICAL ACCOUNTABILITY...

BREAKING NEWS



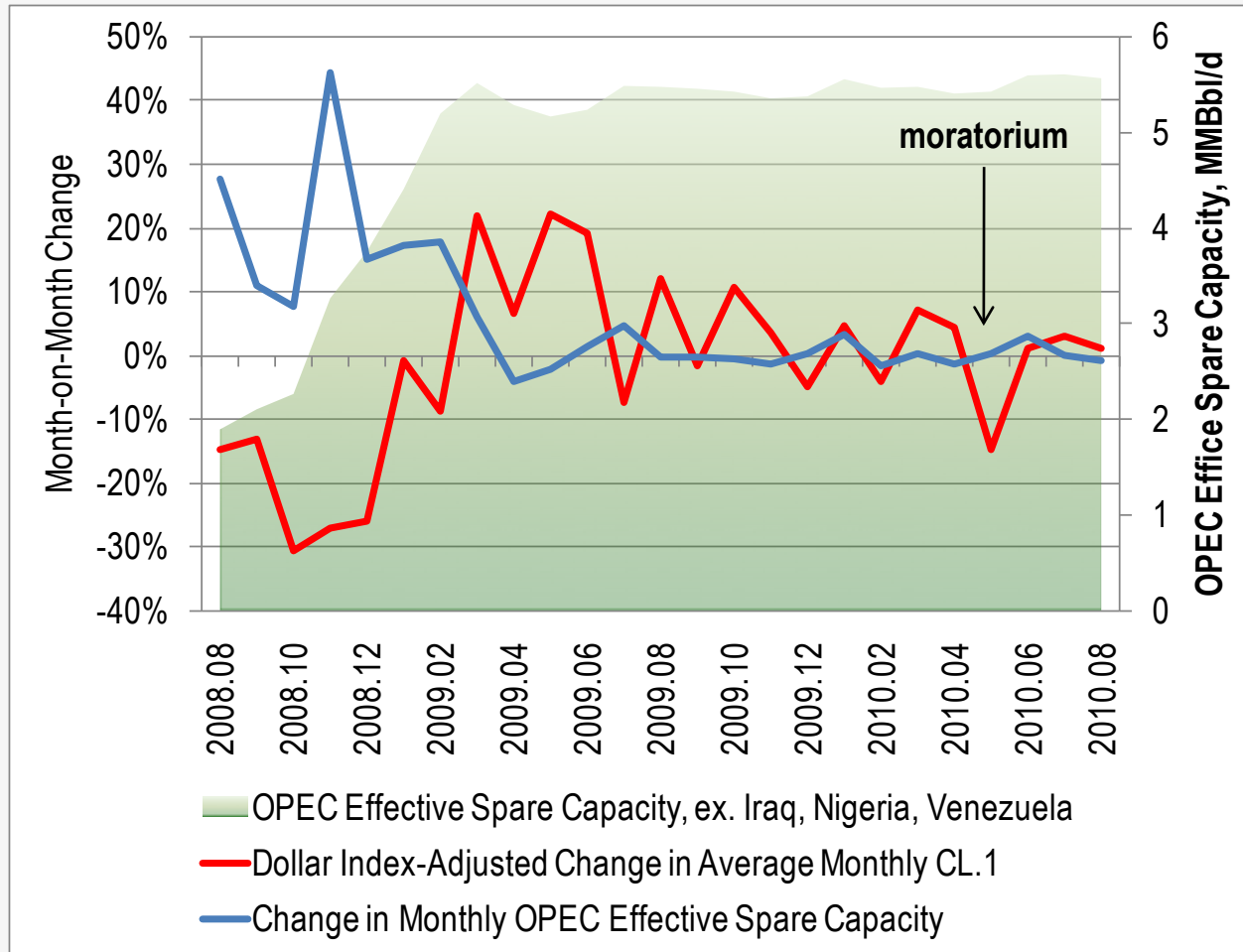
Bailout bill fails; Dow plunges

The House of Representatives today rejected a \$700 billion plan to bail out the U.S. financial system, putting a roadblock in front of the largest government intervention in the markets since the Great Depression. The next steps were not clear, but supporters were scrambling to salvage the package. The Dow was down more than 600 points after the voting ended. [developing story](#)

• [CNNMoney: Stocks tumble](#) • [Read a draft of the bill | Bailout Tracker](#)

Source: CNNMoney

...AND THIS IS NOT



Source: ClearView Energy Partners, LLC using data from IEA, EIA and Federal Reserve

NOLA MEETS ZONA

- **Last Time I Spoke to this Group:**
small increase in global capacity utilization → huge increase in price
- **Now:**
50% of CY2010 IEA Non-OPEC supply growth disappears → crude oil trades flat to down
- **Other Political Feedback Mechanisms:**
 - **Job losses:**
 - Industry initially projected 20,000 – 90,000; White House now says 8,000 – 12,000
 - Companies “did the right thing”
 - 6,000-vessel support effort
 - Maintenance brought forward
 - **What about politicians losing their jobs as a result?**

Source: ClearView Energy Partners, LLC

WHY ETHANOL MATTERS EVEN THOUGH IT'S NOT A PRESIDENTIAL ELECTION

State	Production Capacity (MM gal/Y)	% of US Corn Ethanol	% of US Cellulosic Ethanol	House Delegation	Senate Delegation	House D's at Risk	Senators on Cycle	2006 New House D's	2008 New House D's	2008 Electoral Votes
IA	3,183	24.40%	13.00%	3D, 2R	1D, 1R		1R	2	0	7
NE	1,454	11.20%	5.00%	0D, 3R	1D, 1R			0	0	5
IL	1,350	10.40%		12D, 7R	2D, 0R	3	1D	0	1	21
MN	1,113	8.50%		5D, 3R	2D, 0R			1	0	10
SD	1,016	7.80%		1D, 0R	1D, 1R		1R	0	0	3
IN	706	5.40%		5D, 3R, 1V	1D, 1R	2	1D	3	0	11
WI	498	3.80%		5D, 3R	2D, 0R	1	1D	1	0	10
KS	437	3.40%	5.00%	1D, 3R	0D, 2R		1R	1	0	6
OH	314	2.40%		10D, 8R	1D, 1R	2	1R	1	3	20
TX	250	1.90%		12D, 20R	0D, 2R	1		2	0	34
Top 10 Producers	10,320	79.20%	22.00%			9		11	4	127

Source: ClearView Energy Partners, LLC, EIA, RFA, House Office of the Clerk, CNN, US Senate, Electoral College

THE POLITICAL REALITY OF THE MORATORIUM

State	Oil Production (B bbl/Y)	Natural Gas Production (MM Mcf/Y)	% of US Production (B bbl OE)	House Delegation	Senate Delegation	House D's at Risk	Senators on Cycle	2006 New House D's	2008 New House D's	2008 Electoral Votes
AL	7,546	49,194	0.89%	2D, 5R	0D, 2R	1	1R	0	1	9
MS	22,102	61,408	1.31%	3D, 1R	0D, 2R	1		0	0	6
LA	73,011	245,843	4.99%	1D, 6R	1D, 1R	1	1R	0	0	9
TX	398,014	1,375,563	27.78%	12D, 20R	0D, 2R	2		2	0	34
GOM Producers	500,673	1,732,007	34.97%			5		2	1	58
FL	1,956	486	0.04%	10D, 15R	1D, 1R	4	1R	1	2	27
Net Impact						1				85

Source: ClearView Energy Partners, LLC, EIA, House Office of the Clerk, CNN, US Senate, Electoral College

A FIELD GUIDE TO OFFSHORE DRILLING POLICY CREATURES

- **“Principled opposition”** usually out of concern that drilling activities could harm coastal industries (fishing, tourism, etc.) or disrupt fragile ecosystems. (Florida)
- **“Pragmatic opposition”** by one or several adjacent states seeking greater shares of the proceeds from energy production in federal waters. (Louisiana, Alaska)
- **A “beach brawl”** between adjacent states competing for shares of offshore mineral proceeds. (Border war between TX and LA resolved with 1958 Geneva Convention on OCS)
- **A “turf war”** between coastal states and inland states. Inland states benefit financially from national trust funds financed with offshore mineral proceeds (Dorgan, Bingaman, et al.)
- **A “prize fight”** between leaseholders and the Interior Department over federal royalty payments. (*Kerr-McKee v. Allred*, royalty hikes).

KEY TURNING POINTS IN THE OFFSHORE DRILLING POLICY STORY

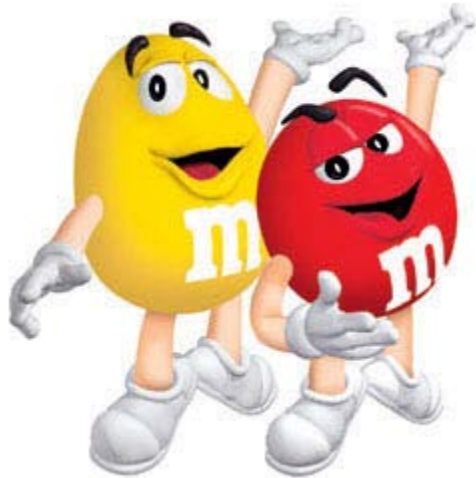
- **1953:** Outer Continental Shelf Lands Act
- **1958:** Geneva Convention on the Outer Continental Shelf
- **1981:** Congressional moratoria begin
- **1995:** Deepwater Royalty Relief Act
- **2005:** EPLRA extends DWRR, creates new incentives for ultra-deep wells in shallow water
- **2006:** Interior department draws “administrative boundaries”
- **2007:** Bush Administration includes Virginia in 5Y offshore leasing program
- **2008:** Presidential withdrawal lifted, Congressional moratoria lapse
- **2010:** Virginia Withdrawn from 5Y program, Alaska delayed

KEY PRINCIPLES

- **Two Types of Policy Responses:**
 - **Legislative** → slow-moving, but long-lasting, if not permanent
 - **Regulatory** → can be quicker, but not necessarily durable
- **Three Tiers of Policy Response:**
 - **Regulatory reform:** regulatory and/or legislative
 - **Fixed and variable cost changes:** regulatory and/or legislative
 - **A Congressional “stampede”:** legislative only (obviously)
 - **Example #1:** Sarbanes-Oxley (if Macondo is Enron, what could be WorldCom)?
 - **Example #2:** 2008 vote to suspend the SPR fill passes 97-0
 - **Example #3:** Dubai Ports World

CHANGING THE CHARACTER OF OFFSHORE REGULATION

MMS



- Hard Candy Shell, Very Sweet
- “Enabling” Regulator
- 30-day turnaround on exploration plans
- Categorical exclusions

~~FAVRE~~ BOEMRE



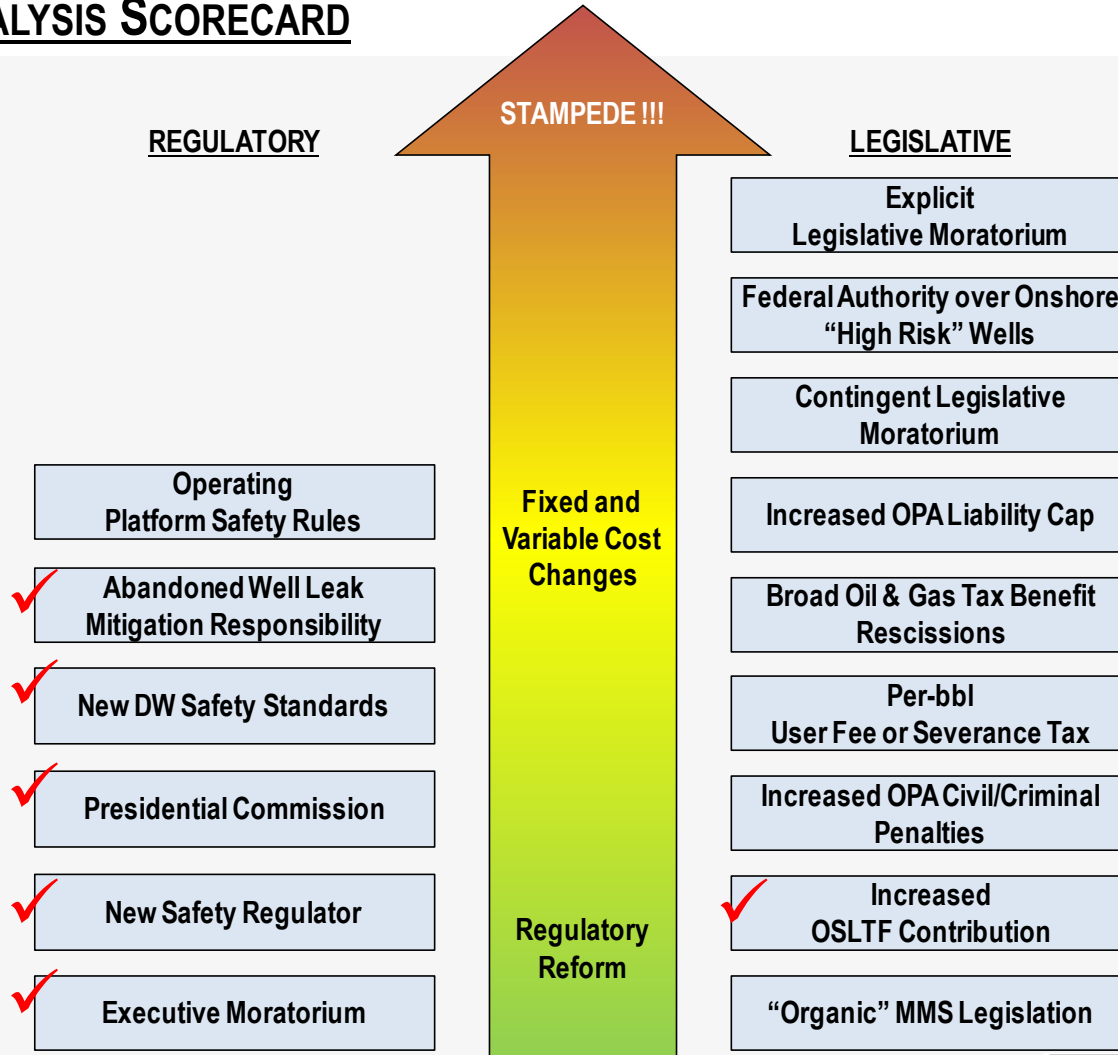
- Hard to Pronounce
- “Enabling” Regulator
- “Limiting” Regulator
- 90-day turnaround?
- New EIS/EA requirements

Source: M&M Mars Corp., Media Sources

FIXED AND VARIABLE COST CHANGES

- **Higher liability limits:** at 2% of liability estimated premium, \$1.5 billion \approx \$30 MM fixed cost
- **Higher bonding requirements:** \$105MM in cash tied up per well?
- **Higher civil and criminal penalties:** \$4,300/bbl is already the largest potential cost of spill
- **Higher mineral royalties:** 16.67% in shallow-water, 18.75% in deepwater, going up?
- **Higher OSLTF contribution:** \$0.08/bbl to \$0.78/bbl in only five months!
- **“Conservation” fees:** \$2/bbl, \$0.20/Mcf cleared the House; \$9/bbl has been proposed

SCENARIO ANALYSIS SCORECARD



Source: ClearView Energy Partners, LLC

IN A CONGRESSIONAL “STAMPEDE”, THERE IS NO DIFFERENCE

DOGS



Source: Mars Veterinary, Associated Press

RIGS



WHY RISK WASHED ONSHORE

Event	Policy Response
Upper Big Branch, April 5, 2010	Regulatory: Company-specific investigations, enforcement
<i>Deepwater Horizon</i> , April 20, 2010	Regulatory: regulatory reforms, fixed and variable cost changes, potential civil/criminal penalties. Legislative: variable cost changes likely, possibly more
Clearfield County, PA gas well blowout, June 3, 2010	Regulatory: company-specific Legislative: change of sentiment?
Moundsville, WV gas well blowout, June 7, 2010	Regulatory: company-specific Legislative: federal concern about adequacy of local regulators?

At the Three Mile Island nuclear plant in 1979, no plant workers died or suffered injuries, but a tremendous number of stakeholders outside the direct extraction value chain could have been harmed. It may be that potential stakeholder externalities produce a greater political reaction than financial losses or worker fatalities.

LAWMAKERS' RISK PERCEPTIONS OF THE OIL & GAS INDUSTRY

Rep. Mike Doyle (D-PA)
1/20/2010



Last year alone Pennsylvania could attribute nearly 50,000 jobs to environmentally safe natural gas production. I have long supported the development of domestic natural gas resources as one of the solutions to meeting the growing energy demands in the United States.

Source: Congressional Record, website of Rep. Mike Doyle`

LAWMAKERS' RISK PERCEPTIONS OF THE OIL & GAS INDUSTRY

Rep. Mike Doyle (D-PA)
6/15/2010



There is simply no reason we should continue to extract our natural resources in a hegemonic and voracious style. [...] The natural gas in the Marcellus Shale isn't going anywhere. I think it's time we take a step back ...

Source: Congressional Record, website of Rep. Mike Doyle

DISCUSSION