

time for action – not words

oil spills, nationalism and risk

The Deepwater Horizon oil spill in the Gulf of Mexico is a tragic accident, and debates about culpability – let alone nationalistic name-calling – are both premature and inappropriate. The priority should be action, not political point-scoring.

Gulf communities' anger at this disaster is addressed at Big Oil, and not specifically at BP as a “foreign” company. This anger could increasingly be directed at politicians, if practical assistance is allowed to take second place to rhetorical name-calling.

The stricken Gulf communities need immediate practical (meaning financial) help – bailing out the Gulf Coast's Main Street is every bit as imperative now as bailing out Wall Street was in 2008, and how the tab is shared out can be left for later.

Though the industry and its regulators will (and must) learn from this disaster, risk is implicit as the industry moves into ever more technically challenging frontier territories. This process, which reflects the perfectly logical past cherry-picking of the easiest and cheapest reserves, is an inevitable concomitant of the maintenance of economically- and socially-vital access to exogenous energy.

Conflicting demands

“What the people of California want”, a senior American oil executive once told us, “is simple. They want no exploration, no production, no pipelines and no refineries. And they have a God-given right to drive a hundred miles a day”.

This attitude – which is by no means confined either to Californians or, indeed, to Americans – sums up society's ambivalent relationship with petroleum. Oil is nasty stuff – it is toxic, it is dirty, its refined products are lethally combustible and, long before the MC 252¹ spill in the Gulf of Mexico, it had ruined habitats in almost every corner of the globe. It has been the cause of numerous wars and insurrections. But, without it, **society would literally grind to a halt.**

We are moved to comment on the Gulf of Mexico disaster for two reasons. First, this tragedy underlines the point, made in a previous report², that the era of “easy” oil is drawing to a close, and that the search for energy will, increasingly, take the industry into areas which are not simply hugely costly and technologically challenging but are also, inevitably, highly dangerous.

¹ MC (Mississippi Canyon) block 252 is the location of the oil spill which is often referred to as the “BP” or “Deepwater Horizon” spill.

² See *Tullett Prebon Strategy Insights* Issue Five, *Dangerous Exponentials*, June 2010

Second, the politicisation of the issue has moved beyond the daft and into the dangerous. In the UK, the American attack on BP is increasingly being interpreted – quite wrongly – as an attack on Britain. **This interpretation is fundamentally mistaken** – Barack Obama’s assault on BP has become wildly intemperate, but it would, we are certain, have been no less vitriolic had the company in question been an American rather than a “foreign” oil giant.

After all, national sentiment did not in any way protect Exxon from a wave of public and political vilification after the (much smaller) *Valdez* spill. The target of American public and political anger is not Britain – rather, it is Big Oil. Protesters’ placards tend to equate the company’s initials not with “British” but with terms such as “Beach Polluter”.

Logic alone is not, we suspect, going to cool international tempers over the nationalistic dimension of this row. We can even anticipate at least one future line of attack – “yes”, somebody in Britain is surely going to say, “we agree that it is awful when innocent people lose their livelihoods because of someone else’s toxic muck – *so will America please compensate the rest of us for sub-prime?*”

Such trading of accusations achieves precisely nothing. Here, we endeavour to stand back and to appraise this issue in a balanced way.

First and foremost, MC 252 is a tragedy of epic proportions. Vast swathes of the Gulf of Mexico are carpeted with a toxic brown sludge which now threatens vitally-important coastal habitats along hundreds of miles of America’s southern coast. The livelihoods of huge numbers of Americans have been imperilled. This is a particularly harsh blow for communities which are only gradually recovering from the tragedies of hurricanes Rita and Katrina. With the hurricane season now beginning, the oil catastrophe does not by any means confer immunity from a re-run of those natural disasters – and even an otherwise-modest hurricane could play havoc with the oil recovery operation.

The sheer scale of this ecological and human tragedy compels a response from America’s leaders, and Mr Obama is uncomfortably aware that George W. Bush’s ill-starred presidency was seriously undermined by the inadequacies of his administration’s response to Katrina and Rita.

But we believe that the tenor and nature of Mr Obama’s response has been wholly misdirected. And the president’s increasingly intemperate and inappropriate stance carries its own hazards. Whilst Mr Bush was castigated for expending too little energy over one Gulf tragedy, his successor risks being accused by posterity (and by the voters) of expending too much energy *in the wrong direction*. What the people of the Gulf Coast need, right now, is help – they do *not* need rhetoric.

Forces of nature

To understand why bombast is inappropriate, we need to be aware of the simple fact that MC 252 – like *Exxon Valdez* before it – is **an accident**. As yet, no one really understands the precise causes of the explosion which destroyed the *Deepwater Horizon*, killed eleven rig workers and unleashed vast pollution into the Gulf. Neither can we, yet anyway, know how blame will ultimately be apportioned between BP, other companies, and the state and federal regulatory authorities.

But there is, surely, one absolute certainty here, which is that **no-one deliberately set out to desecrate the Gulf, and to lose vast sums of money in the process**. Ultimately, what has happened in the Gulf of Mexico is a tragic accident. Like *Exxon Valdez* before it, the political response to MC 252 reveals a distressing and inappropriate tendency to attempt to criminalise accidents.

Comprehensive (and hugely expensive) inquiries will naturally follow, and we may, after a great deal of time has elapsed, finally establish why, for instance, the BOP (blow out preventer) failed to do its job. For the moment, however, blame can wait, and responsibility for this tragedy is not the primary issue. That issue is, surely, capping the well, minimising (in so far as this is possible) the environmental impact, and providing practical help for the people whose lives have been blighted by this tragedy.

In the wildly improbable event of Mr Obama reading this report (and if we had the sheer temerity to make suggestions), our advice would be straightforward – **shift the focus from pointless recriminations to practical assistance**.

When tempers cool, the people of the Gulf Coast might well begin to ask why, if Washington can find \$700bn to bail out Wall Street, it is not equally capable of finding comparably huge resources – in other words, “whatever it takes” – to provide *immediate* help to the stricken communities and industries of Alabama, Mississippi, Louisiana and Florida.

To be sure, Washington is probably going to get most of its money back from the bankers bailed out in 2008 but, when government intervened in the banking crisis, this was very far from obvious, yet assistance was provided anyway. In opposition, Mr Obama was fond of saying, surely quite correctly, that government should provide at least as much help for Main Street as for Wall Street. Well, **here is his opportunity to deliver on this stance.**

Because the same principle surely applies here – government needs to provide massive help to the Gulf Coast, and to do it right now. Depending upon due processes of law, much, perhaps even most, of this outlay may be recovered later. But the stricken Gulf communities need massive help *now*.

The nature of risk

In response to the observation that MC 252 is, ultimately, an accident, we will no doubt be told that, whilst there was indeed no deliberate intent, there must have been negligence. A widespread assumption seems to be that nothing would ever go wrong, anywhere in the world, if appropriate precautions had been put in place beforehand. The guilt for this negligence in this particular instance, some will argue, may lie with BP, with other companies, or with regulators – perhaps with all of the above – but it must lie *somewhere*.

Longer term, we suspect that at least as much mud may stick to regulators as to BP. And, beyond the immediacy of this disaster, Americans might well begin to ask themselves why their country is so bad at regulating commercial activities, be it the mortgage industry, corporations or banks.

But **such an approach would be to miss the point.** Looked at from a standpoint which demands from regulators nothing less than omniscience, it can be hard to think of a tragedy, anywhere in the world, which could not have been prevented if only regulators, and government, had been up to the job.

Whilst society should, of course, never cease in the endeavour to improve regulatory processes, the *automatic* assumption of regulatory culpability is a counsel of perfection in an imperfect world. It is surely implicit in a changing economy that regulators are always behind the curve, and are always, to a greater or lesser extent, playing catch-up.

And it is surely necessary to appreciate that **the pursuit of complete freedom from risk is a chimera** – we do not learn much from the observation that millions of deaths on the world’s roads could have been prevented if only governments had taken the simple precaution of demanding that all vehicles be built from foam rubber and fitted with square wheels.

This recognition that life is intrinsically risky has a particular application to the petroleum industry. At MC 252, BP was undertaking a huge technological challenge, endeavouring to recover crude oil from more than a mile beneath a hurricane-prone ocean. It is all too easy to be blinded from this reality by the relative success and safety with which, generally speaking, oil companies conduct their activities. In the Gulf, as elsewhere, the oil industry is working at the frontiers of technology, and such frontiers can never be rendered entirely risk-free. The oil industry does this on a daily basis, be it in the frozen Alaskan tundra, the inhospitable waters of the northern North Sea, or the deepwater Gulf of Mexico.

In the future, it is inevitable that technology and risk will *increase*, not diminish, as ‘easy’ sources of oil are depleted and as the exploration effort moves into new and ever more challenging frontiers. The only real alternative to this risk escalation is to give up on oil.

This is a particularly pertinent point where the United States is concerned. Last year, America consumed 18.7 mmb/d³ whilst producing just 7.2 mmb/d. Put another way, the US accounts for almost 22% of global petroleum consumption on the basis of barely 2% of world proved reserves.

³ Million barrels per day

Within the 60% of America's oil needs that are imported, the majority does not come from politically 'safe' OECD countries. **This dependency is**, in its own way, **another very material form of risk**.

Understandably, therefore, successive administrations have sought to reduce US dependence on imported energy. The dream of energy self-sufficiency cannot be accomplished – if it can even be accomplished at all – by subsidising low-return energy sources such as corn ethanol.

The industry is likely to find very large reserves of oil in frontier territories such as the deepwater Gulf. Just one such example is the Jack #2-St. Malo discovery, which is potentially huge (even if rumoured reserves estimates as high as 15 bn bbls may need to be taken with a very large pinch of salt). But this field is in even deeper water (7,000 feet) than MC 252 (5,000ft), so inevitably presents similar challenges. Moreover, the Jack #2 well set several records for operating at extreme temperatures and pressures, meaning that this is development will be another technological frontier.

Are such projects now going to be deemed unacceptable on grounds of risk? Whilst a temporary moratorium on Gulf drilling makes perfect sense – since some lessons may well be learned from MC 252 – a longer-term avoidance of deepwater risk will have a very significant impact on America's future energy supplies.

Risk is implicit in exponential progression

Any attempt to de-risk the exploitation of petroleum would have far-reaching ramifications for future energy availability, and not just in the US.

To understand why this is so important, we need to grasp two key issues. The first of these is the utterly vital role played by hydrocarbon energy in modern society, and the second is the concept of "resource constraint". Our interpretation of both issues was outlined in a recent report – *Dangerous Exponentials*⁴ – which outlined our core research strategy.

Essentially, society and the economy as we know them today are energy constructs, because exogenous energy vastly leverages human capabilities such that exponential growth, not just in the world economy but in fundamentals such global population, has, to a large extent, been a function of energy availability.

As we made clear in that report, we do *not* believe in the simplistic "peak oil" interpretation, of which the classical statement is that oil supplies must now go into inexorable decline because we have used up about half of all originally-recoverable reserves. That interpretation implies that original reserves totalled some 2.2 tn bbls⁵, which is simply incorrect, since the actual total probably exceeds 3.5 tn bbls.

But those who deploy such figures to counter the "peakniks" are supplying the right answer *to the wrong question*. The important issues are *not* reserves in the absolute but, rather, (a) deliverability, and (b) the relationship between energy produced and the energy used to extract it (an equation known as EROEI, or "energy return on energy invested").

Whilst we have consumed a great deal less than half of all originally-recoverable oil, the industry has naturally cherry-picked the resource base, having first recourse to those sources that are cheapest and simplest to extract. Increasingly, the oil industry will move towards ever-costlier and more challenging resources which is where, of course, challenging projects such as the deepwater Gulf fit into the equation. It is self-evident that oil companies would not even bother with challenging offshore resources if abundant quantities of oil could be produced, much more cheaply, conveniently and safely, onshore.

Anyone who advocates concentrating instead on safer (and cleaner) energy sources such as biofuels needs to be aware that such an emphasis **would accelerate movement towards the energy returns "cliff edge"** described in that earlier report.

⁴ See *Tullett Prebon Strategy Insights* Issue Five, *Dangerous Exponentials*, June 2010

⁵ Trillion barrels

In other words, our reliance on hydrocarbon fuels, whilst it might conceivably diminish, will remain pivotal for the foreseeable future. This in turn carries an *implicit* uptrend in physical and environmental (as well as financial) risk.

The industry must (and undoubtedly will) learn from tragedies such as MC 252, but **we cannot de-risk an industry which is necessarily moving into ever more challenging technological as well as geographical frontiers**. Regulators should always seek to be better at what they do, but it is simply not realistic to expect perfection.

This logic provides no comfort for the people of the Gulf coast who, from their government, have an urgent need for help, not for rhetoric. They are at least as entitled as Wall Street to expect practical assistance from Washington.

Neither should politicians, in America or abroad, seek to make nationalistic capital out of what is, after all, a terrible tragedy – **not a conflict**.

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