

An aerial satellite-style image of the Gulf of Mexico coastline, showing the Gulf of Mexico in dark blue and the surrounding land in green and brown. The text is overlaid in the center of the image.

**IS THE GULF OF MEXICO
BACK IN PLAY?
OR
IS THE GLASS HALF
FULL OR HALF EMPTY?**

RONALD E. NEAL
HOUSTON ENERGY, L.P.



“WE HAVE MET THE ENEMY AND HE IS US”



Taken from
Walt Kelly's
poster for the
1st Earth Day
held in 1970


THIS IS WHAT THE PUBLIC THINKS OF WHEN THEY THINK OF THE GoM OIL & GAS INDUSTRY



AP/Charlie Riedel

THERE ARE MULTIPLE GoMs

- Shallow Water Players
- Deepwater Players
- Exploration Companies
- Development/Production Companies
- Sunset Life Production Companies
- Service Companies
- NOC's
- IOC's
- Independents

An aerial satellite-style map of the Gulf of Mexico coastline, showing the land in shades of green and brown and the water in blue. The text is overlaid in the center of the image.

**THE FOCUS TODAY IS ON
THE STATE OF THE GoM,
POLITICALLY AND
ECONOMICALLY
AND
THE ROLE OF INDEPENDENTS**

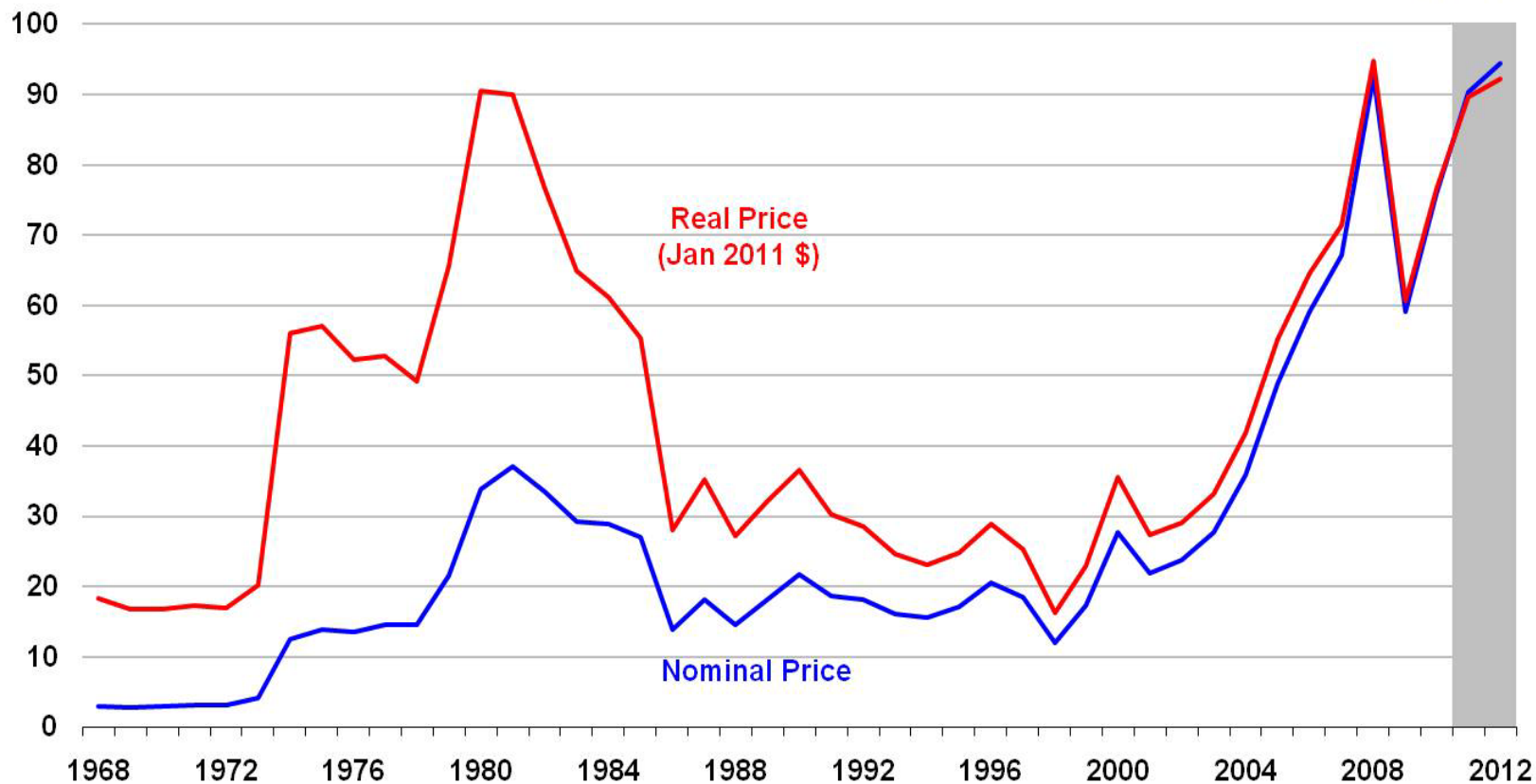
US ENERGY FACTS

- We consume +/- 18.7 MMBO/day
 - We produce +/- 7.2 MMBO/day
 - We import +/- 11.5 MMBO/day (63%)
 - +/- 5.9 MMBO/day comes from OPEC
- We are the largest consumer of oil in the world
- Our consumption continues to rise
- We will be dependent upon fossil fuels for years
- Crude oil prices continue to rise
 - Political unrest in producing regions
 - Growing global economies

Annual Imported Crude Oil Price

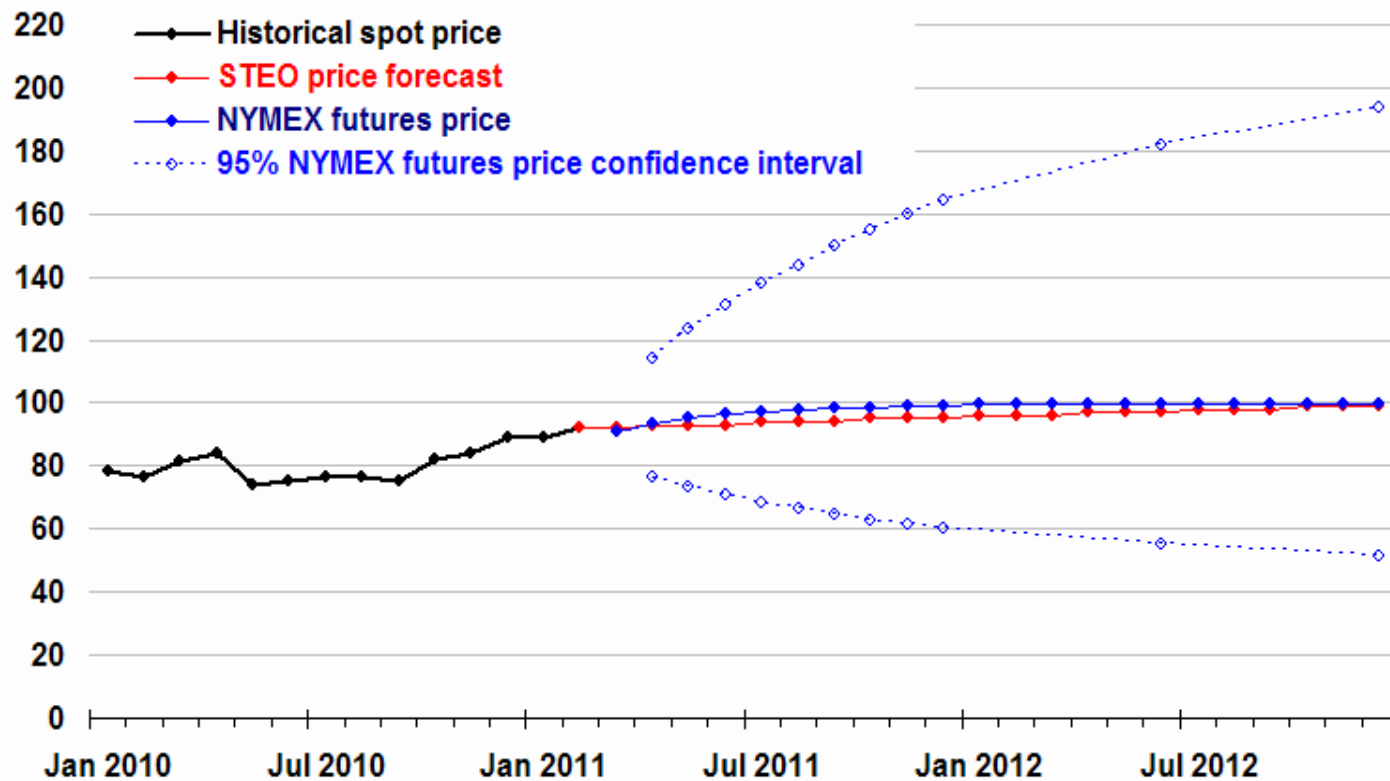
Dollars per barrel

Forecast



West Texas Intermediate (WTI) Crude Oil Price

dollars per barrel



Note: Confidence interval derived from options market information for the 5 trading days ending February 3, 2011

Intervals not calculated for months with sparse trading in "near-the-money" options contracts

Source: Short-Term Energy Outlook, February 2011

A satellite-style map of the Gulf of Mexico coastline, showing the landmasses of Texas, Louisiana, Mississippi, and Alabama. The water is a deep blue, and the land is a mix of green and brown. The text "INDEPENDENTS IN THE GoM" is overlaid in the center.

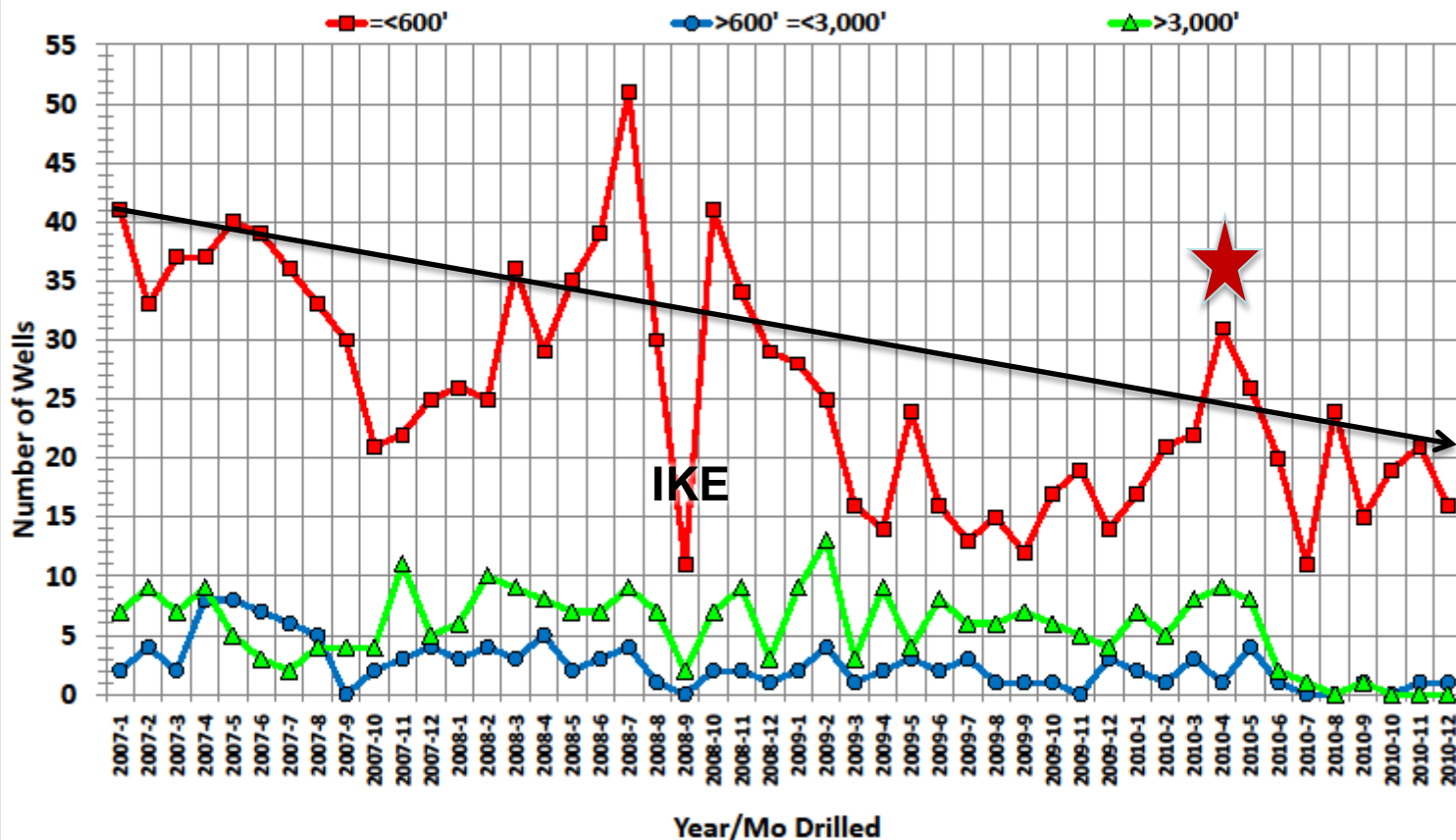
INDEPENDENTS IN THE GoM

INDEPENDENT'S CONTRIBUTION TO GoM

- Independents are the largest leaseholders in the GoM. They own interest in 66% of the undrilled leases in the GoM and in 81% of the producing leases
- Independents own interest in 52% of all deepwater leases
- Independents account for 73% of the production from the GoM shelf
- Independents have drilled 1298 of the 3191 wells (40%) in deepwater
- Independents are responsible for 70% of the farmins
- Four of the last seven years independents have drilled >50% of the wells in deepwater
- The loss of independents will stifle competition for leases and resource development in the GoM

Independents, not just “Big Oil”, help maximize US employment, revenue and National Energy Security.

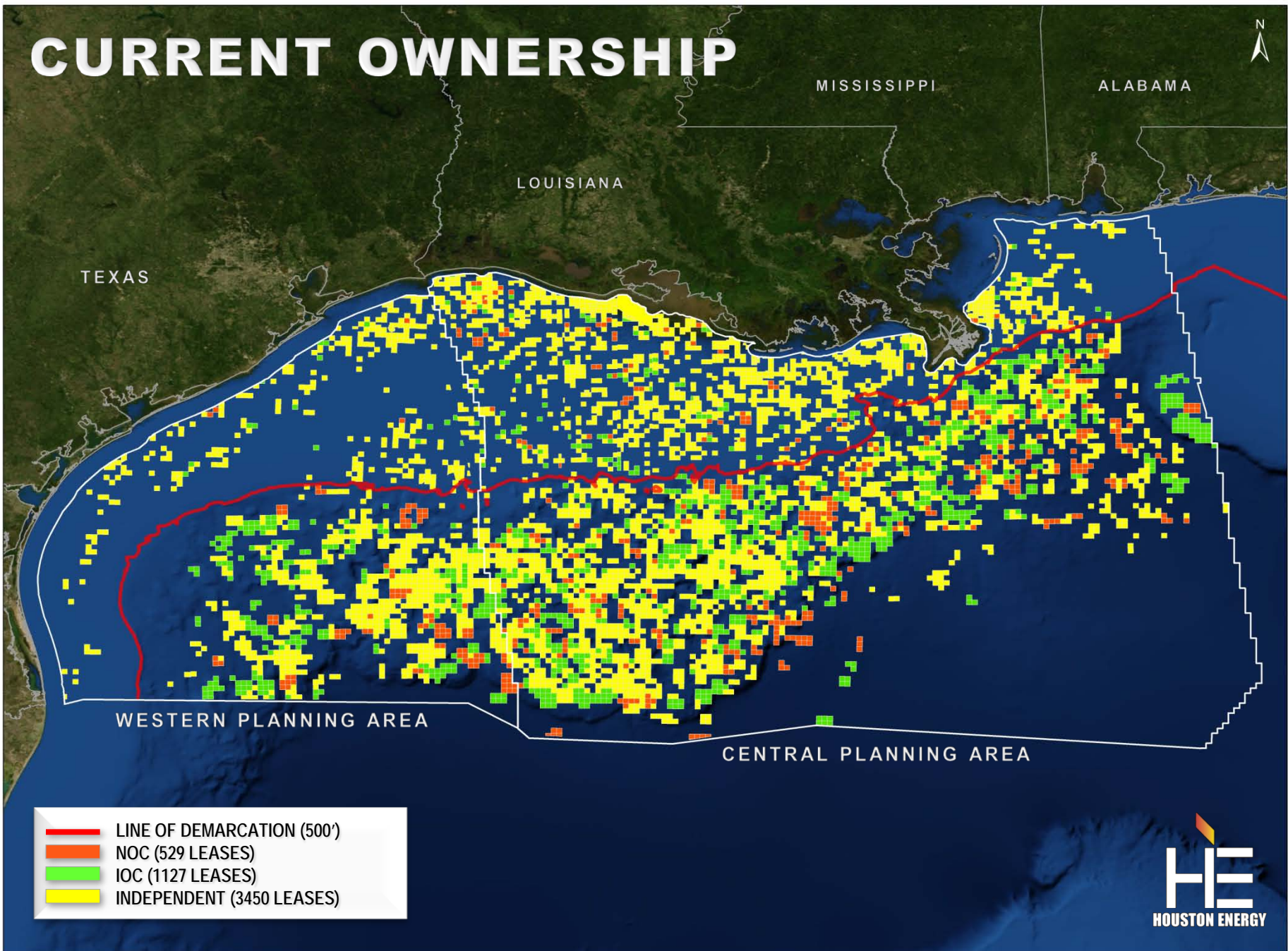
Chart 086 - U.S Gulf of Mexico
 Wells Drilled 2007 - 2010/12 YTD
 By Year/Mo Drilled - Water Depth Ranges



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CURRENT OWNERSHIP



MISSISSIPPI

ALABAMA

LOUISIANA

TEXAS

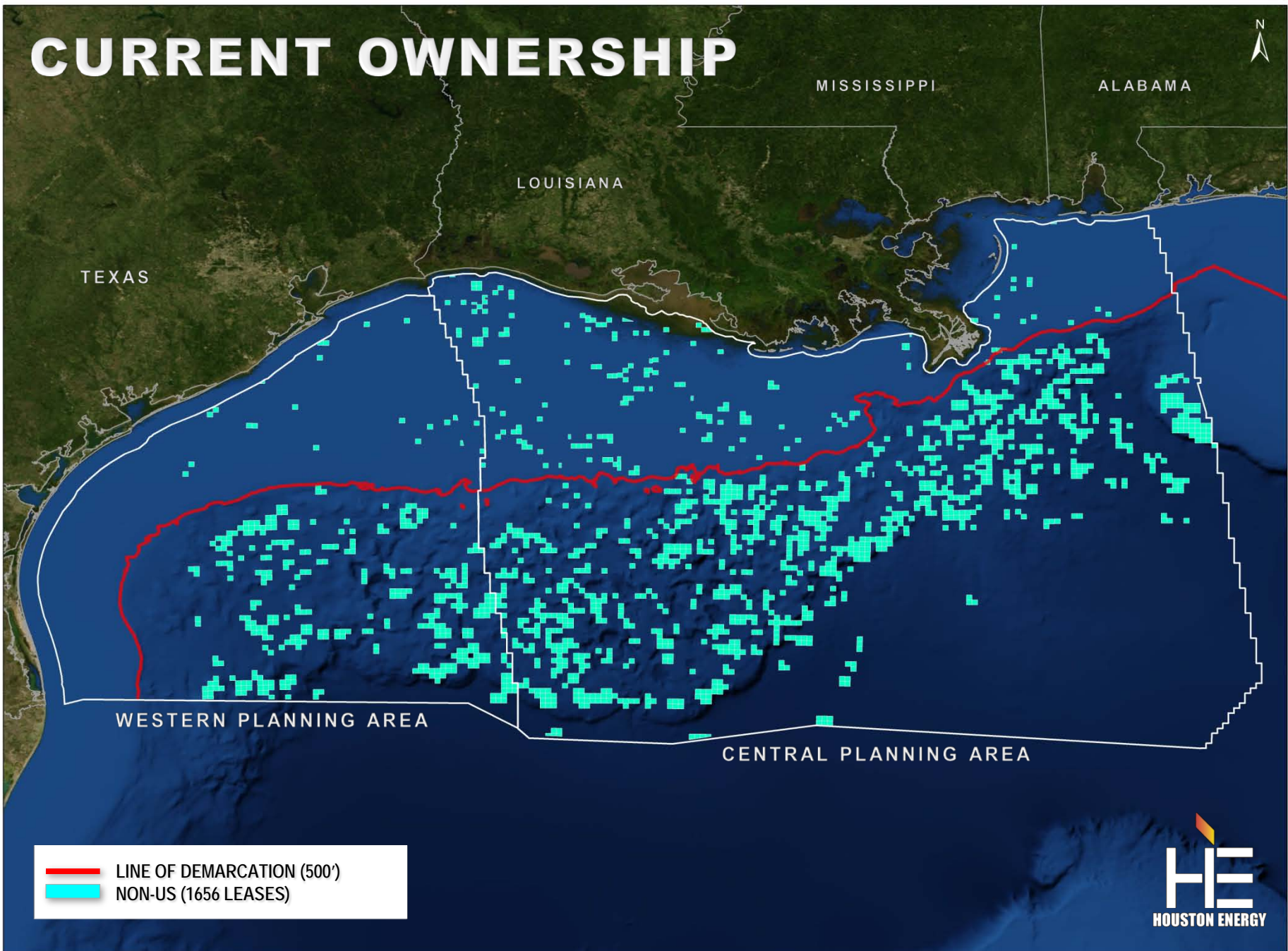
WESTERN PLANNING AREA

CENTRAL PLANNING AREA

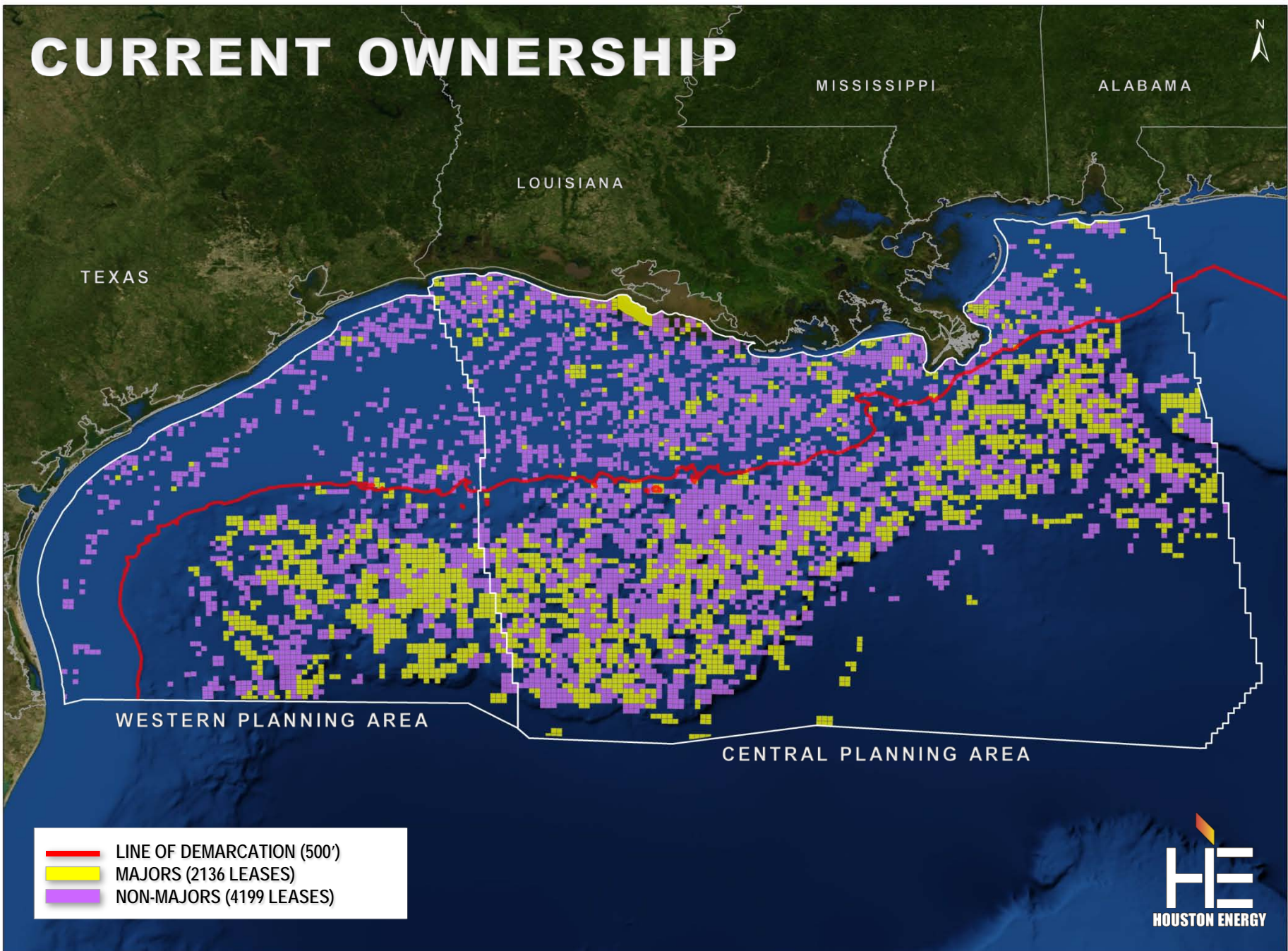
- LINE OF DEMARCATION (500')
- NOC (529 LEASES)
- IOC (1127 LEASES)
- INDEPENDENT (3450 LEASES)



CURRENT OWNERSHIP



CURRENT OWNERSHIP



- LINE OF DEMARCATION (500')
- MAJORS (2136 LEASES)
- NON-MAJORS (4199 LEASES)



A satellite-style map of the Gulf of Mexico coastline, showing the landmasses of North America and Central America in shades of green and brown, and the ocean in blue. The text "THE 'BLACK SWAN' EVENT" is overlaid in the center.

THE "BLACK SWAN" EVENT

MACONDO DISASTER TIMELINE

- **April 20, 2010** – Deepwater Horizon Explosion
- **April 22, 2010** – Deepwater Horizon sinks
- **May 2, 2010** – Drilling of first relief well begins
- **May 6, 2010** – DOI declares a moratorium on all new drilling permits
- **May 16, 2010** – Drilling of second relief well begins
- **May 26, 2010** – Shallow water moratorium lifted
- **August 2, 2010** – Leak officially estimated at 62,000 barrels per day
- **September 3, 2010** – Failed blowout preventer removed and replaced
- **September 16, 2010** – Relief well reaches destination
- **September 19, 2010** – Macondo well effectively killed
- **January 11, 2011** – National Commission on the BP Deepwater Horizon Oil Spill Report Issued

IMPACT OF MACONDO

THE UGLY REALITIES

- 11 dead
- The largest oil spill in history
- The largest cleanup in history
- Federal regulators failed in their oversight of the well
- Lost public confidence
 - “What do the Three Mile Island meltdown, the September 11 terrorist attack in New York and the Gulf of Mexico oil disaster have in common. Ineptitude and complacency by humans in charge.”
 - After the failed “junk shot”. “I was looking for a star wars solution, not something from Forrest Gump”
- Distorted perceptions of the well
 - Not the deepest well
 - Not in the deepest water
 - Not the highest pressure
- Most people (like me) thought the blind-shear rams could cut anything

NATIONAL COMMISSION ON THE BP DEEPWATER HORIZON OIL SPILL AND OFFSHORE DRILLING REPORT

- Places the blame on the management of BP, Transocean and Halliburton.
- Places blame on the federal regulators responsible for overseeing the well.
- The explosive loss of the Macondo well could have been prevented.
- Creation of an industry-funded safety organization to ensure that all companies are sharing information and employing best practices in drilling in deep water.
- A significant increase in budget, manpower and authority at the Bureau of Ocean Energy Management, Regulation and Enforcement, the primary body overseeing offshore drilling. The agency should have its own enabling legislation and a director insulated from political pressure.

NATIONAL COMMISSION ON THE BP DEEPWATER HORIZON OIL SPILL AND OFFSHORE DRILLING REPORT

- Greater participation of government scientists and engineers in oil leasing decisions, including early involvement of specialists from the National Oceanic and Atmospheric Administration and the Coast Guard. The group will recommend greater public input as well.
- Lifting the current \$75 million cap on corporate liability for damages from an oil spill.
- Devoting the bulk of fines levied under the Clean Water Act to restoration of Gulf of Mexico waters, fisheries and shorelines.
- Significantly strengthening the oil-spill-response capabilities of government and industry in the Arctic Ocean before any new major drilling is allowed there.
- Lengthening the time for review of drilling applications from the current 30 days to at least 60 days, to allow for more thorough assessment of the potential environmental and safety risks of the project
- “Complex systems almost always fail in complex ways”

A satellite-style map of the Gulf of Mexico coastline, showing the land in shades of green and brown and the water in various shades of blue. The map is centered on the Gulf of Mexico, with the coastline of the United States and Mexico visible. The text "THE POST MACONDO ENVIRONMENT" is overlaid in the center of the map.

THE POST MACONDO ENVIRONMENT

THE ECONOMIC EFFECT

- Louisiana has lost more than 25,000 jobs statewide since June 2010
- The Energy Department states that 2011 offshore oil production will fall 13% compared to 2010
- The Interior Department estimates that the new rules will add an additional \$1.4 MM in cost for each deepwater well and extra \$90 M in cost for each shallow water well (excluding additional insurance costs)

THE ECONOMIC EFFECT

- Since the drilling moratorium 5 jackups have left the GoM.
- A total of 14 deepwater and shallow water rigs have left.
- In 2009 Majors (\$13.6 billion) and Independents (\$10.4 billion) spent \$23.6 billion in deepwater drilling and support.
- In 2009 Independents (\$1.78 billion) and Majors (\$ 121 million) spent \$1.9 billion in shallow water drilling and support.

ADVERSE EFFECTS TO THE VIABILITY OF THE GoM

ECONOMIC

- Resource plays
- Commodity Risk
 - Weak natural gas prices
 - Oil price swings
- Worldwide economic recession
- Volatile financial markets; no money

GOVERNMENTAL

- Adversarial political climate
- Uncertainty
 - NTL issuance and compliance
 - Financial requirements
- Tax proposals
 - To cut intangible drilling costs
 - To cut depletion allowance
- The administration called for tax hikes on the "oil companies," stating, "I don't know if you've noticed, but they're doing just fine on their own."

THE GREATEST THREAT

- Governmental “ Creep”
- Governance by regulation and not legislation
- Bureaucratic Delays
- Impossible and unrealistic EPA standards
- Catastrophic Financial Standards
- Competing organizations representing different groups with different agendas

INDUSTRY INITIATIVES

- Subsea Well Control and Containment Task Force. The industry with the input from the API, IADC, IPAA, NOIA, USOGA
- The formation of the Marine Well Containment Company by Exxon, Shell, Chevron and ConocoPhillips. Fully operational in 2 years.
- The formation of the Helix Fast Response System. Operational March 2011.
- Clean Gulf Associates

SOLUTIONS

- Cooperative oversight of the industry by the formation of an oversight organization similar to “INPO” which was formed in 1979 after 3 Mile Island
 - Membership in INPO is required to get insurance
 - Operators are graded and rates are based on your grade

An aerial satellite-style map of the Gulf of Mexico coastline, showing the land in shades of green and brown and the water in blue. The text "THE ROAD TO RECOVERY" is overlaid in large, bold, white letters with a black drop shadow.

THE ROAD TO RECOVERY

TWO DIFFERENT AGENDAS

POLITICAL

- To punish the oil industry for the perception of it being an “evil profiteer”
 - Increased taxes
 - Elimination of the intangible drilling deduction
 - Personal criminal liability
- “Obamatorium”: The defacto drilling moratorium
- Take advantage of a crisis to promote a “green” alternative energy agenda
- No recognition that fossil fuels will be needed for decades
- To punish the Gulf Coast States that did not support the administration in the last two elections

INDUSTRY

- Fulfill our role as energy providers for the country
- Provide domestic production necessary for national security
- Keep our dollars at home and not send them overseas; weakening our economy
- Get people back to work as soon as possible

POSITIVES

- A New congress
- The nation needs the energy
- The engineering challenges will be solved
- An improving global economy
- Uplifts from advancing technologies:
 - Seismic: WAZ, RTM, and controlled source acquisition are common place. Computing power keeps improving
 - Chinook is installed as the first FPSO in the GoM and is also the worlds deepest moored FPSO
- Inflation is inevitable and energy commodities are a good hedge
- Prior to Macondo industry drilled over 3100 deepwater wells (wd >1000') without a major spill

NEGATIVES

- Wall Street has little interest in shallow water and no interest in deepwater
- The GoM now has political risk
- Uncertain EPA/NEPA rules, requirements and delays
- Prolonged permitting
 - Complex and uncertain standards
 - Regulators are resistant to place their name on an approved permit because of repercussions
- Unknown but increasing CoFR and liability limits
- Soft gas prices
- Alternative investment opportunities in resource plays taking money away from the GoM
- Exiting players i.e. Devon and Plains
- Industry consolidation i.e. Mariner merges with Apache
- An aging workforce

RESPONSIBILITIES

- **We need to work to win the public's confidence**
 - Work with the government to establish and implement appropriate engineering standards
 - To respect our environment
 - To be responsible stewards of our natural resources
 - Achieve total workplace safety
- **We will:**
 - Meet the engineering challenges to drill and produce safely and cleanly

UNCERTAINTY & UNREALISTIC SCENARIOS

- The BOEMRE creates new requirements then tries to develop rules to support the new regs.
- NTL 2010-N05: New safety regs (BOP's) and CEO certification
- NTL 2010-N06: Worst Case Discharge
 - WCD: No realistic way to ascertain. This is especially true in exploration wells
 - Oil Spill Response Plan: Calculate WCD. Show capacity to handle 50% in 24 hrs, 100% in 36 hrs, 200% within 48 hrs & 400% in 60 hrs then reduce your response capacity by 80%.
- Elimination of categorical exclusions with no clear standard how to meet a new EA to comply with NEPA
- CoFR and Liability levels. Only 10 companies in the GoM have a market cap above the \$30 billion liability incurred by BP.
- Will there be extensions to expiring blocks?
- Will there be a level playing field?
- When is the next OCS sale?
- Delays kill economics.

CONCLUSIONS

SHALLOW WATER GoM

- **Positives**

- Mostly gas
- High rate production
- Jackup rigs with their BOP at the surface.
- Well developed infrastructure
- Reduced competition
- Inexpensive data

- **Negatives**

- The size of the prize
- High decline rates
- Mostly gas
- NTL 5 CEO Liability
- NTL 6 (WCD)
- NTL 2010 –G05 (idle iron)
- CoFR & liability will probably go up
- Money is hard find
- No new players
- Increased environmental liability
- No new technology uplift

DEEPWATER GoM

- **Positives**

- Size of the prize
- Mostly oil
- High rate production
- Developing infrastructure
- New technology uplifts

- **Negatives**

- Complicated regulations
 - NTL 5
 - NTL 6 (WCD)
- CoFR & liability will go up
- Increased environmental liability
- Very competitive
- Will the independents be squeezed out?

THE FUTURE OF THE GoM

The deepwater GoM (WD > 500') will continue to be very active because of the size of the prize.

INDEPENDENTS ARE >50% OF THIS.

The shallow water GoM (WD < 500') will continue to exist but will most likely never recover to earlier levels.

INDEPENDENTS ARE VIRTUALLY 100% OF THIS.

MY VIEWS

- We should be responsibly developing safe “green” energy alternatives alongside our own petroleum based resources.
- America needs its own energy.
- Today, the US sends \$977,000,000/day to other countries for their oil.
- We send \$505,000,000/day to OPEC producers.
- **We send OPEC \$184 BILLION/year.**
- All told we send all of our oil providers \$356 BILLION/year

MY VIEWS

- **With growing oil imports we are killing our economy**
 - **Jobs**
 - **Balance of trade**
 - **Deficit**
 - **Inflation**
- **We have sacrificed our sons and daughters to secure oil for our national interests from hostile tyrants**

MY VIEWS

We are willing to:

Die for oil in another country

Kill for oil in another country

Lose jobs for oil in another country

Sacrifice our economy for oil from another country

Instead of:

Drilling in American waters

**PUNISHING AMERICAN PRODUCERS DOES
NOT CREATE “GREEN” ENERGY OR HELP
AMERICA**