

## THE 2010 OUTLOOK



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Events of the past 18 months prove there are no crystal balls out there worth having. But let's look at the outlook for energy legislation, financing, oil and gas prices and rig counts anyway.

At press time, analysts from Morgan Stanley and a senior official with Barclays Capital declared there will be no energy climate-change bill passed by the Senate in 2009—nor in 2010.

"Here's what I view as the baseline or the undertow to prevent legislation. Four words: health care, jobless recovery. I'm afraid the momentum to pass energy legislation with cap-and-trade in the Senate looks shaky," Theodore (Ted) Roosevelt IV said at a recent meeting of the Houston chapter of Young Professionals in Energy. (By the way, the organization boasts 4,000 members in Houston alone and 20 chapters worldwide, so there's hope for the future.)

Roosevelt, a managing director at Barclays, is also chairman of the Pew Center for Global Climate Change, and capped a 36-year career at Lehman Brothers as chairman of Lehman's council on climate change in 2007.

In mid-November, he said, the Copenhagen climate-summit organizers were already lowering expectations for an international deal and working on Plan B. "If we end up with a weakened bill, we might end up beginning 2011 with higher renewable-fuel standards but no cap-and-trade."

As part of the bumpy road to a new U.S. energy policy, a fierce battle for public approval is under way between the natural gas and coal lobbies. The score is tied, 23-23. Each commodity provides about 23% of total U.S. energy supply. Big Oil supplies 40% and hydro, solar, renewables and nuclear the rest.

The Senate needs 60 votes to pass its energy bill. Of note: there are 31 states that produce natural gas. Other geographic fights are going on as well.

"We see a sort of competition between California and Texas on who is the leader of the green movement," Dr. Michael Webber told the YPE group. He is associate director of the Center for International Energy and Environmental Policy in the geosciences school of the University of Texas, and co-director of clean energy at the Austin Technology Incubator.

"In a carbon-constrained world, Texas can do very well. We'll sell them natural gas, wind and solar. We're No. 1 in gas production, No. 1 in wind, and I expect we'll be No. 1 in solar soon. We've got the can-do spirit. We can sequester carbon in West Texas—we've been doing it for decades. We've got the pipelines to do it.

"We have the ability to do these big projects and the world can pay us for it."

Green technology advocates are indeed bullish, no matter what outcome in Congress. But between uncertainty due to in-flux legislation, volatile commodity prices and just-recovering capital markets, many investors are taking a wait-and-see attitude.

"If you have ideas, they'd better be really good ideas, because people are scared. They don't know if they'll be able to raise another fund," Jeffrey Harris of Warburg Pincus told the Houston Energy Finance Group recently, speaking about private equity in general. "They don't know what kind of legislation is going to get passed. Are we at peak oil or not? Is oil going back to \$30 or back to \$130? Nobody knows what's going on with cap-and-trade.

"There's a huge amount of selectivity going on now."

Despite these uncertainties, most third-quarter conference calls indicated E&Ps are bullish, planning to ramp up their gas production in 2010, many of them by double digits.

"We see a rise of 20% to 30% in capex in 2010," Jon Wolff of Credit Suisse Securities (USA) told attendees at the recent IPAA annual meeting. "We see a median growth rate of 8% in U.S. gas production, and we look for producers in 2010 to outspend cash flow. Drilling costs have bottomed and will begin to creep up as we enter 2010."

The right rigs will be there. In 2009, the U.S. fleet gained a net 93 rigs, boosting the total by 3%, to 3,169. Utilization, however, fell to 40%. This is according to National Oilwell Varco's NOV Downhole Rig Census (formerly the Reed-Hycalog census, which has been issued for 56 years).

Observers say the old rig-count metrics have changed. Each rig that drills horizontally for gas is tapping into higher-flowing wells, making a rig count of 1,000 today equal the productivity of perhaps 1,500 or even 2,000 a few years ago.

What about oil? Demand is inching back up, and China is still pursuing supply worldwide. Beijing just announced it will forgive 80% of the \$8.5 billion in debt owed it by Iraq, with Chinese companies ready to help rebuild the war-torn country. In fact, China's thirst for oil and its imperative to snap up resources may create a new price floor for the commodity longer term.

For more commentary from Leslie Haines, see the blog "Leslie's Notebook" at [OilandGasInvestor.com](http://OilandGasInvestor.com).