

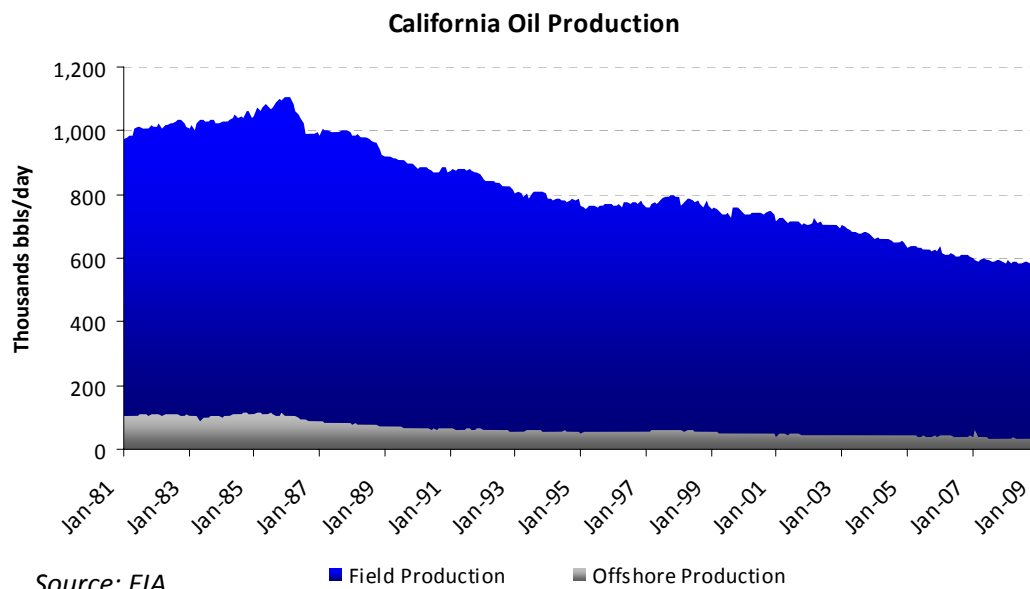


California Dreaming

The California State Assembly has managed to fend off an attempt by a private offshore oil production and exploration company to invade its sphere of influence. Just last week, the proposal to expand on the company's current offshore drilling had climaxed by reaching the plate of the State Assembly, only to be subsequently deflated. For the Golden State, the implications of such a proposal go beyond its borders and resounds around the nation. Policy defeats like this proposal seem to be a developing trend which could haunt the oil and gas industry in the US for the duration of the current White House administration.

The proposal brought forth was to expand upon the production of an existing rig located off the coast of Santa Barbara. This project would have been the first new offshore drilling lease in decades due to bans that have been put in place for offshore oil drilling.

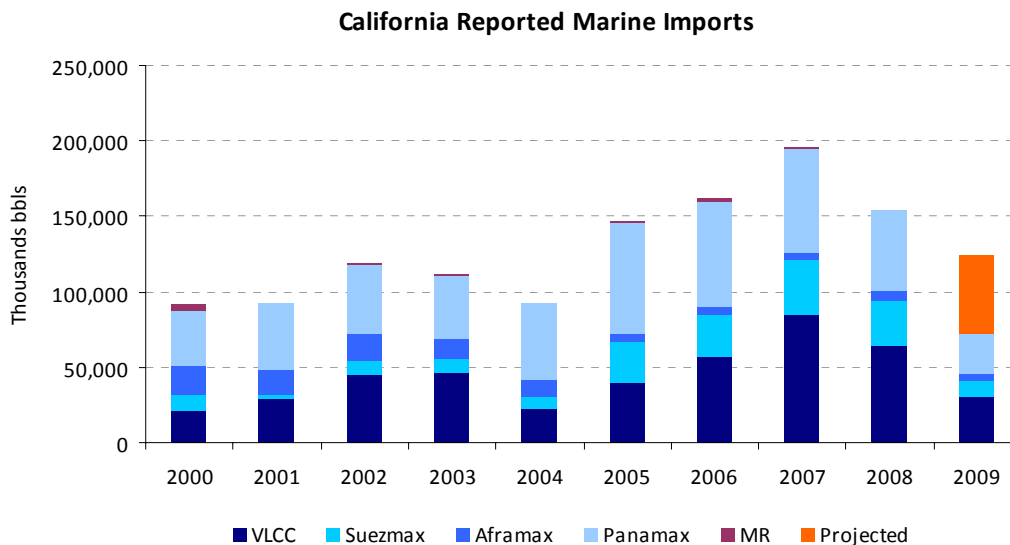
As seen in the chart below, California oil production continues to decline. An expansion like this proposal would have helped to slow this trend in the short-term.



In just the past twenty years, California oil production has declined by 42% and in the last ten years by 27%. In the offshore sector, production only accounts for 6% of California's total production which can be largely attributed to the impacts of the 1969 environmental ordeal.

At the time, Union Oil Company operated a rig off the Summerland coast of California when a pressure build up on a capped oil well surged so high that it created breaks in the East/West fault line, resulting in the seepage of approximately 4,700 bbls of oil. The spill took over 11 days to clean up and caused subsequent long-term ecological damage. Since the spill, which had a hand in starting the world-wide observance of Earth Day in April, the same waters have not seen a new offshore oil lease. So perhaps the California state legislature succeeded in making their point, but maybe it is time to loosen up the noose on the offshore oil and gas industry again – especially with the budget shortfalls and President Obama's initiative to reduce dependence on foreign oil.

On the reoccurring theme of importing foreign oil, California production and consumption mirrors that of a small country. Their oil consumption accounts for roughly 10% of US total consumption and as seen in the chart below, the demand for seaborne imports has been strong in recent years.



Source: Poten

According to the Energy Intelligence Agency (EIA) total California oil imports over the past five years were approximately 1.4 billion bbls with the majority of seaborne imports arriving via VLCCs from the Arabian Gulf and Panamaxes from Central and South America. Although the total reported annual seaborne crude oil imports are on track to finish in the region of 125 million bbls in 2009, the rejection of the recent proposal will likely encourage an increase in this number for years to come.

The irony with the proposal is that favorable support was coming from nearly every angle, including Governor Schwarzenegger, the Senate, Environmental Defense Center, Trust for Public Land and Get Oil Out or “GOO”. However, the actions of the California State Assembly which resulted in the 43-30 defeat of the proposal turned the clock back to 1969. Even the accompanying gilded package of \$1.5 million for low-carbon bus technology, 4,000 acres of public conservation land, \$100 million payment upfront and up to \$4 billion in royalties could not persuade the 80 seat branch of California State legislature.

As a result of this ruling, it seems that the energy objectives of some US policy makers are still unclear. Dependence on foreign oil is frowned upon by the current White House administration; however the outlook for domestic production to fill the growing gap in energy demand is looking none to promising. Those with the capability to shape future US energy policy; from President Obama and Energy Secretary Chu down to the individual voter; should keep in mind that a path needs to be chosen to expand oil supply – be it domestically or on foreign soil.