

SPECIAL FOCUS

Market edges closer to breaking points

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Confusion was the norm in 2004. Working in the service industry was interesting, but, for consultants, the year was hardly more profitable than 2003. Two of our industry clients merged, one sold out, and we added two new ones— not much progress.

Energy policy was a minor issue in the presidential election. It continues to be a situation where the country:

- Relies on natural gas as the fuel supply for new plants to generate electricity
- Relies upon imports of crude and refined products for its supply of oil.

The International Energy Agency and the US Department of Energy (DOE) both continue to believe that oil supply will increase indefinitely, or at least as far into the future as one cares to look. The future of natural gas, according to DOE, is still a 30-Tcf US gas market.

Given those beliefs, it is not surprising that governments, most of the financial community, and even parts of the industry, itself, expect a return to “normal” prices of \$25/bbl and \$3/MMbtu. Those beliefs govern stock prices and the demand for services. They are remarkably resistant to experience.

When I went to work for Mobil Oil in 1966, M. King Hubbert’s prediction that Lower 48 crude oil production would peak in 1970 was controversial. Debate over the timing of the peak in global oil production can be taken as an indicator that it is getting close. Two years ago, Iraq was the emerging oil power, and the timing of the peak appeared to be between 2007 and 2010. Now that Iraq

is a war zone, 2005 is a better bet, and it may have been 2004.

Nearly four years passed between the peak in US production and a large increase in oil prices in 1974. Output in the second largest non-OPEC area, the North Sea, reached its peak in 2000. Another increase in prices four years later should surprise no one.

Adoption in August 1972 of 100% allowables by the Railroad Commission of Texas did not change energy policy. The Arab oil embargo in October 1973 was followed by the Nixon/Ford administration’s Project Independence and then the Carter administration’s Energy Plan. One virtue of current energy policy is that other objectives—foreign affairs, environmental protection, saving the wilderness, etc.—can be pursued without regard to energy consequences. Another virtue is that it avoids having to decide what to do differently.

History suggests that public perceptions and energy policy will not change until something goes wrong badly. Some possible breaking points are:

- Another Arab oil embargo
- Successful test of a nuclear weapon in Iran
- Gas prices rise above \$10/MMbtu in the summer, amid widespread electricity brownouts and blackouts.

There is “no war on terror,” nor can there be. Terror is despicable, but it is not mindless violence. It is, instead, the means that the weaker side uses against the stronger side. Opposition to Israel is the subject upon which there is general agreement in the Middle East. People willing to lose their lives in terror attacks on the US do not come from Canada, Mexico or Europe. They are Arabs, and their issue is US support for Israel.

The logic of the war with Iraq—to prevent future attacks in the US with weapons of mass destruction (WMDs)—did not require that any WMD stockpiles exist. This logic applies to Iran, Saudi Arabia, Yemen, etc. A country with nuclear weapons cannot be attacked, nor can others under its protection. In addition, the other means available are attacks on US commercial interests. Examples are exclusion of US companies from the Middle East, refusal to invest in the US, etc.

Residential and commercial users of natural gas are dependent upon storage in the heating season. If there is a contest between filling storage in the summer and generating electricity, the gas will end up in storage. The problems in California are almost certain to be repeated on a national scale. The only question is timing.

Other peoples’ misconceptions are the problem of the service industry. The longer it takes to change them, the more spectacular the reversal is likely to be.



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