CUMBERLAND ADVISORS℠

Commentary

Special Series: Oil Slickonomics—Parts 1-11

May—August 2010

Part 1, May 2, 2010

"At its current leak rate of 5,000 barrels of oil per day, the spill could surpass the size of the 1969 Santa Barbara spill by next week. If the leak cannot be contained, it could exceed the size of the 1989 Exxon Valdez oil spill off Alaska by mid June." Paul Harrison, Environmental Defense Fund Three scenarios lie ahead. They rank as bad, worse, and ugliest (the latter being catastrophic and unprecedented). There is no "good" here.

The Bad.

Containment chambers are put in place and they catch the outflow from the three ruptures that are currently pouring 200,000 gallons of oil into the Gulf every day. If this works, it will take until June to complete. The chambers are 30-foot-high steel configurations that must be placed on the ocean floor at a depth of one mile. This has never been done before. If early containment is successful, the damages from this accident will be in the tens of billions. The cleanup will take years. The economic impact will be in the five states that have frontal coastline on the Gulf of Mexico: Texas, Louisiana, Mississippi, Alabama, and Florida.

The Worse.

The containment attempts fail and oil spews for months, until a new well can successfully be drilled to a depth of 13000 feet below the 5000-foot-deep ocean floor, and then concrete and mud are injected into the existing ruptured well until it is successfully closed and sealed. Work on this approach is already commencing. Timeframe for success is at least three months. Note the new well will have to come within about 20 feet of the existing point where the original well enters the reservoir at a distance of 3.5 miles from the surface drilling rig. Damages by this time may be measured in the hundreds of billions. Cleanup will take many, many years. Tourism, fishing, all related industries may be fundamentally changed for as much as a generation. Spread to Mexico and other Gulf geography is possible.

The Ugliest.

This spew stoppage takes longer to reach a full closure; the subsequent cleanup may take a decade. The Gulf becomes a damaged sea for a generation. The oil slick leaks beyond the western Florida coast, enters the Gulfstream and reaches the eastern coast of the United States and beyond. Use your imagination for the rest of the damage. Monetary cost is now measured in the many hundreds of billions of dollars.

Some thoughts about markets and impacts.

Usually, the first estimates in any crises are too low. That is true here. 1000 barrels a day is now 5000, and some estimates of spillage are trending higher. No one knows exactly. The containment and boom mechanism is subject to weather cooperation as we can see this weekend. Soon we are entering the hurricane season. The

thoughts of a storm stirring up the Gulf, hampering any cleanup or remediation drilling effort and creating a huge 10,000 square mile black stew is frightening to every professional in the business.

This will be a financial calamity for many firms, not just BP and its partners and service providers. Their liabilities are immense and must not be underestimated. The first estimate of $12.5 billion is only a starter.

Thousands of small and independent businesses as well as larger public companies in tourism are hurt here. This is not just about the source of half the nation's shrimp. That is already a casualty. It's also about the bank loans for the $200,000 shrimp boat and the house the boat owner and/or his employees live in and the fact that this shock piles on a fragile financial system that is trying to recover from a three-year financial crisis. Case study, my fishing guide in the Everglades splits his time between Florida and Louisiana. His May bookings in LA have cancelled. His colleagues lost theirs and their lodge will be empty. They are busy trying to find work in the clean up. For him, his wife and eleven year old daughter, his $600 a day guide fees just went "poof". When I asked him if he thought he had a legal claim on BP, he said he hadn't thought about it yet but it gave him pause. As we suggested above, the $12.5 billion loss estimate is only a starter.

Federal deficit spending will certainly rise by tens, and maybe hundreds, of billions as emergency appropriations are directed at larger and larger efforts to clean up this mess. At the same time, federal and state revenues tied to Gulf-region businesses will fall. My colleague John Mousseau will be discussing the impact on state and local government debt in a separate research commentary.

We expect that the Federal Reserve will extend the timeframe that we have come to know as the "extended period" in the making of its monetary policy. We do not expect the Fed to raise interest rates at all for the rest of this year, and maybe well into next year. We expect to see the deterioration of the economic statistics for the US to reveal the onset of this oil-slick crisis in May, and the negative impact will intensify during the summer months. A "double-dip" recession probably has been made more likely by this tragedy.

We are at the highest level of cash in our US stock accounts that we have seen in over a year and a half. We expect a market correction will present entry points at lower stock prices. We have exited the financial sectors, including the insurance ETF. We now worry about the banks that are exposed. We do not own the major oil stocks now. Some of them face enormous liability payments.

In addition, the offshore-drilling energy sector will face much-increased and more costly regulation. Deepwater and all offshore drilling in the US has been set back for a generation, just as Three Mile Island set back nuclear power development for decades. No politician can win an election now with a permissive view on drilling. Sarah Palin's "Drill, baby, drill" now condemns her to political marginalization. Off shore drilling has lurched to the top of the political agenda in this November's election cycle.

Readers may be interested in following events on the NOAA website:
http://response.restoration.noaa.gov .

Part 2, May 10, 2010

In "Oil Slickonomics", part 1, http://www.cumber.com/commentary.aspx?file=050210.asp , we set forth three scenarios for the BP disaster. They are "bad," "worse," and "ugliest." Events are now moving from bad to worse.

BP's attempt to install a large funnel-type device is running into problems. They have shifted the device several hundred yards away from the well as they try to deal with complex technical issues. Meanwhile the damaged well continues to spew at least 200,000 gallons of oil a day.

Within days we will have reached the second level of damages in the Gulf of Mexico. Under our "worse" scenario the total will be in the many tens of billions before this is all over. There are now early reports of "tar balls" washing up on beaches. Damage is now witnessed in Alabama, Louisiana, and Mississippi. NOAA has expanded the no-fishing zone to about "4.5 percent of Gulf of Mexico federal waters." The original closure boundaries, which took effect Sunday, May 2, encompassed "less than three percent."

Readers please note that this event is still mostly confined to United States "federal waters," which are under NOAA jurisdiction. International claims are a more complex financial liability for BP and its partners.

So far, BP has offered US-based fishermen a one-month-pay settlement package. This is being routinely rejected, according to the professional fishermen we have been able to reach. If this spillage continues, as we project under our second and "worse" scenario, and IF it can be limited to that scenario and doesn't worsen to "ugliest," the ultimate loss of income to fisherman will continue over many, many months or even years.

According to NOAA, "There are 3.2 million recreational fishermen in the Gulf of Mexico region who took 24 million fishing trips in 2008. Commercial fishermen in the Gulf harvested more than 1 billion pounds of finfish and shellfish in 2008." BP's offer of one month's pay is a pittance when compared with the ultimate damages that will be suffered by the fishing industry.

Some readers have asked about the federal fund that is designed to pay for cleanups of oil spills. It is funded by an eight-cent-per-barrel tax and is wholly inadequate for this type of catastrophic event. In the wake of the BP explosion, three Senators have offered a bill to broaden the scope of the fund and raise the tax.

On May 1, the New York Times reported that, "A count made by the Department of Homeland Security last August found that since 1991, there had been 51 instances in which liability exceeded caps. In most years it was a handful; in 1999 there were 11, because of a typhoon in American Samoa that wrecked eight fishing vessels that spilled oil. Numerically, cargo vessels and fishing vessels are the biggest culprits, but oil tankers and barges cause the most dollar damage. The fund's single largest expense so far came after a tanker in the Delaware River, the Athos I, spilled tens of thousands of gallons of crude oil in 2004. Money can be sought by the states for expenses like restoration of a damaged wetland or compensation for loss of use of a resource."

We wondered about the details surrounding the federal fund and asked Jim Lucier of Capitol Alpha Partners for his views. Jim is one very smart analyst, whose firm does superb research on federal political activities and Washington-based intelligence. He is current with the BP spill issue. Jim gave us permission to share his piece on this federal fund. You can find "How the OPA Trust Fund Works" on our website, at http://www.cumber.com/content/Special/HowOPA050410.pdf.

We thank Jim for giving us permission to share it. Please note that Jim is a member of the GIC and will be speaking on the Washington scene at our briefing in Paris on June 18.

Part 3, May 13, 2010

"We have breaking news on the oil spill in the Gulf. There's new information that it could be much worse than believed." Anderson Cooper, 10 PM, May 13, 2010, CNN

CNN breaking news tonight reports that the estimate of 5000 barrels a day spilling from the BP well in the Gulf of Mexico may be very low. A Purdue University professor has used sophisticated scientific analysis to estimate the flow visible in the now-famous video, and has revised the estimate to 70,000 barrels a day, with a margin of error of plus or minus 20 percent. That is the equivalent of an Exxon Valdez spill every four days. Another way to put it is that about 20 million gallons a week or some 60 million gallons have polluted the Gulf since this started.

The new estimate helps explain the large size of the slick, as estimated by NOAA. It also leads us to move to our second case among the three scenarios we have discussed in part 1 and part 2 of this series. See www.cumber.com for the other parts of the series. We were already at "bad." Now we may be at "worse" if tonight's effort by BP is unsuccessful. We should know within 48 hours.

According to Anderson Cooper, other experts who have responded to the new estimate have now called on the federal government to intervene massively and to stop leaving this issue to the oil company. They allege BP is purposefully covering up or excluding information and keeping professionals from participating in a coordinated national effort to deal with this catastrophe.

We have no way to know what is going on inside BP. We do know that the reports continue to be alarming.

Tonight there is another attempt by BP to use another method to stop the flow. BP says that we shouldn't deal with measuring and that we should focus on stopping the spewing of oil. They are partially correct.

Of course the stoppage must come first. But measuring is a way to determine the responses needed to minimize the damage and clean up the mess. And this is a very big mess. BP's liabilities are growing exponentially, as are those of its suppliers and partners who are involved.

In addition there is now risk to shipping lanes, because ships and barges cannot safely navigate through oil spills and slicks. The fire hazard has also greatly intensified. There are insurance requirements to prevent the transiting of ships. In sum, it is not wise to sail through a dangerous stretch of oil-contaminated ocean.

We have seen some firms make investment recommendations favorable to BP and the others involved. They claim the existing loss of market cap makes them cheap. We think that an unknown and growing liability is enough to dissuade us from attempting to bottom fish. You could catch a falling knife. We are not positioned in the ETFs that have heavy weights of these companies.

The other issue has to do with the 30,000 existing drilling wells in the Gulf. They too must be cognizant of the risk of operating with an oil slick underneath them that is spread widely on the surface. Fire hazard again emerges as one of the considerations. We are told by petroleum engineers that these wells may have to be evacuated if the slick reaches the sort of proportions to be dangerous to them. This is true for both drilling wells and production platforms.

This situation in the Gulf has gone from bad to worse. It still may be contained. BP's efforts to capture the gushing oil with the funnel-type device they are attempting to use tonight may still work. We certainly hope so.

Meanwhile the combined federal and oil company effort has now widened to over 500 vessels and 13,000 people. 1.5 million feet of boom and containment-type barriers have been installed, and more are coming. Coastal cities in Florida are making emergency plans. We have evidence of oil spill damage in three states: Mississippi, Louisiana, and Alabama.

Like Yogi Berra said: "It ain't over till it's over."

Part 3A , May 14, 2010 *(A correction and some important additional facts thanks to Andy, Jay and Loren)*

What happens when one writes in a hurry and late at night in response to breaking news? Simply put: one makes mistakes. The good news is that I have friends who look out for me and who are kind enough to add their expertise.

Let me first correct one glaring error. In last night's "Oil Slickonomics – Part 3," I noted that 1.5 million miles of boom have been deployed. That was not correct. Such a number is "impossible" and I thank my dear friend and LSU professor Loren Scott for correcting me. The figure should be in feet and not miles. Loren notes that there are 2000 miles of American beaches on the Gulf of Mexico between the bottom of Texas and the tip of Florida. We could protect them many times over with a million miles of boom. We cannot protect them all with a million feet of boom.

I asked Loren for his take on the crisis. He emailed the following, which is very instructive and supportive of the views we have taken. Loren is a world-recognized expert in the oil area and in the Gulf. He wrote:

"My biggest concern for the country is that the slick will move to the West. If it does there are two serious issues. The first is that that is where the great majority of the producing platforms are and most of the few active drilling rigs. If the slick gets under those platforms---as you pointed out---will the MMS or Coast Guard require those platforms to be abandoned for security reasons (fire)? Some can be remotely operated, but not forever. Even if they can remain manned, there is a huge fleet of supply boats operating around the clock supplying those platforms with potable water, food, supplies, etc. Will the Coast Guard allow those supply boats to motor through the slick to make their deliveries? If the answer is no, then the platforms will have to be abandoned. About 31% of our domestic oil supply will be shut off. You can imagine the impact on fuel prices. Dunce senators who argue we should shut down offshore exploration have no idea how harmful such a move would be.

"The second serious issue concerns another key facility to the west, the Louisiana Offshore Oil Port. LOOP is the only super port in the US and is the only place where very large crude carriers can offload their oil. Will the LOOP be closed if it is surrounded by the slick? There goes another 10% of our nation's oil supply. Combine that with issue #1 above, and the impact on fuel prices is scary.

"Much has been made about the impact on the seafood industry. This is not politically correct of me, but seafood is really a minor player in most of these coastal economies. Louisiana is #2 in the nation in fisheries (second to Alaska). However, the landed value of our fisheries in 2008 was: shrimp - $130.6 mm, crab - $32 mm, oysters - $38.8 mm, and menhaden - $45.8 mm. That's about $247.2 mm in total. I did a study on the value of recreational saltwater fishing in Louisiana about 3 years ago. Including both direct and indirect effects, it created about $528 mm in business sales in the state. It is also important to note that much of this work is not full-time. It only occurs during "seasons," and in the case of oysters, many people come in from out of country to harvest their beds. All these numbers pale compared to the impact of the oil and gas industry. Those supply boats and platforms are operating 24/7 and involve much higher wages than fishing. We are talking about billions here.

"I also keep up with some of the coastal MSAs from Mississippi to the FL panhandle for a group of banks. I really do not think the slick will impact the Mississippi tourism business much at all. People do not go to the Mississippi coastal area to get in the water. The sand is not as white and the water is not as clear, because it is so close to the mouth of the Mississippi River, so there is still a silt effect there. People come to the Mississippi Coast for the casinos, primarily. Unless there is some 'odor' effect as the slick comes ashore, that state should not be hurt all that much.

"Once you get to the eastern side of Mobile Bay, the whole equation changes radically. That is where the beaches are beautifully white and the water is clear. People come there to get in the water. For most of these communities their entire economy is based on tourism and the military. Just the prospect of the slick coming onshore is hurting bookings from Gulf Shores, Alabama to all along the western coast of Florida. The good news is that this should be a short-run problem. Sandy beaches can be cleaned up. New sand can be brought in. If this thing goes to the West---where Louisiana has no sandy, or even identifiable coast---and gets into Louisiana's marshes, that is another more difficult cleanup altogether.

"Finally, a comment about the size of the spill. There is a great deal of uncertainty about how big it is. The number being repeated is 5,000 barrels or 210,000 gallons. This seems like a huge number. However, envision a relatively shallow, Olympic-sized swimming pool like you saw during the Summer Olympics. That pool contains 660,000 gallons of water. The Gulf is huge. That many gallons being spilled is not horrific. Why is the slick so large? Answer: because it is only about a millimeter thick. I am not pointing this out to minimize the size of this problem. It is a legitimate catastrophe, but we still need to keep things in perspective."

We thank Loren for his assistance.

Let's go to NOAA, which is the main source of the data I use, although interviews with petroleum engineers, fishing professionals, and government officials and other experts are among the other sources that play a part.

NOAA reports and updates daily. Yesterday they listed as follows.

"Response to date

- Total response vessels: 526
- Containment boom deployed: over 1.1 million feet
- Containment boom available: over 300,000 feet
- Sorbent boom deployed: over 320,000 feet
- Sorbent boom available: over 850,000 feet
- Boom deployed: over 1.4 million feet (regular plus sorbent and fire boom)
- Boom available: over 1 million feet (regular plus sorbent and fire boom)
- Oily water recovered: more than 5 million gallons
- Dispersant used: over 475,000 gallons
- Dispersant available: more than 215,000 gallons
- Overall personnel responding: more than 13,000"

Also, let me clarify for readers that the 70,000-barrel-a-day rate of spew is not my estimate. It is from a professor at Purdue. The issue of spill size will now be examined by a congressional committee. Also note BP has said repeatedly that they are not certain of the amount of oil being discharged in the Gulf. I had seen estimates as high as 25,000 barrels a day but did not use them as long as the 5000 daily rate was generally accepted.

The 70,000 estimate is enormous by any reference standard. The experts who computed it say their margin of error is 20%. Whatever the actual number, if it is anywhere near correct, the amount of crude oil is much higher than originally estimated.

Stratecon's Jay Simkin notes that large spills and flow rates have references and that the 50,000 or 70,000 daily barrels rate is quite high. Jay cites some historical references of very large spills as examples of their rarity.

Jay's comments follow:

"The 70,000 barrels/day estimate is likely wrong. Here's why: Kuwait's Burgan field – second-largest globally – has some of the most productive wells. Even so, flow rates do not exceed 50,000 b/d.

"In Brazil's new Tupi field, an ultimate per-well flow rate of 30,000 b/d is expected. The Carioca field, also offshore of Brazil, is guesstimated to have wells that will flow at 50,000 b/d, at least for a while.

"For the Gulf of Mexico well to flow at 70,000 b/d means the field is a super-giant. There's no evidence to show this is so.

"Further, medium grades of crude oil (mid-30s, API) aren't very flammable. The volatile fractions evaporate rapidly, especially in the Gulf's late spring heat. The residual oil might burn if napalmed, but likely would not burn for very long.

"Witnesseth: were it possible to burn off the oil that would have been done, to keep the slick from spreading.

"Having a crude oil slick around drill rigs is messy, but not a huge safety danger. If the oil slick were highly flammable, it would not be possible to send into it the ships with equipment to try to secure the runaway well."

Jay may or may not be right on the fire hazard, but the evidence is that insurers do not want ships to go through oil slicks, and they may soon be re-rating the Gulf as policies allow for these changes. Our point is that there are no good outcomes here.

Lastly, Andy (last name withheld) chastised me for being fully invested while writing about this mess in the Gulf. He liked the cash raising in April and wondered why we reversed ourselves. He attributed the cash raise to the rising risk in the Gulf.

That is a very fair question.

We are back in markets because we believe the G4 central banks are now all in synch on easing. Look at the world's currency inventory and one sees that the dollar, pound, yen, and euro are all likely to have very low policy interest rates for the rest of this year. They are experiencing no inflation and have an increasing threat of deflation. Furthermore, it is important to average the four currencies and weight them by the total debt denominated in each. That is how global finance functions. Almost 90% of it is in these four currencies, according to the BIS. Given that, we can expect the average of the four currencys' global short-term policy rates to be between zero and 1% for at least one or two years and maybe longer. That is why are bullish in the face of bad news, whether it originates in an oil slick or in Europe.

We thank Andy for his email, Jay for his comments, and certainly Loren for his help. All errors are mine.

Part 4, May 24, 2010

"The most recent satellite imagery indicates that the portion of the oil previously observed moving to the SE towards the Loop Current (LC) has largely been entrained into a counter-clockwise rotating eddy to the north of the LC. Over flight observations report this oil is in the form of very scattered light sheens. It is possible for sheens on the southern edge of the eddy to become entrained into the LC and persist as very widely scattered tar balls not visible from imagery. Model trajectories do not indicate additional oil from the source region will move south towards the LC during this forecast period."

Source: NOAA, May 22, 72-hour offshore trajectory forecast through May 25

So far we are still going from "bad" to "worse," as outlined in our series on Oil Slickonomics, www.cumber.com . It's not in the Loop Current, yet.

Meanwhile, BP is trying new measures to slow or stop the leak. So far attempts to mitigate the flow have mostly failed. BP and the US Coast Guard each admit that they do not know how much oil is flowing into the Gulf. 5000 barrels a day is an estimate, but there are many other estimates and they range widely.

Some leaking oil is being captured and brought to the surface. Most is still going into the waters of the region. NOAA has now declared about 1/5 of the Gulf's federal waters off limits to fishing. This is about 50,000 square miles. Shellfish buyers told me that, essentially, if shrimp or oysters come from west of the Mississippi River they are OK and east of the river they are to be avoided. In the region there is now a term, "Texas oysters," to describe what is edible. So far the western Gulf has been spared damage, while Louisiana and Mississippi are the hardest hit.

Notice NOAA's use of the term "federal waters." Remember that NOAA is a US government agency. It only deals within its jurisdiction. In addition to the federal waters there are state jurisdictional waters, which amount to the coastlines; and there are international waters, which are beyond the NOAA jurisdiction. We have yet to see any reports of the slick reaching international waters.

Many details may be found on the CNN website www.CNN.com. We will not repeat them here, but we recommend readers to spend a few minutes on the CNN reporting, which has been excellent.

We will comment on three items. First: the drilling rigs and platforms in the Gulf that are registered in the US are under the supervision of our federal government. Others, like the one that is the source of this catastrophe, are registered in foreign jurisdictions. That is done by the oil companies in order to save money. There are representations made about compliance with US law. But the evidence is that the US-registered vessels get much more inspection and scrutiny than the non-US ones. This foreign registry issue is now an exploding area of inquiry and controversy.

The second item is dispersants. EPA has ordered the cessation of the use of Corexit, a dispersant that BP had been using to combat the spill. The reason is that it is too toxic. EPA admits that there is no precedent for the amount of dispersant used in this event and the type used. This is truly an uncharted area. They are now concerned enough to call for only mild dispersants, so as to reduce the risk from the toxicity. No one knows how much damage has been done by the dispersants already used.

Third, The New York Times reports that the laboratory used to do the sampling and testing to determine degrees of damage and eventual liability is owned by an oil-services firm that "counts BP" among its biggest clients. Critics claim conflict of interest. The lab owner says its work is "unbiased."

Several websites have erroneously quoted our writings as estimating the final cost to be $125 billion. They are in error. We have used the $12.5 billion number and have been gradually increasing it to "tens of billions." I believe the website put the decimal point in the wrong place.

If we get confirmation that the oil is in the Loop Current, then our assessment will go from the "bad" condition to the "worse" condition. That confirmation would mean Florida's west coast is in danger and that the possible spread around the tip of Florida has become a serous risk. So far we have evidence that the slick reached within a few miles of the LC, but the establishment of a serous amount of oil there is still not confirmed.

We watch; we wait; we hope. But in our gut we know that the unfolding drama in the Gulf of Mexico is destined to become the largest and most costly oil pollution event in global history. We reiterate our recommendation to avoid investment in BP shares or related companies. Their liabilities grow every day.

Part 5, May 27, 2010

"Any and all injury, loss, destruction and damage arising out of or related to the above described casualty event was not caused or contributed to by any fault, negligence or lack of due care on the part of Petitioners…"

This was excerpted from the May 13, 2010 motion filed by Transocean in the Federal District Court of Texas, in which they are trying to limit their liability in claims against them to $27mm (to be exact, the number is $26,764,083.00), by invoking an 1851 maritime law. We have the full document posted on our website. See: http://www.cumber.com/content/Special/Triton051310.pdf .

This is chutzpah.

Chutzpah is a term that is often used in parts of the United States and originates in European Yiddish. It means brazenness, temerity in a pejorative way, engaging in an effrontery.

Here's an example of chutzpah: a 15-year-old kid murders his mother and father and then asks the court for mercy because he is an orphan. That's chutzpah.

Here's another example: Lehman Brothers' lawyer takes a cab to the bankruptcy court. The cabbie says the fare is $27. The lawyer says, "Come inside and join the unsecured creditors." That's also chutzpah. You get my drift.

Legal process requires that Transocean's lawyers admit no wrongdoing. We shall find out more about that when the allegations of negligence get the clarity of trials, depositions, interrogatories, witnesses, etc. So let's just look at some facts.

Transocean is trying to avoid payment of claims by arguing they are under the rules of admiralty (law applied to the sea) and they are invoking the "Shipowner's Limitation of Liability Act of 1851." That's right, 1851. The same Transocean that has collected over $400 million from its insurers is trying to avoid paying the claims of the injured and dead that resulted from the blowout of their drilling rig. This is also the same Transocean that valued the rig at $650 million before the blowout but now is using the $27 million figure because it is the remaining salvage value of this "vessel."

By getting the case into admiralty court, Transocean may be able to delay the proceedings and may have the ability to limit exposure to a jury trial. They may be able to combine all the claims. They will claim that all they owe the injured and the families of the dead is $27mm. That, too, is chutzpah.

We are just starting to enter the legal proceeding stage of the BP-Transocean saga. This is where the figure will reach into the tens of billions if the Top Kill attempt to seal the well is successful and permanent. Tens of billions in claims are coming. More billions in clean up costs lie ahead. Over 130 lawsuits are already filed. Thousands will be involved before this is over.

New estimates are that the oil spewing rate is somewhere around 20,000 barrels a day; that's nearly 1 million gallons a day. This is now deemed to be the largest and most serious oil catastrophe in US history. And the same politicians who didn't impose strict rules and didn't supervise and didn't do what they were supposed to do, from either the White House or the Congress, are now claiming they have been busily concerning themselves with this event every day. That, too, is chutzpah.

By the way, Transocean says they filed the maritime limiting motion "at the instruction of our insurers" and in order to preserve coverage. Again, pure chutzpah.

The fight now is who pays whom and how much and when. The battles will be between lawyers. Stay tuned as we observe what is about to be one of the biggest legal battles in history. We continue to suggest that these liabilities are going to be huge and cannot be presently estimated. We would avoid these stocks. Some are recommending them over other energy companies. That, too, may come to be seen as chutzpah.

Part 6, May 31, 2010

"The fact that neither the government nor the public sector was prepared for the blowout of the British Petroleum rig indicates a profound failure of planning, execution and regulation. While Congress and others look for individual causes and scapegoats, the truth is that this was a systemic failure with profound consequences for America's economy and energy policy. But it is also another indication of broader flaws in how we manage our affairs and think about complex problems." This is excerpted from the HCM Market Letter, June 1, 2010, www.hcmmarketletter.com, author Michael Lewitt, GIC member and speaker at GIC meeting in Paris on June 17, superb writer and analyst and author of his new book, The Death of Capital, essential reading for any serious investor.

"Top Kill Fails" screamed the headline as Americans awoke to the news on Sunday morning. For many in the five-state Gulf of Mexico (GOM) region and for many others around the US, this holiday weekend started out with the feeling that the nation had just been kicked hard in the stomach. The truth is that it has.

In our series entitled "Oil Slickonomics" (www.cumber.com) we have offered three scenarios: "bad, worse and ugliest." With the failure to cap the well, we have now clearly gone from bad to worse. Whether or not the ugliest scenario can be averted remains to be seen. To get to this third outcome the oil slick will have to reach the Gulfstream and start to threaten the Atlantic Ocean and the East Coast of the United States. To date there is no evidence of that event, but the risk continues to rise every day as the oil slick enlarges in the GOM. Presently the oil seems to be confined to a large eddy in the GOM and has not entered the Loop Current, according to NOAA; however the latest offshore trajectory forecast suggests it is dangerously close. A half-dozen research ships are tracking the oil plumes in the GOM.

Flow estimates were originally 1000 barrels daily. They were increased to 5000 and are now estimated at 12,000 to 19,000 barrels a day. For perspective we must now consider that between 20 and 40 million gallons of oil have spewed into the GOM and the rate continues between 500,000 and 800,000 gallons a day. Dispersant usage is intensified and fully resumed. Remember that dispersants are a tradeoff. They help break down the oil while adding their own form of toxicity instead. There is no precedent in history for the amount of dispersants being used in the GOM.

Right now about 25% of the Gulf's federal waters (60,000 square miles) are off limits for fishing industry use. A moratorium is now in place for deepwater drilling in all US waters. Offshore drilling has stopped. If the top kill had succeeded, there would have been an attempt made to lift the moratorium on existing leases and on shallow-water activity. With the top kill's failure, the likely outcome is an extension of the moratorium. We expect that moratorium extensions will be sequentially continued until the well is finally sealed and until the November elections are concluded, whichever comes later.

Force majeure clauses in contracts are being invoked in disputes between oil companies and drilling rig operators. The pricing of rigs is now highly volatile and unpredictable. It is fair to say that the oil exploration and service industry is in turmoil. We expect that to continue throughout the next few months and until the relief well is firmly in place and the leak has stopped. Then there will be the round of new regulations and massive litigation, with its revelations about alleged negligence and mismanagement. Anyone expecting quick resolution of these issues is going to be disappointed. At some point there may be initiatives by the US government to impose fines and penalties on BP and its partners. The WSJ (May 28) reports these fines could be as high as $4300 per barrel if gross negligence is proven or admitted. In addition there is the prospect of criminal penalties in the billions. These could be in addition to BP's liabilities for the full cleanup and for damages. We continue to estimate the total gross cost of this incident to eventually be measured in the tens of billions.

The oil and gas industry in the GOM has permanently changed because of this event. One can relate this to Three Mile Island (TMI) and its profound impact on the nuclear power industry. It took more than thirty years to overcome the psychological and political damage done by TMI, and there was no actual nuclear leakage. We estimate that Deepwater Horizon may end up larger in national impact than the nuclear event decades ago.

It is important to understand the scope of the Gulf of Mexico in US and global energy terms. GOM "accounts for 12% of the world's active jack-up rigs and 16% of active floating rigs. In 2009 the Gulf accounted for 19% of the operating revenues of the nine largest US-listed offshore drilling contractors. The Gulf's share of global capital spending on subsea production equipment was 20% in 2009. Slightly less than 2% of world crude oil production came from the Gulf last year. Of total US crude oil and natural gas production in 2009, 30% and 13% (respectively) came from the Gulf." (Source: Citi) There is no way to currently assess what the implications of the Gulf events will be for offshore oil-drilling activity elsewhere in the world.

Our expectation is that the oil business is about to enter a period of intense scrutiny and regulation worldwide. It will confront higher cost structures and much more inspection and regulation. This will eventually be reflected in higher oil prices. These strategic cost changes will pile on the geopolitical risks associated with oil. The current news from the Middle East is an example of cause with the outcome being a higher oil price.

The GOM events have given a boost to onshore crude drilling activity and alternate energy sector expansion. These and domestic natural gas will have some positive impact over time. Any expectations of immediate results in those areas are problematic and limited.

We continue to avoid the ETFs that are heavily exposed to this now-troubled industry. We would not invest in BP, or in the shares of BP's partners, since the amounts of liabilities and costs for them cannot be quantified now. We believe the pressures on US-based oil and gas service and exploration companies are likely to grow. We expect the final outcomes to be determined by political forces, and those forces are decidedly unfriendly to this industry.

In sum, five states are experiencing or are going to experience negative economic impacts on their fisheries, oil and gas, and tourism industries that will arise from this worst oil catastrophe in American history. This is larger than Katrina and larger than Exxon Valdez. They are poor metaphors in economic terms. We expect to see the initial results in rising initial unemployment claims that may be observed in non-seasonally adjusted reports from the Statistical Metropolitan Areas bordering the GOM. We already see it anecdotally. How much this impacts national economic reports and aggregates is still unknown. That should become clearer in July, as June monthly survey data is released.

Lastly, today we celebrate America's freedom, something that is hard won by those who serve and those who have served our nation. We respect them, we honor them, and we applaud them. If you see someone in uniform, please tell them you appreciate their service. Please try not to take it for granted.

We personally reminisced this morning with a colleague who served in the US Army from 1971-3; our service was 1966-69. Over coffee, we talked about the meaning of national service and considered how much better the US might be today if there were some forms of it for our young people. Maybe that is something to think about on this Memorial Day as we ponder the need for thousands of helpers in the Gulf cleanup or as we view the news flow of geopolitics.

Try to have a happy holiday.

Part 7, June 6, 2010

"The oil industry's experience base in deep-water well control is limited." A massive oil spill "could easily turn out to be a potential show stopper for the (outer continental shelf) program if the industry and MMS do not come together as a whole to prevent such an incident." Source: May 2000 draft statement of environmental analysis by the Interior Department's Minerals Management Service (MMS). According to Newsweek (June 7) the statement was "dropped" in a subsequent draft. In 2005, MMS adopted regulations that assumed the oil companies could best evaluate environmental impacts. This legacy of the Bush-Cheney administration was continued by the Obama-Biden administration and led to a proposal to expand deepwater drilling by President Obama earlier this year. Everything changed on April 20.

"Can we as a society explore for oil and gas in safer and more reliable ways?" This was asked by BP CEO Tony Hayward in his Wall St. Journal op-ed on June 4. That question will frame the national debate to be held in the United States for, at least, the next two election cycles. It will certainly be the most important item this November in the five states bordering the Gulf, and may also have profound importance in the states on the eastern seaboard of the US if the oil spill gets into the Gulfstream.

At this instant the answer that American politics are giving to Hayward's question is "no." That answer is likely to continue to be "no" until after the Deepwater Horizon well is sealed by the relief wells and after the damage from the oil slick has peaked in impact and become old news. Until then we cannot see how any American politician can be elected or reelected if she or he answers this question "yes" when it comes to drilling for oil in deep water.

President Obama has reversed his offshore drilling initiative in face of the facts unfolding in the Gulf of Mexico (GOM). States like California have reversed their view that offshore drilling would gain them needed revenue (per Governor Schwarzenegger). Politics currently determine that the prospective revenue gained by a seacoast state is not worth the cost and the risk of an accident. Deepwater Horizon is the equivalent for oil of Three Mile Island and what it did to nuclear power. Three Mile Island is the political metaphor we are using. We have argued it in our writings and on CNBC (the June 2 segment anchored by Michelle Caruso-Cabrera is posted on www.cumber.com).

This oil disaster is now a five-state affair. Florida has joined Louisiana, Mississippi, and Alabama in experiencing direct damage to coastline, cancellations of tourism, closure of fishing, etc. The fifth GOM state has been spared from direct spillage so far. It is still at risk depending on currents, winds, and events to unfold during hurricane season. But Texas is now impacted economically because of the drilling moratorium in place. In the rest of this chapter of "Oil Slickonomics" we intend to focus on the moratorium. It is driven by politics.

Right now all drilling in the waters of the United States has been stopped. Wells that are in the middle of drilling operations have been directed to stop once they can do so safely. A commission is being assembled to study the situation and make recommendations within six months. Notice the convenience of the politicians receiving the reports after the November elections. That allows them to duck any actions, accountability, and hard decision making by saying that they are waiting for the commission reports. The commission can also take their time because the ongoing GOM disaster has not run its course. Thus the commission will have the option of waiting to obtain more information as events unfold. Delay of a commission report is a normal political tactic, as is timing the report to follow an election cycle. We see no reason why this one will be any different.

Let's distinguish between deepwater, which is the subject of the commission and the moratorium, and shallow-water drilling, which is technically not within the commission's scope.

Shallow-water first; it has been defined in the moratorium as 500 feet. Drilling to that depth is not covered by the six-month Obama moratorium. But it has been stopped anyway by a procedural shift announced by the Interior Department's Minerals Management Service (MMS). MMS ordered that all permitted and approved shallow-water drilling plans must be resubmitted with "additional information about potential risks and safety considerations." MMS has 30 days under present law to respond. It also has fifteen days to review an application for completeness before the 30-day response period starts. MMS is proposing that timetable be extended to 90 days; the extension requires Congressional approval since the 30-day rule is in the present law.

Details of what the new requirements will be were not available at the end of last week. They are expected any day. Last week no driller or explorer in shallow water knew what to submit in order to comply. One driller's permit for a well in 130 feet of water was rescinded last Thursday. The company was about to start drilling. They do not know what to do and can only await the new rules.

The Interior Department indicated that the new regulations will include blowout preventer requirements and contingency plans for worst-case scenarios. The Washington Post reported that "Shallow water rig operators argued that their risks are different from the deepwater drilling that led to the giant spill now fouling the Gulf. Jackup rigs stand on the sea floor and the blowout preventers are positioned on the rig decks, unlike the malfunctioning one Transocean and BP were using a mile below the water surface. In addition, the rigs are drilling in familiar territory since shallow waters have been explored since the 1950s. Much of the new drilling is tapping into natural gas reservoirs left behind by companies more interested in oil in the past."

We can estimate the impact on shallow-water drilling that is not covered by the moratorium but is stopped by administrative procedures. There are 40 jackup rigs presently scheduled to drill or now drilling in the GOM; 31 more are available. Each of the rigs employs over 100 people on average. They are supported by service providers who also employ hundreds of people. The rigs are usually leased for shorter terms of 15 to 30 days. GOM lease rates for jackups vary by depth and are averaging about $70,000 a day (range $32,000 to $110,000). The rents are due to the companies, and the intervention by MMS triggers large monetary losses and may impose risk on the financing sources. We expect lots of litigation over this shallow-water drilling procedural halt development. Note that possible changes in the liability structure of drilling may render many jackup rigs uninsurable.

The deepwater drilling moratorium is supposed to be six months. We expect politics to extend it for as much as two to four years. Morgan Stanley uses 18 months for their base case when estimating costs; their worst case is an extension to four years. We believe the moratorium will be continued until after the 2012 presidential election or longer.

Deepwater drilling is conducted by floating rigs like the one used in the BP spill. There are 229 floaters in the world and 74 more under construction. The FT reports that there are 33 in the GOM; Morgan Stanley counts 35 with all but one in use. GOM floaters lease for between $350,000 and $400,000 a day. They employ between 800 and 1400 people per rig, plus they also generate large employment in the oil service sector. Note that wage rates on drilling rigs and in the oil service business are high. The FT estimates the average weekly wage lost per person is $1804.

Let's sum this up to an estimate and admit right up front that this is more of a guesstimate, given the limited information we can obtain. We have not been able to find detailed employment numbers on the state websites. The moratorium is too new to measure job impacts in initial unemployment claims and income statistics. We should see those numbers next month, since they are usually reported with a monthly lag.

Okay, here goes. Total lease losses due to the GOM deepwater moratorium and GOM shallow-water procedural halt are $20-$35 million a day. Let's call it nearly $1 billion a month. Furthermore, drilling rig lease rates for both floaters and jackups are now likely to fall substantially as the moratorium causes excess supply of rigs.

We estimate employment losses of about 50,000 to 100,000 if both deepwater and shallow-water halts continue for more than a few weeks. We already know that deepwater job losses will extend for many months. Monthly labor income lost will be between $500 million and $1 billion. States most impacted are Louisiana, Mississippi, Alabama, and Texas. Note that none of these numbers are includable in the estimate of BP's liabilities, since these costs are due to political decisions by the US government.

How long can this continue? And what happens if it goes on for as long as we project? Remember, our assumption is that this deepwater moratorium will continue until (1) after the BP well is sealed and (2) after the environmental impact has peaked and is clearly under some control and damages well-assessed. We have some historical references or metaphors. In the 1979 Mexico spill the Mexican state-owned oil company, PEMEX, initially estimated it would take three months to complete the relief well. It took 11 months. And that was in 165 feet of water, not 5000 feet. Technology has much improved since 1979. Pipe and casing is far superior. The Mexican environmental damage took a couple of years to peak and about 4 to 5 years to be considered contained and mitigated. That was as much due to Mother Nature's time clock to absorb an oil spill as it was due to cleanup efforts.

Another metaphor is the damage done when Saddam Hussein set fire to the oil wells at the end of the Iraq war. That large spill in the Persian Gulf took 4 or 5 years to contain. Damage is still observable; however, fishing and beach use and oil industry expansion resumed within a few years as cleanup started to succeed. Exxon Valdez was in much colder water; Mother Nature works faster on oil spills when the temperature is warm. Some remnants of Valdez damage are still observed; however, claims are long settled and Alaskan coastal activity is considered normal for fishing, tourism, and in the oil industry.

About 1.5 million barrels a day of US oil production presently comes from the GOM. 80% of that is from deepwater. If the moratorium

is long-lasting, Morgan Stanley estimates that production would decline to just a few hundred thousand barrels a day within 4 to 5 years. By then drilling rigs would have moved to other parts of the world where relative lease rates might be higher and where there are no drilling moratoriums. Some of those floating rigs are already staging to move now that the 6-month moratorium has been announced by the Obama administration. One million barrels a day at world prices of $70 per barrel is the estimated loss in US production from a long-term moratorium. We will not address how our failure to achieve a national energy policy empowers our global adversaries or how we fund them by being so dependent on foreign oil. We all know that this is a national tragedy and policy failure. Suffice it to say a long-term moratorium exacerbates that problem at the rate of about $2 billion a month at present oil prices.

The energy sector of the US stock market has been underperforming, in part for the reasons outlined above. The BP spill piles onto an already weakening economic outlook. Energy is a large weight (11%) in the US stock market, so its poor performance impacts broader-based holdings negatively when it declines. At Cumberland we have been avoiding energy-specific ETFs during these last several months of difficulty. We have just changed our view and bought initial positions in natural gas and alternative energy exposure. We expect to be a scale buyer over time and as things continue to evolve in the post-Deepwater Horizon spill era.

At Cumberland, our portfolios reflect our outlook for a decline in deepwater drilling in the United States. Our energy-specific ETF positions are only in natural gas and alternative energy producers. We believe it is too early to build positions in the broad-based energy, oil, or drilling ETFs. We believe that BP and its partners carry particularly high risk, as the liabilities for this spill are still not estimable and may be huge. We have maintained this position from the beginning of this saga and watched from the sidelines as BP lost billions in market capitalization. Buying now is pure speculation: you may win but you may also catch a falling knife.

We thank the hundreds of readers who have commented on our series entitled “Oil Slickonomics.” The entire series is now chronicled on our website, www.cumber.com, so that newer readers may trace the sequence and the revisions to our forecasts as this dramatic environmental and economic tragedy unfolds. We also specifically thank Jim Lucier, his colleagues, and his research firm, Capital Alpha Partners. Their Washington intelligence service is among the very finest we have seen. Readers may find details at www.capalphadc.com.

We leave for Europe on Friday for the Global Interdependence Center meetings in Prague and then in Paris. Issues to be discussed include the sovereign-debt and banking crisis in Europe. Representatives from nearly half the countries in the European Union will be attending. Several governors of central banks are speaking and some are participating in the private roundtable discussions. There is still a handful of spaces left in the delegations in either city, if any reader can make a last-minute adjustment in plans and join us. See www.interdependence.org for details.

Part 7A, June 7, 2010

A few quick notes in response to the many emails about Oil Slickonomics – Part7. We thank readers for them.

First, we had an error in Sunday's Oil Slickonomics – Part 7. We typed 20 billion and meant to type 2 billion. I missed it on three edits, as did our copyeditor Charley S. I will not reveal his last name. But I implore him to help protect me from myself. $2 billion a month is the expected additional cost to the US from the deepwater drilling halt if the moratorium is extended from 6 months to 2-4 years. We thank the readers who called it to our attention.

Next, the employment multiplier in the Gulf of Mexico is not an easy item to measure. My friend and LSU professor Loren Scott uses 4.7. So he guesstimates that each drilling-rig job ends up creating 4.7 jobs of various types. Some of these are high-paying and in the oil business and others are more removed from the oil industry and part of the regional economy. Loren would guess that each rig is responsible for about 1100 jobs. This is consistent with the midpoint of the FT estimate of 800 to 1400 jobs at risk for each rig being idled by the moratorium.

We have had a lot of email responses about our suggestion that this is a Three Mile Island-type event. We do not mean to compare nuclear power to oil. We are talking politics. Three Mile Island changed the political landscape in the US. There is no question about that. We believe the Gulf oil spill is going to do something similar to the deepwater drilling business.

Evidence is mounting daily in support of our view. My friend Jim Lucier, whose praises we have sung, penned a great piece this morning. He has given me permission to share it. Enjoy.

"Oil Spill Politics: The Blob That Ate DC" by Jim Lucier, Capital Alpha Partners, www.capalphadc.com

"Oil spill politics have en-Gulfed Washington. The packed agenda of seemingly long overdue bills that left little time for energy legislation until late in July has disappeared. Immigration? The Kagan confirmation? From now on, it is going to be all oil spill all the time. But don't expect a higher decibel level to mean higher productivity. As far as we can tell, the oil spill has done nothing to move votes in favor of a comprehensive climate and clean energy bill. But we are not sure the administration really plans to move a comprehensive bill. A clean energy bill with big oil industry payfors is also a possibility. But it also seems that energy is devolving into a wedge issue and campaign issue; the Administration will cast Republican reluctance to support a climate bill as allegiance to Big Oil. The populist script against oil companies will be similar to the script against Wall Street that drove the financial services bill far to the left. Still, members who voted to crack down on prop trading and derivatives aren't yet ready to vote in favor of higher energy prices for their constituents.

Oil Spill Liability: Good News and Bad News

"There is good news and bad news on oil spill liability under the Oil Pollution Act. The good news is that nearly all Members of Congress understand perfectly well that random tinkering with liability limits could have extremely negative impacts on smaller oil and gas producers as well as energy production in the Gulf generally. The bad news is that some members would rather play politics than find a reasonable solution. Sen. Bob Menendez is Chair of the Democratic Senate Campaign Committee. His goal, apparently, is to find a spill liability bill so politically toxic that no Republican and probably no Gulf state senator will vote for it. He may succeed.

Offshore Drilling: Six Month Moratorium Could Last Two Years

"On May 29, President Obama announced a six-month moratorium on new drilling permits for wells in more than 500 feet of water. We are hopeful the moratorium will last only six months. But the length may depend on whether the Obama administration decides to wait for the recommendations of a study commission that are also due in six months. President Obama will have to make a political call on whether to allow new permits to move forward before the commission's recommendations can be implemented. He will also have to decide on whether to immediately implement regulatory decisions that normally take at least 18 months through the normal practice. The political uncertainty makes us fear that a supposedly six-month moratorium could last a lot longer."

We thank Jim Lucier for permission to share his morning note with our readers. Jim will be with us at the GIC events in Prague and Paris next week and has agreed to add an energy/Washington update to his private briefing. See www.interdependence.org for details.

Part 8—Chemotherapy in the Gulf of Mexico, June 20, 2010

"Plaquemines Parish President Billy Nungesser was out on Terrebone Bay at the break of dawn with his new industrial strength, compressed air-powered vac. Within 15 minutes, he said his crews had collected 55 gallons of oil and Nungesser -- vocally frustrated by the response from BP and the federal government -- was thinking about whipping out his credit card to pay for more pumps from an online site."

Meanwhile, the BP president, "After being lambasted in Congress on Thursday … was spending the weekend with his family in Britain's Isle of Wight. "On Saturday -- Day 61 of the oil disaster – Tony Hayward was watching his yacht, a Farr 52 named Bob, compete at the J.P. Morgan Assessment Management Round the Island Race." Source: CNN, June 19, 2010

Let's be blunt. Only one of three presidents "gets it." That one is Billy. We wonder how much prep help he got from former BP America board member and former US Senator Tom Daschle? Reminder: Daschle was a prospective President Obama appointee, whose name was withdrawn after financial revelations killed his nomination. Daschle is the former US Senate leader of his, and Obama's, political party.

President Tony continues to demonstrate that he doesn't get it. His congressional testimony proved it.

The third president is now in deep trouble. Our national leader faces huge and growing disapproval and repudiation by his core constituency. "Whose ass to kick" was supposed to be a demonstration of toughness. It backfired. Harvard lawyer and Chicago politician Obama is a skilled orator and chooses every word carefully. This phrase was selected by him to convey some type of forceful political nuance. It failed because it showed Obama out-of-character and therefore suggested that he is a politician first and leader second.

The timeline of events starting with April 20 shows that the White House and the Obama administration had conflicting contingency plans and were disorganized. On April 22, the day the rig sank, President Obama, Homeland Security Secretary Napolitano, Interior Secretary Salazar and others did not know there was a leak. They were in an emergency meeting together in the Oval Office and were operating without good information. That is understandable. What is not comprehensible is why it took them so long to realize the seriousness of their ignorance.

It took Coast Guard Admiral Allen to wake them up. On April 24, Obama's staff was told there was a meaningful spill. On April 28, the White House finally accepted that it was big.

The president made his first trip to the Gulf a week later and two weeks after the rig explosion. And he did not immediately activate sufficient federal resources to the level we now know was needed even when briefed by Admiral Allen and Governor Jindal. That is why Obama is being compared to George Bush and Katrina when the public evaluates the response to crisis.

Sorry, Mr. President. You failed us at the beginning. You were ill prepared. You announced expansion of offshore drilling because of politics and, we now know that, you hadn't considered increased research funding for NOAA and for the preventive measures we now know are necessary. You formed no commission of experts to study it. You failed to heed warnings. And we now know that your administration's Mineral Management Service was a mess.

And we also know that your present moratorium structure is improperly conceived, politically driven and lacks petroleum engineering professional skills. We also know that your present moratorium plan was discussed in Washington last week with Gulf folks who traveled to our nation's capitol. They returned home convinced that Washington is likely to do huge damage to the US by the way you are shutting down existing and non-BP activity. Your moratorium doesn't make us safer. It will make the US dependent on foreign sources for oil to the tune of another 2 million barrels a day as it shuts down the Gulf and if it causes the Alaska pipeline to cease operations for insufficient throughput.

The list of bungling is extensive, Mr. President. When looking for asses to kick, you might want to start with the mirror. But first help me explain the use of this language to my four year old granddaughter after she sees her president demean himself and his office on national television.

Let's get to some very real economic reality.

Five states are now suffering because of the BP spill. Florida, Alabama, Louisiana, and Mississippi are hit by oil slicks that are devastating their fisheries and tourism. Texas is a casualty along with the others because the drilling moratorium that was poorly designed by Obama's team was created out of a political response.

The moratorium payback will be the loss of thousands of jobs.

We now add the Alaska pipeline as a possible casualty, because of insufficient throughput due to the shutdown of existing drilling thousands of miles from the Gulf. The pipeline is built for 2 million barrels a day capacity. It currently carries about 700,000 which is near the minimum necessary to operate. It is supplied by oil drilled offshore. If it doesn't maintain sufficient volume of warm oil the oil will cool and congeal. Five existing offshore wells that would keep the volume sufficient are now affected by the Obama moratorium.

We estimate that an extended moratorium, which we now expect to continue because of Obama political calculus, will cost up to 200,000 higher-paying jobs in the oil drilling and oil service business and that the employment multiplier of 4.7 will put the total job loss at nearly 1 million permanent employment shrinkage occurring over the next few years. Five states have a regional recession/ depression development underway. Alaska could become the sixth state on the damaged list.

Readers may note that for the Gulf region, they can watch the Beige Books of the Atlanta and Dallas Federal Reserve Banks for economic details over the next several months.

And we must not be deceived by the $20 billion fund. It is not nearly enough to cover the liabilities that may develop for BP and its partners, who are already in dispute with each other over who is going to pay for what and when and how much. Remember at $4300 fine for each leaked barrel of oil, the $20 billion is likely to just cover the fine. We expect that the total cleanup and payment of the liabilities to all injured parties in all five states may approach 5 times that amount.

Let's get to dispersants.

The United States has approved and is supervising the administration of chemotherapy to the Gulf of Mexico. I have personally watched chemo too many times. It attempts to restrain the fast-growing cells by doing more damage to them than it does to the healthy cells, in a desperate attempt to keep the patient alive. There are many warnings in chemotherapy about longer-term damage and about unknowns. They are accepted because chemo for a cancer victim is viewed as a life or death option.

Dispersants in the GOM are similarly problematic. Think of them as chemotherapy to a 2000 mile coastline and to hundreds of square miles of sea.

Use them sparingly and on the surface and we have a pretty good idea what will happen – they seem to accelerate evaporation and natural processes that get rid of the oil.

Use them below the surface, however, and we have little experience and simply do not know what the longer-term effects will be. Oil on the sea floor is a naturally occurring phenomenon. There are natural processes that Mother Earth has to deal with it. Microbes eat it. And when it rises to the surface it is then broken down and evaporates. Yes, it's toxic, and, yes, it does do damage.

Dispersants are manmade; no Mother Nature involved in this one. They are toxic chemicals that can do damage themselves.

When they are used in very cold water and a mile below the surface, we simply do not know what the outcome will be. And we do not know if the small droplets they create become an emulsion that travels for hundreds or thousands of miles. There is initial, but inconclusive, evidence that this is happening in the GOM. We will soon find out. I fear it will be the hard way.

The rest of this commentary consists of quotes from the Obama Administration's Environmental Protection Agency and other sources. They were extracted from public documents.

During the GIC meetings in Europe last week there were several discussions on the impacts of the GOM events. We owe great thanks to Jim Lucier for sharing his insight. His database on this subject is enormous.

The quotes follow. They are sequenced and lead to the issue of the use of Corexit. Remember, about 5 million liters of dispersants, mostly Corexit, have been used in the GOM in the last two months. About one-third of that has been at the wellhead, 5000 feet below the surface, in very cold, very high-pressure water. There are numerous reports of deeper-water oil plumes that are sufficiently subsurface to avoid easy measurement and detection. We will leave the rest of this to each reader to consider for her/himself.

As you read these extracts, please note that the UK has now banned Corexit. British oil comes from the cold and deep water off its coast.

First quote: "The EPA and the U.S. Coast Guard have authorized BP to use dispersants underwater, at the source of the Deepwater Horizon leak. Preliminary testing results indicate that subsurface use of the dispersant is effective at reducing the amount of oil from reaching the surface – and can do so with the use of less dispersant than is needed when the oil does reach the surface. While BP pursues the use of subsurface dispersants, the federal government will require regular analysis of its effectiveness and impact on the environment, water and air quality, and human health through a rigorous monitoring program." Source: US Environmental Protection Agency (EPA) website: www.epa.gov

Second quote: "On May 26th, EPA and the Coast Guard issued a directive to BP requiring them to decrease overall volume of dispersant by 75 percent and to cease use of dispersant on the surface of the water altogether unless provided prior written authorization from the Coast Guard. EPA continues to allow BP to use undersea dispersant but only at a maximum of 15,000 gallons per day."

Third quote: "BP's scientific analysis of alternative dispersants, in response to EPA's May 20th Directive, was found insufficient by both EPA and the U.S. Coast Guard. Therefore, EPA and other government scientists are independently verifying the alternative dispersant data presented by BP and will be performing independent scientific verification of the data BP presented. EPA is conducting its own tests to determine the least toxic, most effective dispersant available in the volumes necessary for a crisis of this magnitude and to understand if Corexit remains the most appropriate dispersant, as supported by the science for this situation."

Fourth quote: "EPA listed the components of Corexit 9500 and 9527 -- the two brands that BP has deployed to prevent oil from reaching shore. More than 1 million gallons of the chemicals have been used so far in response to the ongoing Gulf spill, including 317,000 gallons injected directly into the leaking well nearly a mile below the water's surface -- a first-time application EPA authorized last month. Among the chemicals in the Corexit brands are 1,2-Propanediol; Ethanol, 2-butoxy-; Butanedioic acid, 2-sulfo-, 1,4-bis(2-ethylhexyl) ester, sodium salt (1:1); Sorbitan, mono-(9Z)-9-octadecenoate; Sorbitan, mono-(9Z)-9-octadecenoate, poly(oxy-1,2-ethanediyl) derivs.; Sorbitan, tri-(9Z)-9-octadecenoate, poly(oxy-1,2-ethanediyl) derivs; 2-Propanol, 1-(2-butoxy-1-methylethoxy)-; and Distillates (petroleum), hydrotreated light." Source: INSIDEEPA.COM, June 19, 2010

Fifth quote: "People working with dispersants are strongly advised to use a half face filter mask or an air-supplied breathing apparatus to protect their noses, throats, and lungs, and they should wear nitrile or PVC gloves, coveralls, boots, and chemical splash goggles to keep dispersants off skin and out of their eyes." Source: EPA

Sixth quote: "The harm or toxicity of dispersed oil in the environment is generally associated with the oil rather than with the dispersant alone. However, use of dispersants breaks up a slick of oil on the surface into smaller droplets that can go beneath the surface. When applied on the surface before spills reach the coastline, dispersants will potentially decrease exposure for surface-dwelling organisms (such as sea birds) and intertidal species (such as mangroves and salt marshes), while increasing exposure to a smaller population of aquatic life found deeper in the water. It is unknown if dispersed oil has toxic implications to the human population because bioaccumulation through the food chain has not been evaluated." Source: EPA

Seventh quote: "We are currently unaware of published scientific information in the peer reviewed literature about the biodegradation of the dispersant itself. We do have information about the individual components (ingredients) of the dispersant, provided by the manufacturer's Material Safety Data Sheets (MSDS)." Source: EPA

Eighth quote: "While dispersants have been used in previous oil spills, this is the largest application of dispersants at an oil spill response in the United States." Source: EPA

Lastly, NOAA says that this spill seems to remain confined in the GOM for the time being. Here is the latest report (June 18):

"Recent satellite imagery analysis no longer shows the persistent patches of sheen to the S-SE of the main slick. However, non-recoverable sheens and tar balls previously observed in these regions may have been entrained into the large clockwise eddy (Eddy Franklin) that has pinched off the main Loop Current (LC). Trajectories indicate that most of these sheens will continue to move clockwise in Eddy Franklin. The connection between the spill source and Eddy Franklin has been cut off due to a change in the currents. The oil will biodegrade and photo-oxidize over the time frame of weeks to months. No recoverable oil is expected to enter the Florida current over the next 72 hours. The Loop Current is an area of warm water that comes up from the Caribbean, flowing past the Yucatan Peninsula and into the Gulf of Mexico. It generally curves east across the Gulf and then flows south parallel to the west Florida coast. An eddy is water that rotates."

Remember: this NOAA analysis is derived from surface observations. There is no mention of subsurface movements or plumes. NOAA is now continually researching this issue of subsurface toxicity.

Part 9, July 4, 2010

Americans were troubled by a different British threat two hundred and thirty-four years ago when Jefferson's famous declaration launched our grand experiment in democracy. Now, as then, we Americans find ourselves immersed in debate and facing uncertainty.

Then we fought a revolutionary war and rejected dominance from afar. Now we have already lost a global energy war. We have not restrained our oil hunger. We are presently dependent on foreigners for about ¾ of our oil needs. The BP spill, its aftermath, and the Obama drilling moratorium now threaten to raise that percentage to a new all-time high level of 85% dependency.
In Jefferson's time, the authentic tea party affirmed that "taxation without representation" was anathema. America's early decades codified some of our "inalienable rights" like free press, property ownership, and the right to a jury trial with a presumption of innocence. Now our free press shows us daily photos of the oil flow, video of empty Pensacola beaches, the angst of a Louisiana Parrish president, and the business failure of the a Gulf shrimper.

Property was ill-defined at our origins because Jefferson could not achieve a united thirteen colonies any other way. It took a century and a civil war to remove human beings from the definition of owned assets. Our evolving system replaced dueling pistols with lawyers and debtors' prisons with bankruptcy.

Now lawyers duel in the GOM with hundreds and hundreds of actions. Bankruptcy risk is rising, according to market-based pricing of BP and its partners. An unprecedented $20 billion fund will bypass courts. This settlement between BP and the US government breaks new ground in America. In time, we shall see if the unintended consequences end up outweighing the value.

Many analysts, including ourselves, believe $20 billion is too low and will prove to be insufficient to settle all legitimate claims. This fund was created out of a political decision-making process. It was not derived directly through our multi-century evolved process of adjudicating disputes. To be paid from the fund a claimant has to give up some rights. He must settle early and when the ultimate damage claim is unknown as to final size.

During the last two centuries our American government centralized. Its powers grew. After Jefferson, financial obligations evolved through three huge pre-World War II, multi-decade cycles of inflation and deflation, boom and bust. Crisis after crisis led to official attempts to prevent their repetition. This effort has always been unsuccessful for Americans as our political system ebbs and flows between restrictive financial conservatism and liberalistic fiscal and monetary ingenuity.

As the financial reform bill wends its way through Congress, the issue of BP's global derivative exposure begins to surface in markets. This is a global market measured in the trillions. We will soon learn more about BP and Credit Synthetic Obligations (CSO). One detailed analysis from Moody's identifies 117 of them that may be impaired by BP credit downgrades. Remember, BP was once an "AAA" credit. It is now "BBB" according to Fitch.

Friday's employment report was unpleasant reading. It affirmed our forecast of a very slow job recovery ahead in the US. On July 4, 2010, the narrow, and headline-generating, computation shows that one of every ten Americans is looking for a job and unable to find one. One of six is either underemployed or unemployed (we are using the U-6 or broad definition of unemployment). Think about it: 17% of our willing and working-age citizens have income levels below their previous experience.

In addition, our nation has watched trillions in housing wealth disappear. Our homes, the most pervasively owned asset in America, have been the bastion of savings for our stabilizing middle class. It is a damaged sector. Its owners bear scars; its foreclosed former owners suffer.

The national statistics need one more month to be disaggregated in sufficient depth to estimate job losses from the BP spill and from the Obama moratorium. Business condition reports compiled by the Atlanta and Dallas Fed regional banks will begin to discuss the economic pain in tourism, fisheries, and oil service industries. We expect this to make for continued unpleasant reading. If the Obama moratorium holds in its present form, we expect a million more job losses over the next few years to "pile on" the job losses to date. This is in addition to those originating in the loss of fisheries and tourism. Obama may be destined to run for re-election in 2012 with a broadly computed (U-6) unemployment rate of 18-20%. This November the Congress too will be faced with these numbers, which is why some incumbents have decided to retire.

In Sarasota, some locals seem relieved by NOAA's latest probabilities of oil-slick landfall. NOAA says the likelihood of the oil damage reaching the Florida Keys and Miami is greater than the chance of it hitting the Tampa-Naples stretch of Florida's west coast. Why? NOAA says the shape of the continental shelf alters the direction of the currents. We note, however, that the NOAA study looked only at models of the directional flows of GOM currents. It did not consider hurricane activity.

On July 4, one-third of America's GOM is closed to fishing. NOAA's jurisdiction stops at the federal boundary. Thus, Mexico, Cuba, or international treaty enforcement determines fishing prohibitions in the non-US Gulf.

The Sarasota fishmonger on Lemon St. now gets his shrimp from Sanibel. "Louisiana is dead for years," he said. "It will not come back in my lifetime."

At Walt's Seafood, at 4144 South Tamiami Trail, the manager told me his oysters now come from the Texas side of the GOM. I asked him about hurricane-induced changes and underwater dispersant plumes. He offered me a blank stare. "I leave that up to the government to tell me what I can do," he said.

Walt's had some July 4 special offerings to accompany a cold, crisp Sauvignon Blanc from Marlborough, New Zealand. I thought about seafood, personal safety, trust in government, and the GOM. I pondered the damage BP and its partners inflicted. Moreover, I considered that this is now a five-state regional tragedy thanks to politics, which are making it worse.

But what to eat? Is it safe? In the end, some flown in from New England Ipswich steamed clams and a Maine Lobster proved to be succulent.

The belly is sated. The wine was flavorful. However, celebratory joy seems muted on this Fourth of July.

Part 10, July 21, 2010

Since the BP rig explosion, $450,000 of the Louisiana St. Trans Auth Toll Sr. Lien-LA 1 Project-Series A, 4.5% of 12/01/30 tax-free municipal bonds have traded. Prices have ranged from a low of 93.25 to a high of par (100). The average price was about 99, or $990 per thousand-dollar face amount.

The bonds were issued in 2005. At the time, S&P, Moody's, and Fitch rated them AAA. The rating was achieved because Ambac insured the bonds. Today Ambac itself is rated at a low junk-bond status.

Fitch rated this Louisiana bond BBB in January 2009. S&P rerated the bond A+ in October 2009. Moody's rerated it Aa3 under its new global scale. That rating occurred on April 16, 2010, four days before the Deepwater Horizon explosion. The rating agencies based these results on the bond's underlying credit structure; Ambac is ignored because of its junk status.

In May 2010, Moody's said that the Gulf Oil spill would have a major impact on the shoreline, but a minor impact on Louisiana and local credits. Six months before the BP explosion (October 2009), Moody's awarded an A1 rating to Louisiana's General Obligation bonds. Moody's cited the oil industry as one of the strong factors in Louisiana's economy.

Four years earlier, in 2005, Moody's "assigned an Aa3 to the Louisiana Transportation Authority LA 1 Project Toll Revenue Senior Lien Bonds, series 2005A." The reason given was that the bond has a "first lien on toll revenues, but the "security ultimately hinges on a Cooperative Endeavor Agreement between the State and the Authority in which the State agrees to replenish the Debt Service Reserve Fund if necessary, subject to appropriation."

Let us be blunt. This is a toll revenue bond. It is dependent on the use of a 16.3-mile elevated highway and bridge system beginning at Port Fourchon, Louisiana. The major customers are the Louisiana-based oil industry and the Louisiana-based shrimp industry. The toll revenue projections are now in jeopardy. First because the fishery industry is decimated by the BP spill. Secondly because the Obama administration's oil-drilling moratorium threatens oil-industry revenues.

If the tolls are insufficient, the credit support for this bond comes from a state guarantee. The underlying economic assumption for this bond, according to the consultants who prepared the revenue estimates, is that "oil and gas drilling in the Gulf of Mexico will continue unabated, as will the LOOP terminal, with Port Fourchon remaining as the principal service port for these platforms."

However, the state's obligation requires that the legislature appropriate money in order to fund any deficiency. They may face this issue if the Debt Service Reserve Fund runs out of money because the toll revenue is insufficient. Will that happen? We do not know. Could it happen? Absolutely, yes.

Will the legislature fund the debt service at the time their state budget is under pressure because of the aftermath of the BP spill and because of the federal government's oil drilling moratorium? We do not know. However, the pressure to defer any payment will be intense and the legal obligation to fund it is uncertain.

The language in the documents suggests that the legislature's obligation to pay in the future will remain if the legislature fails to fund any debt service deficiencies as they occur. That implies the legislature may be able to delay the funding while it litigates with the federal government.

We fear this issue may become one contested in a court. If so, the bondholders will be dependent on Ambac for the timely payment of their debt service. And Ambac has gone from a AAA credit to a weak junk bond status. Enough said.

No rating agency has downgraded this bond since the explosion. No rating agency has put it on credit watch. We cannot find any rating agency action that reflected any negative response for this bond because of the BP oil spill and its aftermath.

In June of 2010, someone bought a small piece of this bond at par (100), according to public records of trades. If that person checked the status of the bond, they would have observed the investment grade ratings we outlined above. No current credit report would have mentioned this payment intricacy.

Cumberland would not buy this bond. At the current prices we see in the transactions reports, the bond is trading as if there were nothing happening to elevate the risk. The market pricing assumes that the State of Louisiana has negligible negative credit impact due to the moratorium and the BP spill.

We do not understand the rationale behind this lethargic behavior by the rating agencies. We wonder why this bond, and others like it, is not on a credit watch for a possible downgrade.

Since the Deepwater Horizon explosion, Cumberland has sold about 40 different issues of municipal bonds because of possible exposure to the aftermath of the BP oil spill. The only reason we did not sell this one is that we never owned it to begin with.

Proactive Muni management means sell quickly when a contingent risk is evolving. Acting early means that most of the bonds sold will ultimately pay on time. The idea is to manage a rising risk by selling into market pricing that has yet to reflect that risk. This bond is an example of such a rising risk.

Nothing in the documents suggests that BP has any liability for any debt-service shortfall. BP did cause damage to the shrimp industry but BP did not create the drilling moratorium. There is no stated obligation of the federal government to pay for any debt-service shortage because of the moratorium. Ultimately, the Feds will either pay voluntarily or the State will have to prevail in court.

We wish the holders of these bonds good luck. They may need it.

Note: the GIC delegation will visit Port Fourchon by helicopter as part of its August 11-12 research seminar in Baton Rouge. There are four seats still available on the delegation's helicopters. For details see: www.interdependence.org or call 215-898-9453.

Part 11, August 16, 2010

We are back from a fascinating and exhilarating experience with the GIC (www.interdependence.org). One of our delegate colleagues was John Mauldin, who has already published commentary on the trip. He has given us permission to share it with our readers. Excerpts from his report are below.

We believe John has accurately described the meeting and captured the "takeaways" well. We would add our voices to the harsh but well-deserved criticism of BP and to the bungling perpetrated by the US government. The total cost to BP could well exceed $50 billion and may eventually approach $70-80 billion, depending on the form of the fine that BP pays. Using 4.9 million barrels as the estimate of spilled oil, we can offer that, at the low end of $1000 a barrel, the fine will be about $5 billion. At $4300 a barrel it is over $20 billion. If there is a criminal penalty on top of a negligence finding, the ultimate fine could be some multiple of the $4300 amount. We will know that outcome in due time.

John's note below describes the moratorium. We have written about that in detail in our Oil Slickonomics series. Our views about the form and operation of the moratorium are very critical of the US government. The Obama administration is now at risk for a self-inflicted disaster; the cost and impact of it could far exceed the results of the oil spill.

Remember: the economic impact of the oil spill is a transfer payment from BP to individuals, businesses, local governments, and the federal government. In theory, the damage will be fully settled with a monetary penalty.

The impact of the oil-drilling moratorium, on the other hand, is a transfer payment from those who lose jobs and those who use energy and those who pay taxes and those who value American independence, to those from whom we import oil. Therefore, while our transfer goes to some friendly places like Canada or Mexico, it also goes to less friendly folks like Chavez in Venezuela. Note also that a US deepwater moratorium does not entirely stop Gulf deepwater drilling. Repsol is working on its second well in Cuban waters.

If prolonged, the moratorium makes us more dependent on foreign oil and slows any US economic recovery. We will start to see this impact over the coming months in the five states that border the Gulf. The key places to look are in the Dallas Fed beige book and in the employment statistical details in Louisiana and Texas. More details are coming.

Let us now get to John Mauldin's newsletter.

"As I mentioned last Monday night in my Outside the Box, I did not make it to Turks and Caicos, but did end up in Baton Rouge for a special seminar on the Deepwater Horizon Gulf oil spill. I have both good news (and maybe more like less-bad news) and bad news. Today's letter is a report on what I learned.

"The conference was sponsored by the Global Interdependence Center (GIC - http://www.interdependence.org/). David Kotok of Cumberland Advisors organized the event with help from people from Louisiana State University. The quality of the speakers was outstanding. They were extremely knowledgeable and well-connected. The meeting was conducted under the Chatham House Rule, which means all the speakers spoke off the record, unless they indicated otherwise. This allows for a more frank discussion. So, much of what you will read from me is my impressions of what I heard, which I cannot attribute to specific speakers. Indeed, some would be at some occupational risk if I did so.

"Some of what I write today will be controversial to some readers. That is a risk I will take, as the large majority will find this interesting, or at least I hope so.

From Unmitigated Disaster to Merely Disaster

"First, let's begin with the 'good' news. The ecological destruction that was first feared is not going to be as bad as once thought, for a variety of reasons. It is not good, but it is not the unmitigated disaster it could have been.

"Edward Overton, PhD, Professor Emeritus, Dept. of Environmental Sciences, LSU, is an expert on oil spills. He was at the Exxon Valdez. The Exxon Valdez (EV) was a big, black, thick tide of oil. The Deepwater Horizon is a much bigger spill: every ten days the amount of the EV spill spewed into the Gulf, from April 20 to July 15. Professor Overton spoke mostly for the record. He is very much a concerned environmentalist, and he is also a very serious scientist.

"He reminded us that the Louisiana wetlands are a very important part of the ecological system of the Gulf of Mexico. Oversimplifying, they are the nutrient source for the small animal world which feeds the larger. Without the wetlands much of the Gulf ecosystem dies. If

they were destroyed, they would not come back very easily, as without their very root system the land would erode away. Bluntly, oil kills wetlands if it gets into it.

“There are only three ways to get rid of an oil spill. You can mechanically remove it, chemically remove it, or burn it. They used all three methods. But not fast enough. The Obama administration dithered while Rome burned. (This is not from Overton.)

“As The Christian Science Monitor reported in ‘The Top Five Bottlenecks’:

"’Three days after the accident, the Dutch government offered advanced skimming equipment capable of sucking up oiled water, separating out most of the oil, and returning the cleaner water to the Gulf. But citing discharge regulations that demand that 99.9985 percent of the returned water be oil-free, the EPA initially turned down the offer. A month into the crisis, the EPA backed off those regulations, and the Dutch equipment was airlifted to the Gulf.’

“Really? For 0.0015 percent clean water from badly contaminated, toxic water? It takes a month to get that decision? I can guarantee you that there were people arguing for such a decision early on, and some rookie environmentalist at the EPA who never had responsibility in the real world made things a lot worse. Moving on:

"A giant Taiwanese oil skimming ship, The A Whale, is only now working on the spill. It can process 500,000 barrels of oily seawater per day, but it also needed the same waiver from the EPA which, expressed in another way, limits discharged water to trace amounts of less than 15 parts-per-million of oil residue. It also needed a waiver from the Jones Act, which prevents the use of specialized foreign ships from the North Sea oil fields because they use non-American crews. Previously, the skimmers had to return to port to offload almost pure seawater each time they filled up with water." (http://reason.com/archives/2010/07/09/the-governments-catastrophic-r)

“Ok, Let's get this straight. The oil industry screwed up by not having enough disaster equipment and ships available. That's bad beyond words. But for the government to compound that by not allowing needed ships to do the work, just because they did not have US union workers is just as bad. You expect better from government in a disaster, or we should.

“(Overton said we never really did learn whether The A Whale would have been as useful as advertised, as it did not get into the Gulf soon enough.)

“What should have been a no-brainer decision to use the Dutch ships was delayed for whatever reason. What should have been a no-brainer decision to waive the water purity rules was delayed beyond reason. My personal opinion. Whoever participated in that decision should be allowed to return to the private sector. They only made the problem of the spill worse. They should not be allowed near the decision-making process again.

“Please note, this is no defense of British Petroleum. As noted below, they were extremely negligent, and deserve the costs and more. We just don't need to compound stupid, incompetent, irresponsible (choose several more adjectives, some with color) corporate acts with dumb government ones.

The Corexit Decision

“There is a chemical called Corexit that is a product line of solvents primarily used as dispersants for breaking up oil slicks. It is produced by Nalco Holding Company. Corexit was the most-used dispersant in the Deepwater Horizon oil spill in the Gulf of Mexico, with COREXIT 9527 having been replaced by COREXIT 9500 after the former was deemed too toxic. Oil that would normally rise to the surface of the water is broken up by the dispersant into small globules that can then remain suspended in the water.

“In hindsight, Overton thinks the use of Corexit was the correct thing to do. It probably saved the wetlands. But it is not without its own bad effects.

“When you put Corexit on an oil slick, the surface oil disperses but also drops into the ocean about 15 feet. While Corexit (basically a type of soap) itself is not toxic (an admittedly controversial claim), the resulting dispersed oil is quite toxic. Fish swimming through it can be and are harmed. Marine mammals like porpoises are seriously harmed when they rise to breathe through an oil slick.

“But here is the good news. It turns out that there are about the equivalent of two Exxon Valdezes a year from natural oil seepage from the floor of the oceans. The Gulf has an ecosystem of bacteria that eat that oil, which are then eaten again by plankton. To those bacteria, dispersed oil is filet mignon. They thrive and grow rapidly, turning that toxic waste into nutrients, which are absorbed by the

plankton. The bacteria keep on growing until they lose their source of nutrition (the toxic oil) and then die out over time. Note: once absorbed by the bacteria, the oil is no longer toxic. There are no toxic minerals like mercury introduced into the ecosystem.

“Scientists are somewhat baffled. There are tens of millions of gallons of oil that seem to be missing. It seems that the Gulf is providing its own (albeit chemically assisted) defense mechanism. Overton thinks that within less than five years, and maybe only a few years, the ecosystem will largely be back. And fishing may even be better, since the fish and shrimp are not currently being harvested (he called it human predation). At least for a while.

“We traded onshore damage for offshore damage. But the calculation is that much of the ocean is empty of fish. Ever go deep sea fishing? Did they just jump into the boat? Did you fish all day and catch little or nothing? There are large parts of the ocean and Gulf with very few fish. It is not good to create those toxic pools of oil, even if they eventually go away. Some fish will be harmed. But better than on the marshes.

“For that we should all be grateful. It was a very difficult choice to make to use the dispersants. But it was the right choice. Somewhat like the choices we have to make in our current economic environment, concerning deficits and stimulus. There are no good or easy choices in these crucial situations. It was tragic that the choice had to be made, but I am glad it was. Losing the Louisiana wetlands would have been an ecological disaster of biblical proportions.

“Again, we should never have had to make that choice. Better that BP management had observed the warning signals.

Some More Takeaways

“It was clear talking from experienced oil professionals that the blowout was human error, and probably compounded human error, ignoring multiple warning signs and safety procedures. We went to Shell's Robert Training Center, where they train people to work on oil rigs. It is a very rigorous facility and the people running it are very professional. They take safety seriously. They train most of the oil rig workers in the Gulf, including British Petroleum's. They showed us the simulated control rooms. There are lots of safety features and redundancy; and it is *my* take that complacency had set in at BP, as things had gone just fine for so many years, and then some corners were cut. Over time, this will all come out.

“There are two types of Corexit. The newer version is considered less toxic. But for whatever reason (ahem), they used supplies of the older version first. As it turns out, they needed just about everything they had, using over 1 million gallons. But it would seem that someone made an economic decision to empty the shelves of a less desirable dispersant.

“Before we start to drill again (and we must!), we need to build two very large containment devices (to provide for redundancy). The process of building them from scratch this time was too time consuming and was trial and error.

“There is a coalition of large oil companies building a response system at a cost of over a billion dollars. A little late for this disaster, but good for the future. There need to be enough booms to gather oil, skimming vessels, and other equipment at the ready, just as we assume there will be fire trucks if we need them. And that should not be at taxpayer expense, of course.

Time to Lift the Moratorium

“The Obama administration imposed a moratorium on drilling, which in effect has shut down even shallow-water drilling, even though Obama himself said it would not affect such shallow wells. A judge has overturned that ruling. The administration then issued another moratorium, with indications it will issue yet another when this one is overturned.

“Enough already.

“On Thursday night, we had dinner in the Louisiana Governor's mansion, hosted by the Lt. Governor Scott Angelle. (I was privileged to sit at his table, and he is both gracious and quite sharp.) Before being appointed Lt. Governor, Angelle was Secretary for the Department of Natural Resources, overseeing the very large oil industry of Louisiana. He is very familiar with the issues.

“Angelle, a Democrat, has agreed not to run for the Lieutenant Governor's office in the next election, which the Governor said was a requirement for anyone he nominated for the post. Angelle plans to return to the agency once his tenure as Lieutenant Governor has finished.

"Angelle was very passionate about the need to begin safely drilling again. Over 30,000 wells have been drilled without major incident until now. He is clear about the need to address safety, but there are 300,000 well-paid jobs at risk, and Louisiana (and the US) are losing ship rigs to Africa and Brazil, which won't come back for a long time. And those 300,000 jobs have a large multiplier effect.

"But it is more than that. If the US cannot become energy independent, we will not be able to balance our federal deficit without the private sector going into even greater debt.

"… you can run a trade deficit, reduce government debt, and reduce private debt, but not all three at the same time. Choose two. Choose carefully.

"I know some of my friends say trade deficits don't matter (that would be you, Dennis!) But tell that to Greece. They are running large trade deficits. To get their government back into balance, they are going to have to go through very serious wage deflation and other pain. Accounting identities will extract their due. There is no getting around them.

"Now, it would be better to rapidly build nuclear plants and turn our car fleet electric. But that will not happen for some time. Take our truck fleet and have it run natural gas. That takes time as well. In the meantime, we need to be drilling domestic oil or we will all be the poorer for it.

"I consider myself an environmentalist. Not radical, but serious. I want clean air and water for myself as well as my kids. I would be willing to consider a gradual annual increase in gasoline taxes to encourage alternatives (with the taxes going directly to rebuilding our badly maintained roads and bridges). I know we need to make the shift to electric cars and nuclear power, as well as renewables. But I also want my kids to have an economic environment where they can find jobs and prosper. Just a thought."

We thank John Mauldin for permission to share his commentary with our readers. For John's website and to join more than 1 million regular readers of his commentary, see the web address below.

John ends his letters as follows:

"John Mauldin, best-selling author and recognized financial expert, is also editor of the free Thoughts From the Frontline that goes to over 1 million readers each week. For more information on John or his FREE weekly economics letter go to: http://www.frontlinethoughts.com/learnmore."