Volume 57 No. 6 February 2009

# MISSISSIPPI GEOLOGICAL SOCIETY

## *eBulletin*

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## *PRESIDENT'S LETTER*
## *Lisa Ivshin*

***Fellow members:***

***Seems like January went by fast. We did have a great GS meeting on the 11th. Jeff Requarth and John Morris of Savannah Oil & Gas presented a great report on their exploration successes in North and South Winchester Field, Wayne County. We had a full house for the presentation. I have not seen so many people at our meetings in a long time. Lunch was catered by Hamels and it was great as well. I know, everybody enjoyed it.***

***Our meeting for February will be very interesting. Tom Pickens will talk about his unique integrated approach to evaluate shale gas play. The techniques outlined in his talk provide detailed accurate answers to key questions facing the shale gas explorer. Tom is the Principal Geologist for Interpretation Development Schlumberger in the Houston Office. Tom has been with Schlumberger for 37 years, 32 of which he worked for Gulf of Mexico area. Schlumberger awarded Tom Gold, Silver and Wildcatter Awards. I think this presentation will be fascinating and hope many of GS members can come.***

## In This Issue:



***Once again, please check Mississippi State Oil and Gas Board's new web site http;// gis.ogb.state.ms.us/MSOGBOnline/ and let me know what you think about the new site.***

***Make plans to be at the February meeting***
***I look forward to seeing you all there!***

## MGS MEETING SCHEDULE

| When | What | Where |
|---|---|---|
| September 11, 2008 | Fall BBQ | Jackson Yacht Club |
| October 9, 2008 | Larry Baria & Ezat Heydari "Shale Layers in the Alabama Smackover Formation and the Implications for Sea Level Change in Regional Correlations" | River Hills |
| November 13, 2008 | Dudley J. Hughes "The Global Warming Debate" | River Hills |
| December 6, 2008 | MAPL / MGS Christmas Party | Colonial Country Club |
| January 8, 2009 11:30 – 1:00 | Jeff Requarth and John Morris of Savannah Oil & Gas—Perseverance and Technology: Recent Exploration Success—North and South Winchester Field, Wayne Co., MS | Holmes Community College (Ridgeland Campus) |
| February 12, 2009 | Tom J. Pickens — An Integrated Approach to Evaluate a Shale Gas Play. | River Hills |
| March 12, 2009 | Honors Meeting: Boland Scholarships | River Hills |
| April 9, 2009 | TBA | River Hills |
| May, 2009 | Spring Fling | Jackson Yacht Club |

Atmospheric demonstration of a small gel frac

## OFFICERS MEETINGS

August 5, 2008

September 2, 2008

October 7, 2008

November 11, 2008

December 2, 2008

January 6, 2009

February 3, 2009

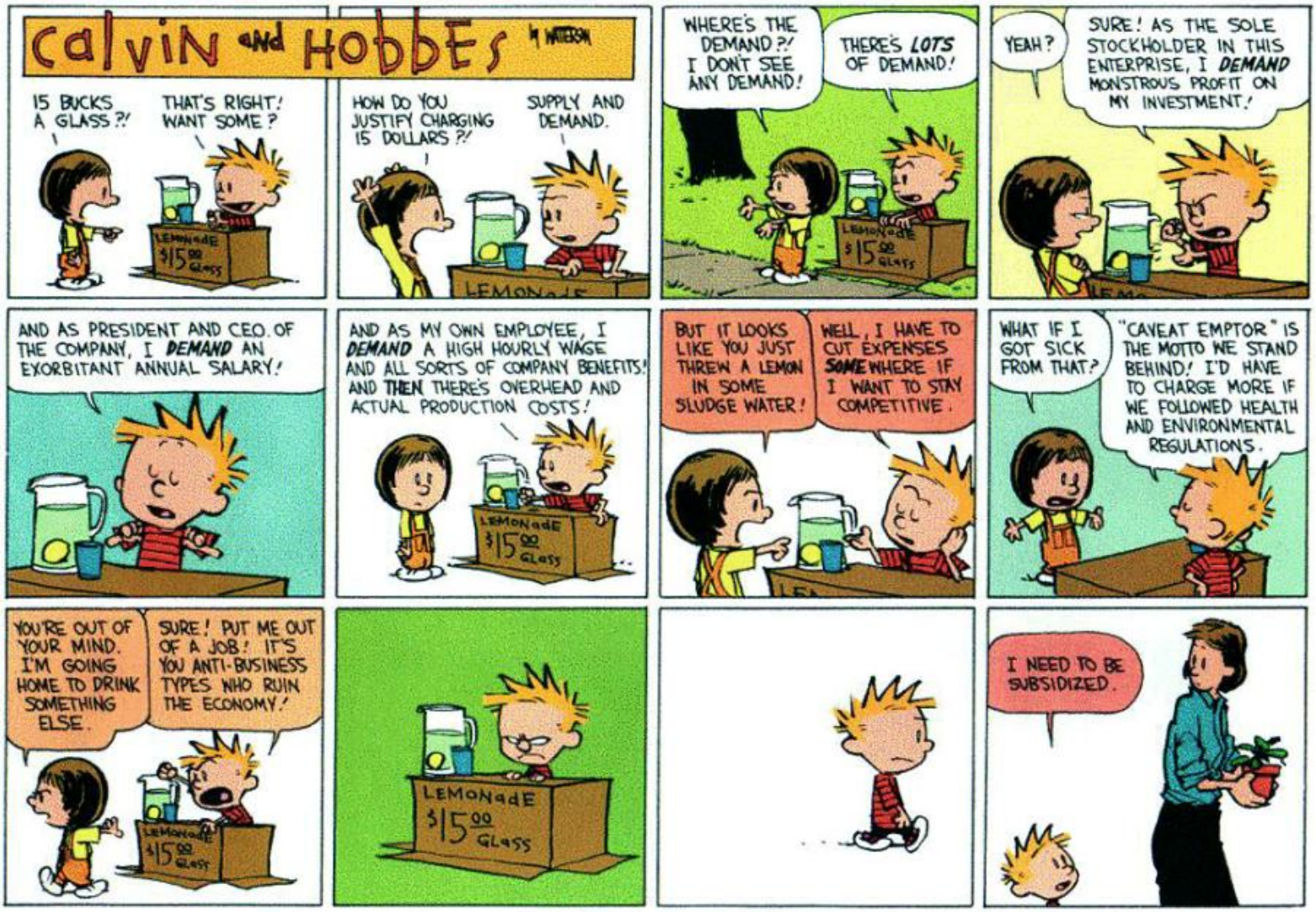
March 3, 2009

April 7, 2009

May 5, 2009

**IEA slashes 1 million b/d from 2009 oil demand outlook**
**Marilyn Radler**
*Senior Editor-Economics*
**HOUSTON, Jan. 20** -- In its most recent monthly Oil Market Report (OMR), the International Energy Agency slashed its oil demand outlook for 2009, and updated its demand figures for the fourth quarter of 2008.
The agency has lowered this year's oil demand forecast based on a revised picture of the world's economic weakness and now assumes 2009 global real gross domestic product growth of 1.2%. A month ago, IEA based its outlook on an International Monetary Fund estimate of 2.1% GDP growth for the year.
The January OMR shows that oil demand in the Organization for Economic Cooperation and Development has been cut by 500,000 b/d from estimates in the IEA's December OMR report. Meanwhile, oil demand in non-OECD countries has also been reduced by the same amount.
Worldwide demand for 2008 is down 100,000 b/d from previous estimates to average 85.8 million b/d, as demand in the final quarter was 300,000 b/d lower than previously estimated.
IEA also lowered its outlook for 2009 non-OECD supply, with a 100,000 b/d reduction in 2009 output from the former Soviet Union based on less-optimistic company forecasts, as well as the slower than anticipated Sakhalin-2 ramp-up. However, IEA said, declining Russian output would appear to be due more to a punitive fiscal and regulatory regime, which is impeding investment.
The Paris-based agency's 2009 total Russian supply figure now stands at 9.7 million b/d, implying a decline of 280,000 b/d from last year.
Estimates of supplies of natural gas liquids from the Organization of Petroleum Exporting Countries in the first half of this year also have been mildly cut from a month ago. But IEA still expects OPEC NGL output to average 5.6 million b/d this year.

**This cartoon was drawn over 15 years ago!**



THE FIVE FLATIONS.

When used in connection with the economic term inflation, which is a steady rise in prices over time, the other four "flations" are:

Disinflation is the shift from high inflation, when prices are rising rapidly, to lower inflation, when those price increases are more contained. There are several causes for this — one of the most common is a sharp tightening of credit, often the result of a shift in policy by a country's central bank. A boom earlier in this decade tightened supplies of natural resources like oil and metals, accelerating the rise in prices of those commodities. The recent global slowdown has reversed that trend, touching off worries that falling prices may lead to deflation.

Deflation is the opposite of inflation: prices fall steadily, which can produce widespread economic harm if it persists. The problem is that consumers and businesses get used to the idea that prices will be lower in the future, so they postpone spending and investing, which causes the economy to contract, which forces business to lay off workers and cut prices to generate new business. If this downward spiral takes hold, as it has occasionally in the past, it can be difficult to break.

Reflation is the process of breaking that spiral — typically through government efforts to lower interest rates, cut the cost of borrowing and pump money into the system. Those measures are now being taken in the United States and other countries around the world to stop the current global recession and get the economy started again. Even if the economy responds relatively quickly though, there is a risk that the trillions of dollars that have been pumped into the system will touch off another round of inflation down the road.

Stagflation is the worst of all possible worlds: Inflation takes hold in an economy that's not growing. This presents government policy makers with an impossible choice. If they try to revive the economy by pumping more cash into the system, they run a major risk making the inflation worse. If they try to tame inflation by tightening up on credit and the supply of money, they risk making it harder for the economy to grow.

The last time inflation was a severe, sustained problem in the U.S. was the 1970s, when the government made a series of failed attempts to contain it — including wage and price controls during the Nixon administration. After a decade of stagflation, the ultimate cure was a government-induced recession in 1980 (and again in 1981) that sent interest rates peaking at 20 percent and the unemployment rate to just above 10 percent.

"This year, taxpayers will receive an Economic Stimulus Payment. This is a very exciting new program that I will explain using the Q and A format:

"Q. What is an Economic Stimulus Payment?
"A. It is money that the federal government will send to taxpayers.

"Q. Where will the government get this money?
"A. From taxpayers.

"Q. So the government is giving me back my own money?
"A. Only a smidgen.

"Q. What is the purpose of this payment?
"A. The plan is that you will use the money to purchase a high-definition TV set, thus stimulating the economy.

"Q. But isn't that stimulating the economy of China?
"A. Shut up."

Below is some helpful advice on how to best help the US economy by spending your stimulus check wisely:

If you spend that money at Walmart, all the money will go to China.

If you spend it on gasoline it will go to the Arabs.

If you purchase a computer it will go to India.

If you purchase fruit and vegetables it will go to Mexico, Honduras, and Guatemala (unless you buy organic).

If you buy a car it will go to Japan.

If you purchase useless crap it will go to Taiwan.

And none of it will help the American economy.

We need to keep that money here in America. You can keep the money in America by spending it at yard sales, going to a baseball game, or spend it on prostitutes, beer (domestic ONLY), or tattoos, since those are the only businesses still in the US."

A guy stuck his head into a barber shop and asked, 'How long before I can get a haircut?'
The barber looked around the shop full of customers and said, about 2 hours.'
The guy left.
A few days later the same guy stuck his head in the door and asked, 'How long before I can get a haircut?'
The barber looked around at the shop and said, 'About 3 hours.'
The guy left.
A week later the same guy stuck his head in the shop and asked, 'How long before I can get a haircut?'
The barber looked around the shop and said, 'About an hour and a half.'
The guy left.
The barber turned to a friend and said, 'Hey, Bill, do me a favor. Follow that guy and see where he goes.
He keeps asking how long he has to wait for a haircut, but then he doesn't ever come back.'
A little while later, Bill returned to the shop, laughing hysterically.
The barber asked, 'So where does that guy go when he leaves?'
Bill looked up, tears in his eyes and said, 'Your house.'


Vol. 230 No. 1

What's new in exploration

ARTHUR BERMAN, CONTRIBUTING EDITOR, BERMANAE@GMAIL.COM

## Shale plays and lower natural gas prices: A time for critical thinking

In mid-July 2008, the US somewhat unexpectedly discovered that it had an oversupply of natural gas, and prices fell sharply. Jen Snyder, head of Wood Mackenzie Ltd.'s North American Gas Research Group, recently said that the development of shale gas plays has caused "a significant potential oversupply" ( *Oil & Gas Journal* , Dec. 1, 2008). I am disturbed by an irrational tendency in the E&P industry to pursue shale plays despite oversupply of natural gas and lower prices, since most of these plays were marginally commercial at higher gas prices.

I have struggled to understand the economic appeal of shale plays. I thought that lower gas prices would greatly reduce shale activity, but this has not occurred. In the first half of July, spot gas prices were more than $13/MMBtu. Six weeks later, the price had fallen below $8, and further dropped below $6 in early December. Some analysts predict $5-6/MMBtu range at least through the end of 2010.

At $10/MMBtu, about half of horizontally drilled and fracture-stimulated Barnett Shale wells were commercial, so while prices were rising above $10, shale plays made some sense. At $6, however, only about 25% of Barnett wells will pay out ( *World Oil* , November 2007), and all indications are that prices will fall lower or, at best, remain near current levels. While leasing has largely stopped, drilling continues, and enthusiasm seems strong, at least for the Barnett, Haynesville and Fayetteville Shales. How can we understand what is happening with shale plays?

The Diffusion Model of Innovation (Ryan and Gross, 1943; Rogers, 1962) shows that people adopt new ideas and technologies slowly, and that only about 5% of people make the decision to adopt something new based on information. The other 95% decide because of the views of opinion leaders in the community, and on the eventual social momentum that develops - what Malcolm Gladwell called the "tipping point."

What causes people to decide to abandon a previously accepted idea? It is reasonable to assume that conventional thinkers do not see that anything has changed until opinion leaders shift their views. Thomas Kuhn ( *The Structure of Scientific Revolutions* , 1962) explained that scientists resist abandoning a ruling theory in favor of a new paradigm with a kind of orthodox fervor of conventional thought, and often ostracize those critical thinkers who point out problems with the existing model. At some point, when opinion shifts to support a new paradigm, the previous theory is unceremoniously dropped, and its remaining supporters are criticized as dinosaurs.

How did our industry get to its present state? The collapse of oil prices in 1982-1986, and the ensuing 13 years of oil oversupply and low prices, created an environment in which cost-cutting and reducing risk were paramount. Thousands of jobs were lost, and companies disappeared as layoffs, reorganizations, mergers and consolidation became the core business of oil and gas companies.

As oil prices slowly recovered, risk analysis teams were formed to manage technical work. Executives abdicated their technical responsibilities to risk committees, and turned their attention to business models. With the help of consultants, they envisioned companies in which exploration and production would become a manufacturing operation, and risk was eliminated. Execution was paramount, standardization was essential, and new geological ideas were unnecessary. The new vision for the E&P business represented the victory of conventional over critical thinking.

Shale plays not only satisfied this model, but they also solved the perennial E&P problem of being opportunity-constrained. Because shale is almost ubiquitous, there are no limits to what can be spent pursuing new and existing opportunities. This shift was widely supported by the capital investment community because of the low perceived risk, and the fact that non-scientists and conventional thinkers could understand the play.

While these plays are an important component of domestic gas production, even among unconventional gas supplies, tight gas and coalbed methane dominate current production.

These plays involve considerable risk. The fact that 75% of wells are commercial failures at current gas prices is a tangible risk. Great emphasis is placed on engineering ideas and technology, but concern for geological and geophysical controls is uneven among shale players. All shale plays are different and require a thorough understanding of thermal maturity, structural geology, rock fracturability, silty or sandy beds within the shale package, and sweet spots.

Also, economic models must be aligned with full-cycle PV10 industry standards. Wood MacKenzie's Jen Snyder says that established shale plays have "sufficient volumes available at a development break-even price of $5.50/MMBtu or below." I don't believe that. I do not know of any credible industry analyst who believes that shale plays are commercial below $6; many believe that it takes $8.

Additionally, the current gas oversupply is not mainly due to shale production. Prices fell when about 2 Bcfd of additional supply came online, not from shale, but from conventional reservoirs in the Gulf of Mexico at Thunder Horse, Tahiti and fields supplying the Independence Hub.

Finally, rig counts and rates have fallen sharply in recent weeks, and some predict that hundreds of rigs will be idle in early 2009. Huge resources have been claimed in shale plays with relatively few wells and little performance history to support them. Huge investments have been made in dozens of shale plays. Only a few of these have any realistic possibility of resulting in commercial outcomes, and then only when operators greatly reduce costs and improve well performance. Even Snyder concludes, "Simply stated, there is no requirement for the rapid near- to mid-term development of some of the more expensive or challenging shales, such as the Marcellus or Horn River; the market can be adequately supplied without those volumes."

Shale plays represent a disturbing tendency away from critical thinking and conscientious accounting. The SEC did not perform well in regulating the practices in the banking industry that led to the current financial crisis. Perhaps it is time for regulators to ask executives in the domestic E&P industry some critical questions about shale plays before another financial fiasco unfolds.

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# MGS BOLAND SCHOLARSHIP FUND

The Society's L. F. Boland Scholarship Fund is open to donations (tax deductible) year round. Your contribution will help the Society recognize and reward outstanding earth science students at its annual Honors Day meeting on March 12, 2009.

Since inception in 1980, the Society has honored 112 students with the Boland Award. If you would like to contribute, please contact Dave Cate at 601-718-9397 or mail your check (L. F. Boland Scholarship Fund) to him at 217 W. Capitol St., Jackson, MS 39201.

The MGS gratefully acknowledges this years contributors to the L. F. Boland Scholarship Fund for the 2008-2009 year.

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# Where is oil going next?

- Posted by Jeff Parish on January 15, 2009 at 9:52pm in Ripped from the headlines...

HOUSTON (International Herald Tribune) -- From the Indian Ocean to the South Atlantic to the Gulf of Mexico, giant supertankers brimming with oil are resting at anchor or slowly tracing racetrack patterns through the sea, heading nowhere.

The ships are marking time, serving as floating oil-storage tanks. The companies and countries leasing them for that purpose have made a simple calculation: the price of oil has fallen so far that it is due for a rise.

Some producing countries are trying to force that rise by using the tankers to withhold oil from the market, while traders are trying to profit by buying cheap oil now to store and sell at a higher price later. Oil storage has become so popular that onshore tank capacity is becoming scarce.

Only six months ago, companies up and down the energy pipeline were rushing oil to market, struggling to keep up with galloping demand and soaring prices. Now, with the global economy slumping and people driving less, demand for oil has plunged — and the same companies are acting in ways that would have been unimaginable until recently.

Oil producers are shutting down rigs, refiners are producing less gasoline, and investment planning throughout the industry is in turmoil.

The problem for the companies is not just that prices are lower, but that they have become volatile — historically, a sign of an unstable market whose direction is uncertain. Between Christmas and a week ago oil prices soared 40 percent, only to reverse course almost as sharply in recent days. Just last week, the price of a barrel of crude oil dropped by nearly 12 percent in one day alone.

"The oil markets are suffering acute whiplash," said Daniel Yergin, an energy consultant and author of "The Prize," a history of world oil markets. "Price volatility is adding to the sense of shock and confusion and uncertainty."

The wild price swings are a continuation of last year's trends, when the price of a barrel of oil swelled to nearly $150 in July from just below $100 in January before collapsing to less than $35 last month. Daily oil prices rose or dropped by 5 percent or more 39 times, versus just four times over the previous two years. The only recent year that was comparably volatile was 1990, the year Iraq invaded Kuwait.

The continuing volatility is sending waves of anxiety up and down the complex production and investment chains of the oil world.

A year ago, oil producers and refiners could not move their products fast enough to meet growing world demand and chase rising prices. Now, with demand and prices slumping, they are sitting on 327 million barrels at tank farms around the country, particularly at Cushing, Oklahoma, a major storage hub and a crossroads for pipelines. That is more than 40 million barrels more in storage than this time last year, and more than 30 million barrels higher than the five-year average.

The mounting buildup has come during the last 100 days or so, as consumption of oil fell behind imports and domestic production.

With storage tanks filling up onshore, private and national oil companies, refiners and trading companies are storing another 80 million barrels aboard 35 supertankers and a handful of smaller tankers, the most in 20 years, according to Frontline Ltd., the world's largest owner of supertankers.

The different players have different reasons for storing oil, whether onshore or offshore.

National oil companies are hoping to reverse the price slide by holding oil off the market. Iran alone is reportedly using as many as 15 tankers to store crude oil in hopes that higher prices will prop up its economy, which is dependent on oil exports.

Private trading companies like Vitol and Phibro are storing oil in expectation of higher prices. They are taking their cues from markets where traders buy and sell contracts for future delivery of oil, which are signaling higher prices down the road.

Adam Sieminski, chief energy economist at Deutsche Bank, noted that a trading company could buy oil at the spot price of nearly $40 a barrel, store it and sell a contract to deliver it in a year for about $60. "You pay between $6 and $10 a barrel to store it, and you can make $10 a barrel," he said. "That's why Cushing is filling up rapidly and people are leasing tankers."

One small example of how the price uncertainty has affected behavior is the Devon Energy Corporation, an Oklahoma City company that in recent years has excited the energy world with announcements about expensive new investments in Canadian oil sands and deepwater oil exploration projects.

The company recently put off announcing details of its drilling program. Chip Minty, a Devon spokesman, said: "The volatility we have seen in the last year, and particularly the last few months, is making it more difficult to plan a drilling program that is funded through cash flow. Everybody is laying down rigs."

"Volatility is just another way of saying uncertainty," said Adam Robinson, director of commodities at Armored Wolf, a California hedge fund. "The demand outlook is very uncertain, the general outlook for prices is very uncertain, and the supply outlook is very uncertain."

Devon's caution is a sign that the go-go days of investment are giving way to more modest expectations. Schlumberger and Halliburton, the two top oil service companies, are cutting jobs. Many oil companies are delaying investments in more expensive projects, like mining Canadian oil sands. A couple of refiners face bankruptcy.

The volatility is showing up at the retail level. Drivers who only a few weeks ago were finding relief from the summer's $4-a-gallon, or 80 euro cents per liter, gasoline are now shaking their heads as the average national price for unleaded regular gasoline has surged to $1.79, from $1.62, since Dec. 30.

Oil volatility has complicated the efforts of automobile companies to figure out future strategies. Toyota had to suspend production at one plant that builds the Tundra pickup truck for several months when gasoline prices soared last summer. Toyota then delayed completion of a second plant meant to build the Prius hybrid when falling gasoline prices led to weakening demand for that fuel-efficient model.

The gyrations in prices affect shipping and other businesses around the world. Cathay Pacific, one of many airlines that use fuel hedging strategies, recently acknowledged that it had hedging losses of hundreds of millions of dollars as a result of the collapse in fuel prices.

The slowdown in oil investment is so rapid that some analysts say they believe it is a matter of time before shortages appear that will push oil prices to new heights and damage the economy.

From day to day, the price swings reflect a push and pull among the various players in the market, and diverging geopolitical and economic trends.

After months of sharply dropping prices, psychology on the oil markets seemed to shift strongly after Christmas — sending oil prices to almost $50 in January, from just below $34 on Dec. 19.

Traders were putting investment money back into oil as OPEC appeared to be serious about cutting output. Fighting between Israel and Hamas in Gaza appeared to threaten a broader Middle East conflict that might crimp oil supplies. The conflict between Russia and Ukraine over natural gas shipments threatened European supplies, raising fears that Europeans might have to switch from natural gas to oil.

But the mood shifted just as quickly last week when the Energy Department reported that crude oil inventories at Cushing had climbed by four million barrels, to 32 million barrels, for the week that ended Jan. 2, the highest since the government started tracking supplies in 2004. That number jumped again in a report on Wednesday, to 33 million barrels, near Cushing's operating capacity of 35 million barrels.

Spooked by the signs of surplus, traders drove the spot price of oil down to $37.28 a barrel on Wednesday, a drop of 1.3 percent.

Gasoline, meanwhile, has become pricier at the pump because refiners have been producing less of it. Profits from refining have been so thin over the last several months that refiners have been earning little, or even losing money, on producing gasoline. So now they are storing oil or selling it to traders, or retooling their refineries to produce less gasoline and more products with better profit margins, like heating oil, diesel or jet fuel.

Valero has curtailed gasoline supplies by extending maintenance time at some refineries and cutting production at eight of its 16 refineries. "There is not a lot of incentive right now to produce gasoline because there is lots of it," said Bill Day, a spokesman for Valero, the nation's largest refiner. "Obviously it would be better for us if there were more stability in prices."

While Goldman Sachs has predicted the slumping global economy will soon drive the price of oil down to $30, a top Kuwaiti oil official predicted recently that big production cuts by the Organization of the Petroleum Exporting Countries would soon push oil prices back up.

"It's a sure bet that both will be right," Yergin said, basing his opinion on the sharp swings of recent days.

Analysts foresee prices staying volatile for much of the year.