Drilling in Cuban waters raises spectre of disaster

Environmentalists are keenly aware of the short distance across the Florida Straits to Cuba, where Repsol will be drilling for oil

Barry Parker – New York

THE echoes of the Deepwater Horizon accident at the Macondo well, now almost a year and a half ago, continue to reverberate across the US Gulf and into the financial markets where companies are valued.

The news is not all bad; energy guru Daniel Yergin, on the interview circuit in connection with his new book The Quest, has talked about a shift of historical proportions in which the Western Hemisphere will start to move back towards self-sufficiency in energy.

Energy independence not withstanding, environmentalists in southern Florida are keenly aware of the short distance across the Florida Straits to Cuba, where Repsol will be drilling for oil in Cuban waters with the Saipem-owned semi-submersible Scarabeo-9, built at Yantai Raffles and completed in Singapore by Keppel FELS.

The proximity to Florida, in the face of a strained relationship between the US and Cuba, has brought about a diplomatic approach. Cuba is still subject to a trade embargo with the US dating back to 1960.

Ken Salazar, Secretary of the Interior, the Cabinet department that oversees the energy regulator Bureau of Ocean Energy Management, Regulation and Enforcement, or BOEMRE, had journeyed to Spain and met top exploration executives at Repsol. According to BOEMRE, which will be reorganised at the end of this month, Repsol had agreed to comply with US environmental requirements for offshore drilling.

According to local newspapers in the Florida Keys, drilling would start in December after the rig had arrived on station, to avoid drilling during the hurricane season.

The Scarabeo-9 is described as a Generation-6 rig, with dynamic positioning 3 capability, able to handle 100-knot winds and wave heights of 27 m, according to Saipem's specifications. It is on charter to Repsol at a day rate of $403,000. After up to two months of drilling for the Spanish company, it will then move over to blocks controlled by PDVSA and by Petronas.

The Keys Reporter, published in Key West approximately 50 miles from the drilling location, was also citing a mid-September joint visit to Cuba by the International Association of Drilling Contractors and the Environmental Defense Fund. According to the report, the team visiting Cuba also included William Reilly, a former official with the Environmental Protection Agency and co-chair of the White House task force that investigated the Macondo spill, which issued its report in early January. A retired offshore drilling executive from Shell was also part of the group.

Back in June, after Mr Salazar's meetings in Madrid, the New York Times' Green Blog ran an article called "Oil Drilling Off Cuba Raises Specter of What-If". When the possibility of a spill near the Florida Keys was mentioned, the NYT's bloggers said: "It would be difficult for oil companies to get equipment and other help from nearby American facilities" with the trade restrictions in place.

The IADC, through remarks of its Houston-based spokesperson, and reported by National Public Radio, suggested that the organisation was emphasising the political impediments to a proper spill response. The IADC also stressed that Cuban personnel have been working on projects in Brazil and Norway, and that Scarabeo-9 will have state-of-the-art safety features. The rig, originally ordered by Frigstad Offshore in 2006 and transferred to Saipem in 2007, is built to Norwegian standards, according to Saipem.

Frigstad says that the unit "will be the most powerful and capable ultra deepwater semisubmersible drilling rig ever constructed, equipped with a dual Ramrig drilling package from Aker Solutions and able to operate in water depths of up to 12,000 ft and drilling depths of up to 50,000 ft". Its blowout preventer, from Texas-based Cameron International, is equipped with seven rams: two 18.75" x 10,000 psi and five 18.75" x 15,000 psi. ■

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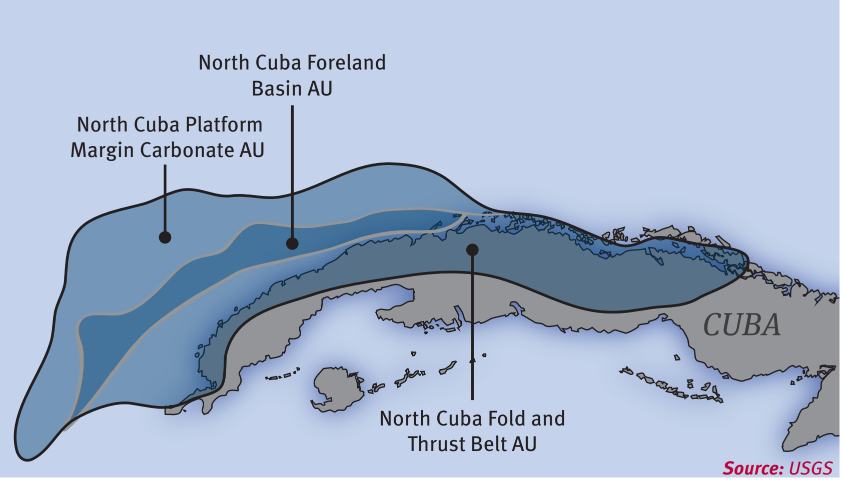
NORTH CUBA BASIN



Source: USGS

US Secretary of the Interior Ken Salazar has visited Spain to meet Repsol. *Bloomberg*

Politics meets reality

NOT surprisingly, reactions to political and trade association diplomacy over the Repsol deal to drill for oil in Cuban waters are predicated on political leanings, *writes Barry Parker.*

Political reactions have included condemnation of a recent trip to Cuba made by the International Association of Drilling Contractors, the Environmental Defense Fund and William Reilly, a former official with the Environmental Protection Agency and co-chair of the White House task force that investigated the Macondo spill.

Writing in the Cuba Standard, Jorge Piñón, an international energy consultant, visiting scholar and one-time Amoco executive who handled relations with Latin American host countries, made a series of specific and timely recommendations for the commercial interests and governments involved.

In order to carry out a timely and professional response to oil spills, Mr Piñón suggested that US equipment and supply companies be exempted from the US trade embargo dating back to 1960, in conjunction with granting of licences for providing emergency services by responders Helix Containment and the oil company consortium Marine Well Containment Company.

The ex-oilman also suggested that CubaPetróleo, or Cupet, the country's national oil company and partner in the Repsol drilling effort, be allowed to join IADC to share in its world-class knowledge base.

His ideas are rounded out by the view that Cuba and the US should develop a joint spill response and emergency services protocol, emulating US arrangements in place for Mexico and Canada.

Many of Mr Piñón's ideas are echoed in a report issued two months ago by the independent governmental watchdog Congressional Research Service, titled 'Cuba's Offshore Oil Development: Background and US Policy Considerations'. This report highlights legislative efforts under way to implement these recommendations. It also mentions that Florida-based Clean Caribbean & Americas, a spill responder and mitigator, has been licensed through the Treasury Department's Office of Foreign Assets Control and the Department of Commerce's Bureau of Industry and Security to backstop companies operating in Cuba.

OFAC, the agency known in the maritime trades because of its enforcement roles in the Iranian oil sanctions and ransom payments in piracy cases, had also provided a licence permitting the IADC discussions in Cuba.

The CRS discussion of how accords between the US and Mexico provide useful operational models for co-operation with Cuba underscores a recommendation made in the January, 2011 White House report on the Macondo spill. CRS suggests that a tripartite arrangement be struck between the US, Mexico and Cuba, putting in place a "common, rigorous set of standards, a system of regulatory oversight, and operator adherence to an effective safety culture, along with protocols to co-operate on containment and response strategies in case of a spill".

CRS notes that the US and Cuba, though not talking directly, are both signatories on two multilateral treaties, the Oil Pollution Preparedness, Response, and Cooperation, administered by the International Maritime Organization, and the Cartagena Convention, dealing with spill response across the Caribbean.

Also swirling around in this complex brew of politics and business is the recent investment by Pemex in Repsol. The Mexican company recently spent the equivalent of $1.7bn in upping its stake from just under 5% to around 9.5% of Repsol. The Mexican press said Pemex intends to work towards a "strategic partnership with Repsol",across a wide spectrum of activities ranging from oil exploration to building tankers.

One well-known writer for Hoover's Bizmology blog, Texas-based energy expert Stuart Hampton, raised the question of what might happen if there were a big oil find offshore Cuba. Indeed, estimates of likely reserves around northwest Cuba vary widely from 4.6bn barrels, a US Geological Survey estimate, to the 9bn-barrel figure mentioned by Cuban sources in April, 2011.

Mr Hampton asked, in a comment to the the New York Times' Green Blog, what might happen "if vast reserves of oil and gas are found in Cuban waters right under the noses of major US oil companies banned from drilling there?".

Quickly, by way of an answer, he said: "The US' 50-year-old Cuban trade embargo (a true relic of the Cold War) would be lifted almost immediately." ■

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The Deepwater Horizon incident has heightened industry focus on disaster response. *AP*

BOEMRE report on Deepwater Horizon released

AS THE discussions about spill response in Cuban waters were heating up, the final coda in a joint report on the April, 2010 Deepwater Horizon explosion and the subsequent oil spill was released by the Bureau of Ocean Energy Management, Regulation and Enforcement, which shared jurisdiction with the US Coast Guard over various aspects of the rig and the well, *writes Barry Parker.*

The USCG released its report in April, 2011. The lengthy BOEMRE report described a sequence of events where the blowout, which occurred following a failed application of cement, buckled the drill pipe in a way that disabled the proper operation of the blowout preventer.

From an investment standpoint, the 'blame game' is top of the mind, particularly for holders of Transocean shares with concerns about potential liability. Transocean was the owner of Deepwater Horizon.

One analyst, Scott Burk from Canaccord Genuity, summarised the situation in a report to investors, saying: "The BOEMRE report ... faulted some of the actions/training of Transocean's crew, but largely places the blame for the blowout on BP."

Mr Burk, who maintains a 'hold' rating on the driller, stressed that oil priced above $100 per barrel is a positive for Transocean, which had seen its price, recently around $60 per share, battered down below its current Net Asset Value, which Mr Burk calculates to be around $71 per share.

STOCK PRICE TO NET ASSET VALUE (NAV) RATIO

Selected drillers estimates for 2011 and 2012

	2011 e			2012 e		
Company	Price	NAV	Ratio	Price	NAV	Ratio
Seadrill	31	12	253	31	16	198
Noble Energy	34	27	128	34	32	106
Ecsco	49	42	117	49	50	98
Hercules Offshore	4	3	116	4	3	120
Atwood Oceanic	40	35	116	40	40	94
Rowan Companies	37	37	100	37	37	87
Siamond Offshore	59	63	93	59	72	82
Transocean	63	73	86	63	76	83

***Source:** Factset, Morgan Stanley*

Analyst Ole Slorer, at Morgan Stanley, puts an 'overweight' on Transocean shares. Like Mr Burk, he sees Transocean as less culpable than BP, which jointly handled the failed cementing operations, and expresses optimism about the soundness of Transocean's indemnification from BP.

Morgan Stanley's net asset value calculation, at $72 per share, parallels that of Mr Burk, but Mr Slorer points to a historical 90% floor on the share price-to-NAV ratio — well above the ratio implied by estimates of the 2012 NAV. He also looks for Transocean to improve the efficiency of its operations while negative sentiment abates.

BP, which has set aside $40bn for possible Macondo-related claims, is seeking to apportion part of its liability to other parties; its case is expected to come to trial in early 2012.

Following a detailed analysis of Transocean insurances, Morgan Stanley said: "In our opinion, Transocean has the financial stamina to endure a protracted legal battle." ■

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