

The Politics of Energy

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since 1992, and has managed more than 200 transactions ranging from start-ups and private placements to middle-market acquisitions and divestitures. Mr. Wottrich has closed transactions in 15 countries in manufacturing, food and beverage, ship building, automotive, technology, engineering, aerospace, agriculture, energy and business services. Mr. Wottrich is a past Board member, Chairman of the Board and President of IMAP, an exclusive global organization of leading merger and acquisition advisory firms. He currently serves as Head of the Alternative Energy sector of IMAP's Energy and Power Group, as well as a Member of the IMAP Teaming Committee, charged with forming international IMAP I-Banking Teams for global transactions. Mr. Wottrich was instrumental in taking IMAP to international levels, having assisted in bringing in the first six European partner offices in 1998. Mr. Wottrich was the recipient of the 2005 first-ever IMAP Dan Denby Award, voted on by the investment bankers of IMAP for best representing the mission and business purpose of IMAP internationally. Mr. Wottrich is a Member of the Association for Corporate Growth (ACG) in Chicago. Prior to joining Dresner, Mr. Wottrich was the Founder, Managing Director and President of DSI Global M&A based in Chicago. Mr. Wottrich is a graduate of Dartmouth College in Hanover, NH. Mr. Wottrich has initiated M&A transactions in China, having delivered the lead platform speech at the "2005 Summit of CEOs and Career Managers of Chinese and Foreign Enterprises" in Beijing on June 26, 2005. More than 400 Chinese business leaders attended this first-ever government sanctioned Summit. Mr. Wottrich has initiated M&A transactions in India, focusing on renewable energy, bio-fuels and sustainable economic transactions. Mr. Wottrich was recently a speaker at the Greater China Business Conference at the Kellogg School of Management, Northwestern University, April 2008. The topic was "Investment and New Venture Strategies: Identifying Successful Opportunities in China." More than 150 Kellogg attendees from China, India, Taiwan, the U.K. and the U.S. participated in the conference. Mr. Wottrich is a specialist in Intellectual Property and Patent valuations, having assisted companies in the commercialization of IP in more than three dozen corporate assignments with companies such as SKF USA, Inc., Parker Drilling Company, AMEC plc (U.K.) and KaVo Dental Corporation (Germany). Mr. Wottrich's blog is called "Centercut – Alternative Energy & Sustainability" and can be found at centercut.blogspot.com.

Introduction

As an international investment banker with Dresner Partners, I am very interested in the politics of governments and how they affect the flow of business transactions globally. In multiple trips to China, India, Turkey and other emerging economies, I have observed first hand the voracious energy appetite of these high growth economic engines. As the global energy industry comes under ever increasing political scrutiny, and as governments worldwide begin to favour and fund alternative energy technologies, these politics become ever more important.

Historical Nationalization of Oil & Gas Reserves

Global trends in the nationalization of oil and gas reserves are well understood with the historical formation of national oil companies such as Petróleos de Mexicanos (PEMEX), Saudi Aramco, Petróleos de Venezuela, PetroChina⁽¹⁾ and Russia's Gazprom. While many private citizens in most countries usually assume that the major oil companies control their product, in fact nearly 80 percent of the world's oil reserves are held by national oil companies with no private equity, and there are 13 state-owned oil companies with more reserves than ExxonMobil, the largest public multinational oil company.

The politics of nationalized oil usually revolve around jingoistic themes that a country's oil is being "taken" by foreign oil giants. But in reality, the economics of nationalized oil most always revolve around a few elites gaining extraordinary wealth at the expense of their country's citizens. The history of oil-dependent countries has produced what Stanford University professor Terry Lynn Karl⁽²⁾ has called "the paradox of plenty."

Relatively speaking, oil creates few jobs and it distorts and destroys jobs in other economic sectors. The export of oil distorts an economy, for example, by increasing a country's exchange rate. "Oil rents drive out any other productive activity," said Karl. "Why would you bother to produce your own food if you could buy it? Why would you bother to develop any kind of export industry if oil makes your money worth more and that hurts all your other exports?" Norway is the exception that proves the rule, with a national oil sovereign fund⁽³⁾ worth 2.28 trillion kroner (\$357 billion) for just 4.8 million citizens.

As and when the world's economy begins to recover from the present deep recession, global demand for oil will resume its steady growth. Based on what is known about the world's petroleum reserves, nearly all of future increases will have to come from countries that have national oil company monopolies. These governments are, in many cases, politically unreliable except in their desire to keep the price of a barrel of oil high.

Insufficient Global Supply to Meet Demand

Energy efficiencies, conservation, alternative energy and giant new oil and natural gas fields in areas where private companies

can explore will not be enough to meet the rising demands of our growing global economy. Even if these sources could meet the demand in developed economies, they fail when we factor in demand from China and India. Tata Motors in India, for example, is manufacturing the first sub-\$2,500 car in history with its new Nano⁽⁴⁾, and more than 200,000 Indian citizens have already paid deposits to receive one. Meanwhile, China is expected to account for one-third of the increase in oil demand in the next two decades, with auto ownership growing to at least 150 million by 2030. Finally, two-thirds of the world's known oil and gas reserves are in countries that either limit access or close their reserves to foreign companies. Something has to give.

Projected \$35 Trillion in Government Public Works Spending

The politics of energy are changing. As the cost of oil resumes its increase from roughly \$62 per barrel to \$100 and higher, the hurdle rate for investments in a variety of alternative energy sectors will be reached. Until then, the politics of recent government stimulus spending globally in this recession are providing tax subsidies in a myriad of forms to influence immediate development. "A wave of government bailouts around the world and a sharp deterioration in existing infrastructure could lead to as much as \$35 trillion in public works spending over the next 20 years, according to a new study by CIBC World Markets."⁽⁵⁾ We estimate that nearly 20 percent of these funds will influence the development of alternative energy. This, by definition, is politically "hot" money that attracts projects, good and bad.

Nationalization of Alternative Energy Systems

We predict that the same nationalization trends that overtook the oil and gas sectors in the last 50 years will eventually migrate into the establishment of heavily subsidized alternative energy industries as well. The sheer scale of alternative energy demand will favour large multinationals. Once such energy sources are integrated into national "smart" energy grids, they present very attractive taxation opportunities for governments. This will satisfy governments for a time, until alternative energy profit curves begin to match oil and gas. At that point, governments will be tempted to intervene and nationalize or heavily regulate alternative energy assets. The rationalization for this political intervention will be simplicity itself; the recovery of years of tax subsidies spent in developing each alternative energy sector in question.

As massive offshore wind power projects begin to blanket a country's coastal waters, it is not difficult to imagine that country invoking its 200-mile marine boundaries and nationalizing wind farms. Control over wave and tidal power are easy concepts once wind power is acquired. As large-scale solar power "farms" are aggregated into ownership by one large multinational or another, it is equally plausible that the government will step in as the sovereign owner of the "air rights" that facilitate access to light. In short, there is no reason not to suppose that governments will ultimately follow the same path they have historically followed with oil and gas. Investors in alternative energy would be wise to take this into account.

If this sounds alarmist, one might consider that H.R. 2454: American Clean Energy and Security Act of 2009⁽⁶⁾ (known as "cap and trade") passed by 219 to 212 votes in the U.S. House of Representatives on June 26, 2009. This 300 page bill (plus a 300 page amendment) is perhaps the most pervasive energy taxation vehicle in the history of America. Its premise is to slow global warming, but a close read of even a few pages describes mechanism after mechanism for existing units of government to control and tax energy at every level. As Thomas Jefferson said, "Great innovations should not be forced on a slender majority."

The Future of Energy

The vast global infrastructure of oil and gas will continue to supply the majority of world energy needs in the near term. However, the voracious tax appetites of governments will route deficit spending into alternative energy systems as revenues generated by traditional energy sources inevitably decline as oil and gas reserves are depleted. The rules of supply and demand will trump political market distortions, albeit at great cost to consumers the world over.

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Provenance—Original unsolicited manuscript, **The Politics of Energy** (2009-10-14GE). Abstract submitted for review June 30, 2009; editorial comments sent to the author(s) July 2, 2009; revised manuscript received July 2, 2009; paper approved for pre-press July 2, 2009; final approval July 7, 2009.♠

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