



**Full text of Dick Cheney's speech at the IP Autumn lunch
15 November 1999**

Your Excellence, Ladies and Gentlemen, pray silence for the President of the Institute of Petroleum, Mr Chris Moorhouse.

Thank you.

It's my privilege and honour to welcome all our guests to this, the second Autumn lunch arranged by the Institute of Petroleum. It's very good to see so many friends, old and new here today. Close to three hundred I've been told, so welcome. Guests represent not only a broad cross-section of the UK energy industry, including the major energy companies, contractors, suppliers, consultants, but also representatives from many of the industries associated with the energy business. My own guests include a broad cross-section of the senior representatives of the Institute of Petroleum itself, welcome gentlemen, and I would make special mention of Basil Butler and Larry Farmer who helped to secure today the presence of our principal speaker. The breadth of representation around the room clearly demonstrates a wish to have this kind of opportunity to meet colleagues from the energy industry in such an informal setting, but even more demonstrates a real wish to hear the views of our eminent speaker today. So on behalf of all, I would like to say a very special welcome to Dick Cheney. Dick Cheney is a household name around the world, not only as the Chief Executive Officer of Halliburton, but also from his previous long and distinguished career in US politics. He grew up in Wyoming and was educated at the Universities of Wyoming and Wisconsin and embarked on a career in public service. After appointments to the staff of the Governor of Wisconsin and as a congressional fellow on the staff of a member of the House of Representatives, in 1969 he joined the Nixon administration. He served in a number of positions at the Cost of Living Council, the Office of Economic Opportunity and in The White House, when Gerald Ford took over the presidency in August 1974, Dick Cheney was invited to serve on the transition team and later as Deputy Assistant to the President. In November 1975 he was named Assistant to the President and White House Chief of Staff, a position he held throughout the remainder of the Ford administration. Returning to his home state of Wyoming in 1977, Dick Cheney was elected to serve as the State's sole congressman in the US House of Representatives in 1978. He was re-elected five times. At the end of his first term his Republican colleagues elected him to serve as Chairman of the Republican policy committee. He later became Chairman of the Republican Conference and House Minority Whip. As Secretary of Defence from March 1989 to January 1993 Dick Cheney directed two of the largest military campaigns in recent history, Operation Just Cause in Panama and Operation Desert Storm in the Middle East. He was also responsible for shaping the future of the US military in an age of profound and rapid change as the Cold War ended. For his leadership in the Gulf War Dick Cheney was awarded the Presidential Medal of Freedom by President George Bush on 3rd July 1991. After leaving the Defence Department in 1993, Dick Cheney served as a Senior Fellow at the American Enterprise Institute and lectured widely around the country. He currently serves on the Board of Directors at Proctor and Gamble, Union Pacific and EDS. He is a member of the Board of Trustees of Southern Methodist University and the American Enterprise Institute. He also serves on the Board of Directors and the Public Policy Committee of the American Petroleum Institute. Not surprisingly, with such a wide ranging career in politics and now at Halliburton, Dick Cheney has a deep interest in the geo-politics of the energy industry, so we are privileged today to have his unique insight into the energy industry in the new century. Ladies and Gentlemen, I ask you to join me in welcoming Dick Cheney.

Applause.

Dick Cheney: -

Thank you very much for that welcome and that introduction. I am delighted to be back in London today and have an opportunity to spend some time with all of you. To hear that resume reciting all of my political background and experience, of course oftentimes people say that work in the oil industry is not really sort of an uppercrust kind of organisation and I say, 'Yeah, but I used to be a Congressman and it's clearly a step up for me to go from the political world to the world of the oil and gas industry. I'm often asked why I left politics and went to Halliburton and I explain that I reached the point where I was mean-spirited, short-tempered and intolerant of those who disagreed with me and they said ' Hell, you'd make a great CEO', so I went to Texas and joined the private sector. But I am delighted to be here and I want to try to avoid, I understand last year when Sheikh Yamani spoke that he was rather pessimistic about the outlook for oil prices and the ability of OPEC to arrive at a price level and maintain it over time and I'm not sure that it's fair to come back a year later and second-guess and I hope a year from now people won't do that to me in terms of the forecasts I'm going to make, but I do want to talk about the outlook, certainly from the perspective of Halliburton, how we look at what may occur here in the future and let me say at the outset that I am unreasonably optimistic about our industry. From the standpoint of the oil industry obviously and I'll talk a little later on about gas, but obviously for over a hundred years we as an industry have had to deal with the pesky problem that once you find oil and pump it out of the ground you've got to turn around and find more or go out of business. Producing oil is obviously a self-depleting activity. Every year you've got to find and develop reserves equal to your output just to stand still, just to stay even. This is true for companies as well in the broader economic sense as it is for the world. A new merged company like Exxon-Mobil will have to secure over a billion and a half barrels of new oil equivalent reserves every year just to replace existing production. It's like making one hundred per cent interest discovery in another major field of some five hundred million barrels equivalent every four months or finding two Hibernias a year. For the world as a whole, oil companies are expected to keep finding and developing enough oil to offset our seventy one million plus barrel a day of oil depletion, but also to meet new demand. By some estimates there will be an average of two per cent annual growth in global oil demand over the years ahead along with conservatively a three per cent natural decline in production from existing reserves. That means by 2010 we will need on the order of an additional fifty million barrels a day. So where is the oil going to come from? Governments and the national oil companies are obviously controlling about ninety per cent of the assets. Oil remains fundamentally a government business. While many regions of the world offer great oil opportunities, the Middle East with two thirds of the world's oil and the lowest cost, is still where the prize ultimately lies, even though companies are anxious for greater access there, progress continues to be slow. It is true that technology, privatisation and the opening up of a number of countries have created many new opportunities in areas around the world for various oil companies, but looking back to the early 1990's, expectations were that significant amounts of the world's new resources would come from such areas as the former Soviet Union and from China. Of course that didn't turn out quite as expected. Instead it turned out to be deep water successes that yielded the bonanza of the 1990's. A fundamental challenge for companies is to do more than replace reserves and production. The trick obviously is also to replace earnings. For most companies the majority of their profits come from core areas, that is areas where they have significant investments, economies of scale and large license areas locked up, but many of these core areas are now mature and it can be difficult to replace the earnings from the high margin barrels there. Some of the oil being developed in new areas is obviously very high cost and low margin. Companies that are finding it difficult to create new core areas through exploration are turning to production deals where they can develop reserves that are already known, but where the country doesn't have the capital or the technology to exploit them. In production deals there is less exploration risk but dealing with above ground political risk and commercial and environmental risk are increasing challenges. These include civil strife, transportation routes, labour issues, fiscal terms, sometimes even US-imposed economic

sanctions. Many companies are more comfortable dealing with the below ground risk like drilling and reservoir performance than they are with the above ground political risks. The other major element that is changing is the nature of competition. One of the biggest questions is what the competitive field will look like in the new industry after this current wave of consolidation in the oil business. Clearly the main driver behind the biggest mergers are the cost savings that are anticipated as a result of economies of scale. Concentration and critical mass are clearly keys to success. There are also cases where difficulty in sustaining and growing the companies as led management to offer the firm to a bigger player. In the world-wide competition for capital, there are imperatives for size and scale. Larger companies tend to have the highest credit ratings and therefore the lowest borrowing costs, but they also tend to have higher multiples in the stock market. The share price premium becomes a valuable currency for take-overs. They also have stronger financial staying power to undertake the larger projects and to ride out the lean periods. The result of all this consolidation is that now four out of the five largest oil and gas companies by market value are European. For oil companies I do not believe that the bigger is better model is the only viable one. While Halliburton has certainly grown bigger through its merger with Dresser and other key acquisitions, this made sense in part because it gave our company both a broader array of services and also greater depth in products and services. For oil companies I see four basic types of firms that I think will survive and prosper in the new environment. First, we will obviously have the super majors, but they have to be careful to avoid the dragdown of facts and the distractions of physically merging, plus the danger of becoming lumbering giants. I think there is a good chance they will avoid becoming bloated bureaucracies because they are very focused on delivering cost saving synergies for their shareholders. The second type of survivor will be those companies that have dominance in a region or a market. These integrated companies may not be in the top five globally, but they will be number one or number two in their respective markets. This gives them the critical mass and concentration to compete and win on their turf. Repsol YPF is an example of this type of company; number one in Iberia and the southern corner of Latin America and very profitable. A third model for competing in the new century is that of what I would call the super independents. These are firms that focus on one line of business but have sufficient scale to have several core areas of material size where they can go head to head with anyone. These combine the advantages of a super major with the agility of an independent. A common element in these three classes of firms will be critical mass and concentration. A fourth category of survivor in the new competitive world will be what I call niche players who can prosper off the properties that the bigger firms don't want or because of the very special circumstances they find. Those in the special players will obviously have to compete somewhat below the radar screen of the more dominant companies. The immense portfolio restructuring that we think lies ahead in the wake of the recent large mergers should create opportunities for competitors to strengthen their positions. New aggregators are likely to emerge which, together with a lot of the brain drain from staff cuts at the majors, could well provide the bigger companies with unexpectedly strong competition in the decade ahead. In many ways the traditional role of oil companies are changing. Increasingly we are seeing international oil and gas companies concentrating on managing investment, financial, commercial and political risk or above ground risk, while service companies are managing technical, completion and operating risk. Meanwhile, national oil companies are focused on managing their country's national interest and its resources and in the domestic markets. This is part of the new resource rationalism of the 1990's. NOC's may own the resources, but when it is in the national interest to bring in outsiders to help develop them, they do so. Venezuela obviously is a clear example of what I would define as the new resource nationalism. Some NOC's are still looking outside their own borders, but I expect that in the future the emphasis may well be closer to home. NOC's can focus on becoming regionally dominant players, leveraging off their strong domestic base to move into neighbouring countries. This will occur where there are links and synergies with their home business, not just going global for its own sake. I think Petrobras in Brazil may be an example of this in Latin America. People ask about the future role for OPEC. Certainly the organisation represents companies that have a vast amount of oil reserves and it has held together for over a quarter of a century already. OPEC have shown the ability for crisis management every time oil prices have dropped to single digit levels, but the group may ultimately bring about its own undoing if it shoots for too high a level for oil prices. As observers point out, in the long run, this effectively underwrites higher cost oil

exploration and development around the world all at the same time, limiting demand growth below what it might otherwise be. Nonetheless, I believe most of us in the industry have welcomed the restraint in the leadership shown by OPEC in recent months and the improved outlook for the international oil markets. I know I am pleased with the leadership provided by Saudi Arabia, Mexico and Venezuela and in the long run I think the world will be best served, and the consumer best served as well as producers, by stable prices at reasonable levels. The oil industry will become more integrated in the new century but not necessarily in the traditional sense of link ups between producers and refiners. The new integration will bring together new capabilities, skills, technology and risk management to create synergies that add value. From my perspective in the oil service industry I see an integrated role for us in helping to manage certain technical risk, leaving oil companies to retain control but focus on investment decisions, commercial and political risk and financial risk. Oil companies probably spend the most and make the lowest returns on the actual development and operation of their assets. It is here in the middle of the opportunity chain where service companies can add the most value on the below ground aspects of the operation. Service companies can assist oil companies in making knowledge based value added decisions and implementing them quickly; through this type of integration oil companies can better leverage their skills and resources to maximise value, focusing on their core competencies. For NOC's, working with service companies can make use of the best technical expertise available world-wide, whilst still retaining control and managing the state's interest in its own natural resources. Service companies are becoming more integrated themselves oftentimes offering integrated solutions.

Let me say a word or two about the impact of technology in the new century. Clearly technology has revolutionised the oil business in the last decade with rapid advances in data interpretation, reservoir management, enhanced oil recovery, directional drilling and deep water operations and the pace of advancement is accelerating. The oil industry is saddled with this image problem as a polluting manufacturing industry when in reality it has become a knowledge based business. The application of technology and information processing is remarkable. Our success as a company and as an industry will depend even more heavily in the future on our ability to develop and deploy new technology.

Let me say a word, if I can, about natural gas because we think there will be tremendous growth occurring in this area in the years ahead. In terms of the North American natural gas market, we are consciously bullish over the next five years and beyond. The demand side has plenty of up side and gas is likely to grab a greater share of US energy consumption in the decade ahead. Virtually all new US power plants are likely to be gas fired and residential penetration is growing fast as well. On the supply side, onshore gas outputs should be weaker and this means that the demand gap will need to be met by perhaps double digit growth rates and Canadian imports and various significant increases in production out of the Gulf of Mexico. The industry will need to get busy bringing on new production facilities and pipelines systems to meet these needs. Deep water gas, obviously, will have a very important role to play.

There are a number of factors which we believe will drive the growing role for gas on a global basis. The environment, obviously, will be a key driver in the natural gas business in the new century as there is increasing opposition to so called 'dirty fuels' like coal and high sulphur fuel oil. Gas is the preferred fuel for power generation. There are continuing technological innovations in gas for power generation, combined cycle plants, greatly increased output efficiency. Gas to liquids is in the threshold of commercial success. There is growing demand in emerging markets like China, India and Brazil. For international oil and gas companies, gas is increasingly a key element of the E and P portfolios - oil becomes more difficult to replace while gas reserves and production will grow. Another reason natural gas will have a huge role in the next century is that the world's gas resources are obviously vast. The Middle East and Africa have over one hundred year's supply of gas reserves at current low usage levels and the former Soviet Union and Latin America have gas reserve to production ratios which should last over seventy years. Even estimates of proved gas reserves understate the volumes involved, since there is plenty of gas

still to be found and many existing discoveries have not been booked, usually due to the difficulty of getting gas to market. As companies find more gas, they need to find ways to monetise the remote fields, developing stranded gas often entails new risk involved in building a new market to use the gas. The three main options for moving this gas to market are pipelines, liquefied natural gas and now gas to liquids. The world will get more and more connected with gas pipelines in the new century as high strength steel and automated equipment allow pipelines to become economical over long distances. In LNG new markets will fundamentally alter the nature of the business. The days of the twenty year take or pay contracts and top drawer buyer credit ratings like Tokyo Electric are over. New buyers will be local power generators in places like India and Turkey. Credit worthiness of new buyers, contracts lengths and base floor prices will be under pressure, introducing new risk. New structures will be needed to share the risk in building the new markets amongst all the participants: producers, consumers, governments and project managers. The long waiting list of green field and LNG expansion projects may signal market limitations for LNG, problems for putting together new projects are due in part to economic slow down in Asia. LNG producers are facing greater competition and lower returns and they may need to look at investing down the gas chain and re-gasification and power as well. Long term, there are innovations on the way such as power generation synergies with re-gasification, cost reductions and smaller scale projects that could permit floating LNG terminals. An alternative to LNG as a means of monetising gas reserves is gas to liquids, or GTL which serves a completely different market. This is a well established process for turning low value gas into high value, ultra clean, refined products that are easily transportable meeting the coming demand for green fuels. With a huge world market for refined products, gas to liquids is much more flexible than pipeline or LNG projects which require rigid contracts and offtake commitments. GTL products can be exported inexpensively on product tankers and distributed through existing infrastructures. The appeal of gas to liquids is that there is no exploration risk as with oil, no market risk as there is when trying to open up new areas to gas. The remaining hurdle has been the economics, but while the conventional wisdom is that gas to liquids viability is still a way off, there are commercial projects on the way right now that have attractive rates of return with the right tax incentives and when viewed as part of a larger strategy. For example, Chevron and Sasol's plant, Escravos GTL plant in Nigeria is the enabler that permits things such as more gas processing with associated liquids productions, lubes and an ethylene plant. The project, together with Shell's rebuilding of the MDS plant in Bintulu Malaysia, and projects in Cutter and elsewhere show that GTL's time is finally arriving. The viability of gas to liquids will be further enhanced through incremental improvements and radical technology breakthroughs in areas such as process, catalyst and reactor technology leading to lower costs, increased efficiency and greater scale and this could herald a revolutionary new era for the international gas industry. Companies are looking at all the sectors : gas transmission, gas distribution, gas trading, power generation, electric utilities, even electricity trading. Some think the opportunities are in owning the infrastructure, while others see the preferred role in the merchant banking function in the energy business, especially trading and providing financial instruments. Still, others think the key is in having the customers and cross selling services. In some instances, gas and electric utilities facing the loss of monopoly positions want to diversify into higher growth, unregulated businesses like oil and gas. For the other side, oil and gas companies may seek the earnings stability of an utility business that can broaden or integrate their business. These new businesses could cushion the earnings volatility of the petroleum side of the business, for example one of the companies whose earnings held up the best in 1998 during the oil price downturn was Repsol due to its stable income from Gas Natural. In any event, gas and power will be of growing importance in the portfolios of many energy companies with new forms of integration and this has the potential to expose companies to new and unfamiliar risk. Firms have a lot to learn about electricity price risk and spark spreads. In addition to new risk there will be new competition. Major players may include names likes CMS, AES, Duke Energy, Reliant, Dominion Resources etc. In the minds of many, the energy business is becoming a commodity business whether it's oil or gas or kilowatts. I think that in many ways it is also a service industry and in any event, on the product side, one has to concede that these are nonetheless unique commodities. Oil is unique in that it is so strategic in nature. We are not talking about soapflakes or leisurewear here. Energy is truly fundamental to the world's economy. The Gulf War was a reflection of that reality. The degree of government involvement also makes

oil a unique commodity. This is true in both the overwhelming control of oil resources by national oil companies and governments as well as in the consuming nations where oil products are heavily taxed and regulated. Essentially, the petroleum industry deals with extreme risk and with billions of dollars on the line. Oil is produced in distant lands as a result of huge risk and enormous capital outlays, it is transported over vast distances, refined in expensive refineries with very heavy outlays required to protect the environment and to comply with strict and expensive regulations, distributed through a wide network of pipelines, trucks and wholesale outlets and sold at stations in prime locations and taxed heavily. It is the basic, fundamental building block of the world's economy. It is unlike any other commodity. The oil and gas industry provides essential goods at the lowest possible cost with regular reliability while still ensuring a cleaner environment and the industry provides security of supply even though at the same time we are required to manage huge political risk. What we do isn't always appreciated by the public and this is part of our industry's image problem that we need to work on in the next century. Frankly the focus in today's economy on globalisation and emerging markets is old news to the oil industry. Ours are global companies investing outside the industrialised companies at the turn of the last century. People need to realise that the energy industry often represents the largest foreign investment in many parts of the world and its interest, insights and experience need to be considered. Oil is the only large industry whose leverage has not been all that effective in the political arena. Textiles, electronics, agriculture all seem oftentimes to be more influential. Our constituency is not only oilmen from Louisiana and Texas, but software writers in Massachusetts and specially steel producers in Pennsylvania. I am struck that this industry is so strong technically and financially yet not as politically successful or influential as are often smaller industries. We need to earn credibility to have our views heard.

Another concern is the disruptive volatility of the industry. In the new century the oil business needs to learn how to break out of the boom and bust cycles we have experienced over the last century. Perhaps it is part of being a commodity business, but it wreaks havoc with planning processes and can drive smaller companies out of business and, needless to say, creates problems for consumers as well. One hope might be that the new super majors would use their financial staying power to keep capital spending steady throughout the cycle or even to invest counter-cyclically. This would help smooth out the bumps and of course the financial community could do its part by taking a longer view of financial performance and not pressuring sound companies to cut back during periods of weakness, however unlikely. Technology can help smooth out the cycles by lowering costs. A key challenge for companies in the commodity business is growth and there are basically only two avenues to grow earnings: one is through increasing volume and the other is through improved unit efficiencies. These two options have been driving company strategies. On the volume side we can see the aggressive production targets that some companies have announced of late. On the unit efficiency side we have the cost cutting targets most firms announced for 1999 and beyond, as well as the mergers designed to generate savings through synergies, economies of scale and reduction in overheads. The view is that in the commodity business the lowest cost producer will be the winner. In the last century and up to World War Two coal was king and looks to have a lock as the primary source of energy. It was dethroned by oil, mostly due to transportation fuels, but also because oil was less polluting and easier to handle. Coal is still with us today, but oil is clearly dominant. In the new century, will the oil age give way to another source of energy or to new technologies? Some predict natural gas will erode oil's performance, others say that technology, fuel cells, telecommuting on the internet or some other breakthrough will lessen our dependence on hydrocarbons. Well, the end of the oil era is not here yet, but changes are afoot and the industry must be ready to adapt to the new century and to the transformations that lie ahead. It will mean showing more speed and agility. As I have outlined today, there are new areas to co-operate in, new risk, new competition, new roles, new integration and a new convergence with power. This will be a challenging environment as we cross the threshold into the new millennium. You don't here our times referred to as the Space Age anymore, instead it's the Information Age. You will notice they call it the Information Age, not the Knowledge Age. Well, I would conclude today by saying that this industry must be at the forefront of moving into the Knowledge Age. Successful competitors will be those that best manage knowledge. This means technology, expertise, best

practices, country, market and competitor intelligence and opportunity assessment. These will be the hallmarks of the energy industry in the new century. I for one am proud to be a part of the industry and I am optimistic about our future in the coming century.

Thank you.

Applause.

Chris Moorhouse: -

Ladies and Gentlemen I would just like to conclude today by giving a vote of thanks to Dick Cheney for coming to speak to us today. I think it's been a marvelously inspiring speech. I picked up a couple of things: what we do isn't always appreciated by the public - I definitely feel that from time to time - and that we are the only large industry which has not been politically influential. Finally, as far as the Institute of Petroleum is concerned, I picked up on the remark that the industry must be ready to change and I would add to that its institutions too. So thank you very much and thanks once again to Dick Cheney.

Applause.

© Institute of Petroleum, 61 New Cavendish Street, LONDON, W1M 8AR, United Kingdom
Tel: +44 (0)20 7 467 7100 Fax: +44 (0)20 7 255 1472 e-mail: ip@petroleum.co.uk