



House Energy and Minerals Subcommittee
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Leasing and Development of the Oil and Gas Resources on the Outer Continental Shelf
By

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Mr. Chairman and Committee Representatives:

Thank you for the opportunity to be with you this morning to discuss the leasing and development of oil and natural gas resources on the U.S. Outer Continental Shelf.

My name is Jim Farnsworth. I'm President and Chief Exploration Officer of Cobalt International Energy, L.P. My degrees are in Geology and Geophysics and I have 28 years of experience in the Energy field. Prior to Cobalt, I worked for BP where I was responsible for their world-wide Exploration business. During that time, I became familiar with the geologic complexity of many of the world's petroleum provinces, and also their fiscal and tax regimes. Within the U.S. my career has centered on the OCS, participating in over 30 Lease Sales and the drilling of many wells in The Gulf of Mexico, Alaska and Atlantic East Coast.

In my brief remarks this morning I would like to cover three things: First, I would like to give you an overview of Cobalt, a relatively new start-up. I'll do this only to provide some context and insights into the offshore leasing and exploration process; second, give some insight into the significant challenges and risks we face (financial, geological, technical, and commercial) in exploring for and then developing hydrocarbons in the deepwater Gulf of Mexico; and finally the importance of creating a comprehensive energy strategy for the OCS.

Cobalt International Energy, which was formed in November 2005, is a privately held company, headquartered in Houston, Texas and founded by four seasoned internationally experienced industry executives, of which I'm one. Our intent was to build a company with a unique business model and through access to great talent, the latest technology and sufficient capital, compete and succeed in some of the most technically challenging and prospective areas in the world, and against some of the world's largest companies. All with about 50-60 people.

The Gulf of Mexico is a key basin in this business model and a well established and stable OCS leasing process was essential for our success. From my experience, the deepwater Gulf of Mexico is one of the most technically challenging hydrocarbon basins in the world. It is highly complex and to be successful requires scientific expertise and the disciplined application of the very latest technology. Above all it requires a long-term, multi-decade commitment. Many years of experience also helps.

Since its inception in late 2005 Cobalt has hired approximately 50 employees, including world-class geoscientists, engineers and commercial experts. These people have both in-depth experience in the Gulf of Mexico and substantial experience in other basins and oil and gas projects around the world. Within the first year, Cobalt spent over \$200 million on state of the art seismic data and technology, which we've used to understand the geology of the Gulf of Mexico and high-grade specific areas which might have the potential for large oil and gas accumulations.

This allowed our experts to evaluate thousands of leases in the deepwater Gulf of Mexico prior to bidding on only a small fraction. Over the past two years, Cobalt has spent over \$635 million acquiring the rights on over 140 leases at four separate, highly competitive, record breaking OCS Lease Sales. We were amongst the top 2-3 bidders in terms of money spent and competitive bids won. This gives us nothing more than the right to explore on those leases. There is no guarantee of finding any oil or gas. This scientific, highly technical and costly endeavor is no place for guessing or dart boards.

Earlier this year, three years after our inception, we and our partners completed drilling Cobalt's first two wells in over 5000 feet of water. The first well cost over \$100 million, the second, well over \$200 million. The average industry success rate for these type of prospects is less than one success in three attempts., Let me say this another way, we and our partners were prepared to invest over \$300 million on these two wells alone with absolutely no guarantee of success. This is the nature of our business. We were very fortunate in that both wells resulted in significant new oil discoveries.

Cobalt and Partners will now begin additional seismic analysis and drill more wells on these discoveries in order to understand their size and commercial potential. This will likely take at least another two years to execute and is absolutely essential before committing to multi-billion dollar developments of the new discoveries. In addition we will continue to test our inventory of other exploration opportunities both in the Gulf of Mexico and elsewhere in the world. In fact a new 5th generation floating deepwater rig is being built now for Cobalt's use. The rig will be capable of operating in 8000 feet of water and drill wells 6 miles deep at a cost of over \$500,000 a day. The construction of the rig is expected to be completed and arrive for Cobalt's use in the Gulf of Mexico in late 2010, five years after the founding of Cobalt and four years after acquisition of our first leases.

In late 2005 when Cobalt was founded, the oil price was approximately \$45/bbl, pretty close to today's price. As you know, oil prices climbed briefly to over \$140/bbl and back down again to the \$30-\$40/bbl level. Our costs also went through the roof, with rig rates, services, and costs of steel more than doubling. These unfortunately have not yet followed the oil prices down. The cost of offshore leases also increased

substantially with high bids escalating from a few million dollars to in some cases over \$100 million dollars. Tomorrow there will be another Gulf of Mexico lease sale and it will be interesting to see the level of interest by industry.

Fluctuations in prices and costs are something we in the industry have come to expect and have learned to manage. What has taken us by surprise however, is the change in fiscal terms in the United States. For us, the high cost and technical complexity of the Gulf of Mexico was off-set by a stable tax and royalty system. Since 2005 when Cobalt was founded and we began investing over \$1 billion dollars, Federal royalty rates in the offshore have increased by 50%, and lease rental costs have increased by 47%. This increase has occurred despite the fact that oil prices have reverted back to 2005 levels. Additional taxes and fees are now being considered to add even more burden to companies that are trying to find new oil and gas fields here in the U.S.

As you can appreciate, the process I have just described does not take place overnight. On average, starting from seismic acquisition through discovery, appraisal and development, to first production, can take 7-10 years in the deepwater Gulf of Mexico. Thus it's important that the lease duration fully reflects and supports the ability for the industry to successfully implement the exploration discovery to production process. It is Cobalt's view that the current leasing process is working.

Our actions confirm that Cobalt and the industry are keenly interested in domestic offshore oil and gas exploration and development opportunities. Currently only a very small proportion of the OCS is available for leasing. We strongly support additional area-wide opening of the OCS, including the Atlantic East Coast. This approach in the Gulf of Mexico has been remarkably successful for the United States.

The Federal Government's scientific assessment suggests that there are 86 billion barrels of oil and 420 trillion cubic feet of natural gas that is undiscovered and technically recoverable on the federal OCS. What the study doesn't provide of course is the precise location of these prospective resources. That would require enormous work and investment, just as it has in the deepwater Gulf of Mexico and other basins in the world.

While we really don't know the true potential, with close to 30 years in this industry, I would assert the assessment will probably prove to be conservative. The Energy Information Administration has observed that "the estimate of ultimate recovery increases over time for most reservoirs, for the vast majority of fields, all regions, all countries, and the world." This is not because the initial assessments were flawed. Rather it is because as we explore and develop oil and natural gas resources, our knowledge of the subsurface improves, which leads to better geologic models, new technologies and new exploration ideas.

This point is emphasized as we look back at the hydrocarbon exploration and development history of the Gulf of Mexico. Initially, the focus was the shelf in relatively shallow water. We then moved to the deeper water, but with the objective of tapping geological reservoirs that were still relatively shallow. We have now progressed to exploring in the deepwater, looking for hydrocarbon reservoirs some 30,000 to 35,000

feet deep, below huge salt canopies that distort our ability to accurately target the objectives.

The U.S. offshore oil and gas industry has and continues to be a significant economic driver creating both direct and indirect benefits. These range from the development of skilled jobs here at home, the continual supply of goods and services needed by the industry, taxes and royalties paid, to capital expenditures on the order of billions of dollars.

The U.S. oil and gas offshore industry has a tremendous track record in the application of science to exploration, development and production of hydrocarbons. Through the continuous development and implementation of new technology (most of it developed in the U.S.) coupled with the rigorous environmental and safety standards of the federal government, our industry is well positioned to prove the potential resource base in those areas now restricted in the OCS. If successful, I'm convinced this would result in new sources of domestic supply.

It is Cobalt's view that through a consultative process with industry, the key areas of the OCS where the potential is greatest could be refined. This must be driven by geological and geophysical analysis. Some of these resources will be far from shore, others will be closer in. But scientific understanding should guide this process, so that the nation's resources are developed most efficiently for the benefit of its people.

It will take a partnership to create new domestic supply.

The oil and gas industry will look to the government to do its part; creating a comprehensive and diversified energy strategy. Further investment and new supply can be encouraged by an energy policy which combines new access opportunities, efficiency, conservation and stable and competitive fiscal and royalty terms.

The oil and gas industry will do our part. In our risky, capital intensive business, the government can look to our 'self funded' industry to continue to invest in new technology to safely, environmentally and efficiently explore, develop, and produce additional energy in new and existing domestic offshore basins.

On behalf of Cobalt International Energy, L.P., I would like to thank you for the opportunity to participate in this very important hearing.