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PERSPECTIVE

Electric vehicles drown while we swim in a sea of oil

By Jonathan Michaels

Last year the U.S. achieved a goal long considered unapproachable: It surpassed Saudi Arabia and Russia to become the world's largest producer of oil. At 12.5 million barrels per day, the U.S. now extracts more oil than any of the OPEC countries, and more than Iran, Iraq, Kuwait and Qatar combined.

It wasn't always this way. In 2006, the U.S. produced 8.3 million barrels, and before that one must go back to the 1960s to see production anywhere near 2014 levels. But crude oil prices of \$140 per barrel in the late 2000s brought in a bevy of pioneering oil explorers, hoping to ride the wave of demand and profitability.

Oil production from shale rock formations, and in particular hydraulic "fracking," enabled exploration into areas once thought impenetrable. The controversial method of fracking is where rock is fractured by hydraulically pressurized liquid made of sand, water and chemicals, allowing oil to flow through the fractured rock horizontally. U.S. Energy Information Administration estimates about 29 percent of U.S. oil production comes from tight oil formations. The process has drawn criticism from those concerned about ground water contamination and stimulation of seismic activity.

The combination of reaching oil in tight places and the settling of global politics has resulted in crude oil trading at \$45 per barrel — some 70 percent off the high water mark of 2009. The question is, how long will it last? The last time oil was in a free-fall was in the mid-1980s, when the oil market saw a drop of 80 percent. It took 25 years for the market to rebound to pre-disruption levels.

While it is unlikely the recovery (if, in fact, we are at the bottom) will take that long, there is reason to believe that soaring prices may not be on the horizon. At the November 2014 meeting of the OPEC nations (Algeria, Angola, Ecuador, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, the United Arab Emirates and Venezuela), the consortium decided to not respond to falling prices by reducing supply to



AP Photo
Gasoline prices were above \$5 per gallon at a gas station in downtown Los Angeles back in 2012.

meet demand. Saudi Arabia responded to the 1980s oil crash by doing just that, only to find that prices kept falling, causing it to lose valuable market share. It was not about to make the same mistake.

The net result for Americans is good, unless you are in an oil rich state like Texas or North Dakota. While high crude oil attracted scores of profit-seeking explorers to the oil patches, the opposite is true when oil is trading for a fraction of 2009 prices. With profitability gone, miners are seeking to scale back spending on everything that is not critical, which is being felt by the townships that surround them.

But for the rest of us the result is euphoria, with significant market impact. For every \$20 decline in the price of a barrel of oil, consumers should expect to see a \$0.50 decline in the price of gas at the pump. The national price of gas is hovering at \$2 per gallon, and the Energy Information Administration estimates that the average U.S. household will save about \$750 per year because of the lower gas prices. As Goldman Sachs chief commodity analyst Jeff Currie stated, the oil crash is the most "startling and far-reaching market development" since the financial crisis.

And there's more. Americans will likely see a dip in the cost of air transportation this year. American Airlines, the world's largest carrier, is estimating a savings of \$1.3 billion in 2015 because of depressed fuel costs. And the goods we buy and consume that are trucked in from ports and assembly lines will likely cost less.

There is reason to believe this could go on for a while. The U.S. has 30.5 billion barrels of proven oil reserves (defined as being 90 percent likely to be recoverable under existing economic and political conditions, with existing technology),

and the Energy Information Administration estimates we have another 198 billion barrels that are technically recoverable, yet undiscovered. The U.S. has also for the first time surrendered the title of being the world's largest importer of oil, passing the mantle to China, who consumes 11 million barrels a day and only produces 4.4 million barrels.

Americans have assuredly changed their diet over the past decade, weaning itself off their severe oil dependency. In the early 2000s, Hummers and Escalades were the way to be seen; today, Hollywood's elite roll in Teslas and Priuses. But, will this too change?

To a large extent, the rush to alternative fuel vehicles was in response to surging oil prices; now that the sting at the pump has softened, will the industry for electric vehicles cool? The Corporate Average Fuel Economy (CAFE) regulations put in place in by President Barack Obama in 2011, which require automakers to increase fuel economy to 54.5 miles per gallon by 2025, will in many ways prevent a full retreat, but consumers may be less willing to switch to new technology now that they don't have to.

Electric vehicles have been newsworthy, but their sales figures demonstrate slow market acceptance; and \$2 gas could stunt further adoption. From 2010 to date, Chevrolet has only sold 72,000 Volts in the U.S. (compared to a prediction of 45,000 units per year), and the much-hyped Tesla has only sold 50,000 vehicles. To put those numbers into perspective, consider that Ford sells about 750,000 F-150 trucks in the U.S. each year.

And it is the traditional internal combustion vehicles that are highly profitable — not the new technology vehicles. Each Volt, which sells for \$39,000, costs General Motors about \$88,000 to produce, resulting in \$49,000 loss per vehicle. For an industry still recovering from the great recession, high profit vehicles are a must.

Low oil prices are here to stay — at least for a long fortnight — and markets will bustle with stimulation. Prices will dip and consumers will have more to spend, creating elation for all — other than those at the epicenter of the oil production. And as for the auto industry, no one should be surprised to see manufacturers pushing the profit-rich vehicles they have been building for decades. Until the next surge, the good times are here again.



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