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IN TOO DEEP: HOW BP BLEW IT IN THE GULF OF MEXICO

BREAKINGVIEWS

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PREFACE

The BP crisis is not yet over – but it has already become a case study in how not to handle a corporate calamity. The lessons are many: the critical role the chief executive plays when things go wrong; the importance of good public relations; the downside of political risk; above all, the capacity of even the strongest companies to inflict colossal destruction of shareholder value.

The pieces in this book provide a running commentary on the saga. We have included articles on BP from before the disaster as well as views on key moments in the crisis as it unfolded.

We took an early lead in calling on BP to suspend dividends and arguing that Tony Hayward should stand down as chief executive once the leaking well was plugged. We challenged the market's initial overoptimistic assessment of the costs of the incident, although when BP shares were at a 14-year-low even we were persuaded there was upside for the brave. We also analysed the political challenges to any takeover of BP, and explored the implications of the disaster for U.S. energy policy. The articles republished here were written by nine Breakingviews columnists on both sides of the Atlantic, and are accompanied by images from Reuters Pictures.

With a supersized asset disposal programme and the planned replacement of Hayward with Bob Dudley, BP is seeking to draw a line under this costly affair. But the task of renewal is only half done. The board still needs a more radical reshaping – starting with the appointment of a new chairman. BP's slim-to-health strategy also carries considerable execution risks. And with BP's shares still well below their pre-crisis levels, the risk of a takeover persists. There will be plenty more to comment on.

Chris Hughes
Assistant Editor, *Reuters Breakingviews*
August 2010

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CHAPTER 1

THE SEEDS OF BP'S TROUBLED U.S. RELATIONSHIP

BLINDED BY THE SUN KING

BY JOHN PAUL RATHBONE

BP has tripped up in the United States – again. Last year, an explosion at its Texas City refinery killed 15, triggering several federal investigations. This year, authorities opened a criminal probe into the company following a large spill from its pipelines in Alaska. And now the European oil giant has been charged with cornering the $30 billion a year U.S. propane market, forcing up prices for millions of rural Americans in 2004. Other oil majors haven't suffered a similar string of mishaps in the United States. What has BP got wrong?

There is no cut and dry answer. It is not just because BP is unmanageably big. Other oil majors like Exxon and Shell haven't had a similar run of bad luck in the country. Nor has BP had the same problems elsewhere. Something seems to be particularly wrong for the company in the United States, which is why it has just appointed a new regional head to improve matters.

One theory is that BP didn't properly integrate Arco and Amoco, the two U.S. firms it bought in the late 1990s, and that somehow a "wild west" mentality continued. But that looks unlikely, given that BP's acquisition machine has successfully integrated other deals.

A more likely theory points in the opposite direction. BP did successfully integrate Arco and Amoco. It also successfully exported its emphasis on performance. But the approach backfired in the United States because BP's desire to improve financial returns led to corners being cut among its downstream assets, such as refining and distribution.

For many years, these have been the unloved orphans of the whole oil industry. But their status may have been especially low at BP, for two possible reasons. First, BP has traditionally focused on exploration and production. As a result, its downstream operations attracted less capital and perhaps lesser BP managers too. The only reason why similar failings didn't crop up in Europe or Asia is that BP has relatively less refining capacity there.

Second, and more seriously, the company may be increasingly dominated by a "Yes, Lord Browne" culture. This has led to managers over-promising their highly regarded chief executive on the results and budgets they can deliver. That is especially tough for underperforming and underinvested areas of the company's operations, such as refining. If that is the case, the company's problems in the U.S. were inevitable. It may not bode that well for their solution either.

June 29, 2006

IN AT THE DEEP END

BY FIONA MAHARG-BRAVO

Dealing with a damning report on your company's operations is hardly the best way to start life as a chief executive-in-waiting. But that is precisely the situation facing Tony Hayward, whose appointment at BP to replace John Browne came on the eve of the Baker report on the oil giant's safety record in the United States.

Hayward's priorities should be clear. First, improve safety. The oil giant has been sweating its assets in order to boost returns. That helps explain the problems at the Texas City Refinery and its Alaskan pipeline. In a letter leaked from BP's intranet just before Christmas, Hayward admitted that getting 100 percent of the task completed with 90 percent of the resources doesn't always work. BP has already upped spending on improving safety at U.S. refineries to $1.7 billion, but the figure could still rise.

Throwing money at the problem probably won't be enough. BP's culture needs to change too. The scale of change isn't as big as that confronting rival Shell after is reserves debacle in 2004. But it is not trivial.

Third, Hayward needs address the problem of falling production. As the current head of the exploration and production division, pumping barrels is presumably something he should be good at. Here, Hayward should also benefit from Browne's legacy: BP has a strong foothold in Russia, and a few juicy projects in the pipeline. Some big ones, like Atlantis in the Gulf of Mexico or various fields in Azerbaijan, are due to come on-stream in late 2007 and 2008. Although he's set up reasonably well, there may be operational or political slip-ups for Hayward to manage.

What about something more radical? That may not be the priority now. BP has looked at more radical options in the past – such as a merger with Shell, or even breaking itself up into two smaller and more manageable companies. But even BP, which has deserved reputation for being responsive to investor concerns, has not gone that far. Yet.

Jan 16, 2007

BUY CIA STOOGES

BY MARTIN HUTCHINSON

It says something about the state of the energy world that Muammar Gaddafi is now considered a safe pair of hands. When the name of Libya's Brotherly Leader and Guide of the Revolution comes up, it is generally preceded by an adjective such as "mercurial". But the big energy companies have been lining up to invest in Gaddafi's Socialist People's Arab Jamahiriya. BP, which announced a $900m deal on May 29, is the latest.

Libya has never come close to fully exploiting its substantial oil and gas reserves. Gaddafi nationalised the industry, including the BP concession, in 1971. Until a few years ago, foreigners were unwelcome. But all that has changed. Gaddafi's renunciation of terrorism – which caused him to be described by the Arab TV network Al-Jazeera as a "CIA stooge" – has been accompanied by a welcoming attitude towards foreign investment.

So it is now pretty easy to make an investment case for Libya, even for Gaddafi's Libya. The country's finances are strong – little debt, and its budget and trade balance are both healthy. With a small population and oil wealth, widespread middle-class living standards should be readily achievable, reducing the likelihood of major disruption by the Arab street. Then there are the under-explored reserves, and the proximity of its gas fields to Europe. Also, while Libya is a member of Opec, Gaddafi is still allergic to groupthink of all sorts.

For all that, Libya remains a high-risk destination, at least by the standards of a decade or two ago. The tax regime for oil companies is fluid, as are Gaddafi's desires. Nor will the Guide of the First of September Great Revolution last forever. While Saif al-Islam, Gaddafi's son, is generally considered both heir-apparent and more reasonable than his father, succession in autocratic states is never a sure thing.

But the investment environment for non-state-owned oil and gas companies has changed almost as much as Gaddafi. In the Middle East, Russia and Venezuela, national governments call increasingly nationalist and anti-Western tunes. It makes Gaddafi's Libya look almost enticing.

May 30, 2007

CHAPTER 2
A TRAGIC ACCIDENT THREATENS BP'S LIFE

BEYOND PLAUSIBLE

BY CHRIS HUGHES

BP wants to be "judged by its response" to the Gulf of Mexico oil disaster. The politicians and the public already seem to be concluding that the UK oil giant has failed in its duty to address the consequences of the accident. BP should not be surprised that authorities with an interest in diverting attention from their own failings want it take all the blame. But it has not helped itself either.

The company has made much of its overkill response, including record-breaking amounts of dispersant for tackling the oil slick. But that simply reflects the size of the calamity. Results are what counts – and oil is fast approaching the Louisiana shoreline.

It increasingly looks like BP and its regulators were too confident that the supposedly failsafe blowout preventer would seal the well in the event of catastrophe. True, this is the last in a chain of emergency stops. But implausible events happen more often than you might think. Perhaps that explains why insurers would not cover this risk.

Contingency planning for the blowout preventer's unprecedented failure was inadequate. A steel dome to be dropped on the well was only partly constructed and is weeks from being deployed in what will be its first test in deep water. Miles of booms have proved incapable of containing oil in the face of waves higher than a few feet.

Meanwhile, some of BP's public statements have been off key. BP has said the disaster was not "our accident" – it happened on a rig managed by deep-water specialist Transocean – and is promising to pay all "legitimate" damages claims. The "no quibble" approach to damages is laudable, but BP was always responsible for the consequences of any spill.

REUTERS/U.S. COAST GUARD/HANDOUT

Fire boat response crews battle the blazing remnants of the offshore oil rig Deepwater Horizon, off the Louisiana coast in the Gulf of Mexico, April 21, 2010.

If BP really can do no more, then it should say more. A more contrite tone would help, as would an explanation of its contingency planning. BP will not be judged just on its response, but also on its preparedness, and on results. For Tony Hayward, the chief executive who started his oil career on a rig, the stakes are rising.

May 3, 2010

BACK TO SQUARE ONE

BY FIONA MAHARG-BRAVO

Investors appear to have vastly overestimated the cost to BP of cleaning up the spill in the Gulf of Mexico. The $29 billion drop in the oil and gas major's market capitalisation is more than three times the likely total expense of cleaning up the spill. But the market's reaction may not be totally irrational.

The April 20 explosion will set BP back billions of dollars. Morgan Stanley says the clean-up bill could reach $3.5 billion, based on six months of work at $20 million a day, against BP's estimate of $6 million a day. But Exxon Mobil's Valdez spill in 1989 cost the U.S. oil major $3.5 billion, excluding damages. Bernstein estimates that would be the equivalent of $7 billion today.

BP isn't responsible for the rig, owned by Transocean, but the well owners will pay out damages. This is not remote Alaska, where Exxon eventually paid out $500 million or so. Investors aren't taking much comfort from a law passed after the Exxon's spill that put a $75 million liability cap on economic damages such as lost earnings and damage to local resources. Bernstein says $5.5 billion is possible. On hyper-pessimistic assumptions, costs and damages together could exceed $12 billion. BP, which owns 65 percent of the well, would be liable for about $8 billion – a far cry from the $29 billion wiped out by investors.

But these calculations ignore other issues. Investors hate uncertainty, and this clean-up comes with lots of it. The spill got much worse in the first few days and investors may not be entirely persuaded by BP's reassurance that the relief well will eventually plug the hole, or that it will not take longer than three months to do so. There are also concerns about other expenses: tighter regulation, higher insurance premiums and the costs of additional safety precautions.

But the most expensive damage is likely to be reputational. For example, the uncertainty over the explosion may make it harder for BP to secure exploration licenses in the United States. True, Exxon's share price had largely recovered just three months after its disastrous spill. But Exxon, unlike BP, had not just spent the better part of four years restoring its reputation for safety.

BP shares look cheap, but it may be too early to pile in.

May 4, 2010

EQUALITY OF MISERY

BY NEIL COLLINS

BP has probably been as open about its oil spill disaster as a big company can be (watch the horror story in real time on BP's webcam), but it's not enough. Paying for the clean-up is only the start. BP should now suspend dividend payments and bonuses to senior management until the incident is closed.

The clean-up will be expensive. The Valdez disaster, when 250,000 barrels escaped, cost Exxon $3.5 billion. That looks like small change today, and is increasingly irrelevant. BP says the Macondo well is spewing 5,000 barrels a day, and the real number could be much higher.

Worse still, a criminal investigation under the Endangered Species Act seems inevitable. The early worst-case loss estimate from Bernstein Research of $12.5 billion, of which $8 billion would fall on BP, now looks optimistic.

Yet even if it is, the $47 billion slump in BP's market value since the fatal fire is far beyond any realistic final cost. The slumping share price reflects political, not environmental damage.

The Obama administration's threats to throw BP off the case are empty, since there is no evidence of better expertise elsewhere. But U.S. commentators are still cranking up the pressure, and to buy them off the administration could bar BP from operating on federal land. This would be a very serious blow.

BP must claw back some political lost ground, and suspending dividend payments would certainly do that. As the costs escalate, the payment is under threat anyway, so it makes sense to take the initiative.

There would be howls of pain from income funds who rely on the high yield (BP is about 6 percent of the total UK market dividends) and the senior management would have to share the pain by foregoing any bonuses or incentives. That too would help lower the political pressure.

Reuters' consensus profit estimate for BP – before exceptional items – is $20 billion for 2010. If the $10.5 billion cost of the annual dividend goes

REUTERS/SEAN GARDNER

Oil-covered pelicans sit in a pen waiting to be cleaned at a rescue center facility set up by the International Bird Rescue Research Center in Fort Jackson, Louisiana June 7, 2010.

instead to repairing the environmental and political damage, it will be money well spent.

May 26, 2010

LIFE THREATENING

BY NEIL COLLINS

BP has spent a round billion dollars trying to cap the underwater gusher in the Gulf of Mexico, but it is hardly closer to stopping it now than when the Deepwater Horizon rig exploded and sank 43 days ago. The damage to the share price is also approaching catastrophe levels. After another plunge on Tuesday following the failure of the "top kill", what used to be Britain's biggest company by market value has slumped by 35 percent in six weeks.

The latest bout of selling may look like panic, but is not entirely irrational. Some funds fear contamination of their own reputation by association.

Others rely heavily on cash from the oil majors – Shell and BP between them paid a quarter of the UK market's total dividends of 50 billion pounds last year – and can see that BP's dividend is at risk. Income funds cannot hold shares which yield nothing.

It would be politically foolish for BP, which is currently declaring dividends at the rate of $10 billion a year, to carry on paying as if nothing much was wrong, even if the balance sheet could stand it. It still has time to seize the initiative on this subject, at least. The company should announce the suspension of all dividend payments until the catastrophe is resolved and there is a clear view of the likely total cost.

If the oil flow is not stopped, then there is no limit to that total cost. Those drilling the relief wells must hit a target two feet across, a mile under water and a further half-mile through the seabed, bending the drill pipe as they go. This is at the limit of what is technically feasible, and they are working under relentless pressure for speed and the looming threat of hurricanes.

The worst case scarcely bears thinking about. The second-worst case leaves BP so badly damaged, financially and politically, that it can no longer continue as a stand-alone company. The chances of that may still be low, but they are no longer negligible.

June 1, 2010

CHAPTER 3
STARRING INTO A BLACK HOLE

GULF OF LEHMAN
BY ROB COX

BP's deepwater debacle is shaping up as Lehman Brothers in the oil patch. The toxic ingredients that led to that Wall Street firm's implosion are abundantly present in the British energy giant's Gulf of Mexico fiasco: flawed risk management, systemic hazard and regulatory incompetence. And as in the financial industry, the policy response will almost certainly lead to energy's biggies getting even bigger.

At first blush, the tricky business of drilling oil a mile below the ocean would seem light years from the pin-striped work of investment banking. But fundamentally, the failures of BP's management to prepare for, and then handle the current crisis, evoke striking parallels with those of the bust securities firm.

Nowhere is this more evident than in the realm of managing their respective risks. BP's failure to prevent – and so far stop – the leak on the Deepwater Horizon suggests the company did not adequately prepare for the possibility of a spill – a risk that chief executive Tony Hayward put at "one in a million."

Lehman – and many other banks – made similar mistakes forecasting risk. Few of their financial models took account of the possibility for "25-standard deviation moves," to use the words of Goldman Sachs chief financial officer David Viniar. The blowout of BP's well, like a 20 percent dip in the housing market, was just such an event.

Similarly, while Lehman's fallout created a shock to the financial system, the hundreds of thousands of barrels of oil leaking from BP's broken well are oozing noxiously throughout the ecosystem of the Gulf, causing untold environmental and economic damage. And the U.S. government has had to intervene to try and contain the oil's spread, just as it did to prevent the impact of Lehman's collapse on the financial system.

Finally, like the Securities and Exchange Commission that failed to ensure Lehman did not take on excessive risk, the regulator overseeing BP in the Gulf, the Minerals Management Service, flopped. The president has broken up the MMS, fired its director and attributed its failings to its "scandalously close relationship" with oil companies.

Again, the industries are dramatically different. But there is at least one instructive lesson to draw from Lehman. After its bankruptcy sparked a financial panic in September 2008, regulators permitted the strongest banks to eat the weakest. That allowed big institutions like Bank of America, Wells Fargo and JPMorgan to get even bigger.

That will almost certainly be the result for the deepwater drilling business. BP is on the hook for up to $27 billion in clean-up costs and legal claims, according to Credit Suisse. That's a liability no investor will be comfortable taking, even for a company the size of BP, much less Anadarko Petroleum or other, smaller independent drillers.

Equally, when the government hands out permits to drill, it will only want to deal with counterparties with pockets deep enough to take on such potential liabilities. Add it all up, and the biggest players in the oil industry will just have to get bigger.

June 2, 2010

CODE-BREAKING

BY NEIL COLLINS

BP and Prudential are two of Britain's biggest and most respected companies. Their lavish annual reports contain dozens of pages on how these great corporations are run. Both boast of their compliance with the code of corporate governance, which encourages proper boardroom debate to avoid bad decisions, boosts the chairman, and insists that he cannot also be the chief executive, lest one person become too powerful.

At BP, a powerful chairman in the shape of Peter Sutherland was replaced in January by Carl-Henric Svanberg, who had been chief executive of Ericsson. He has been the invisible man at BP.

In normal times, this might not matter. As the company's oil pollutes the southern coastline of the United States, it's a PR disaster. In a crisis, the chairman must be seen to be supporting his chief executive. Unfortunately, Svanberg's chief executive, Tony Hayward, is not media-friendly either.

Hayward is only starting to show that he grasps the severity of the crisis facing BP. The board seems to be further behind. It should have decided to suspend dividend payments until the Macondo incident is closed, before external pressure to do so becomes irresistible.

The failure at Prudential is a different sort of corporate disaster. Chairman Harvey McGrath has indeed stood right beside Tidjane Thiam, his chief executive, throughout the doomed attempt to buy AIA, the Asian insurer.

The Pru board is full of luminaries, some of whom may even understand life insurance company accounts. Yet they allowed an untried executive team to try to pay a high price for a business the Pru couldn't afford.

There is no simple recipe for good corporate governance. In the United States, where chairmen are usually also chief executives, the list of failures – Enron and Lehman Brothers, for example – is long.

The UK's division of responsibility can constrain rampant chief executives, but an alliance of chief executive with chairman can still leave the rest of the board powerless. And a strong personality in charge can make a big difference in a crisis. Unfortunately, the chief executives and chairmen who are men for all seasons do not yet exist.

June 3, 2010

CRUDE CONSPIRACY THEORY

BY ROB COX

Did Goldman Sachs sabotage the blowout preventer on BP's doomed Deepwater Horizon well? Of course it didn't. But the British oil giant's troubles in the Gulf of Mexico have certainly handed Goldman a public relations reprieve. Similarly, the Wall Street firm's travails following accusations of fraud took Toyota Motor's recall woes off the front pages.

There's no obvious link between a bank, an oil driller and a carmaker. But the reputational struggles of these three global giants suggest one lesson that won't be lost on shrewd corporations: the court of public opinion – led by the political class and including the press – only appears capable of coping with one villain at a time.

That, at least, is the impression from a cursory news search using Factiva. In the three months leading to March 19, Toyota was cited in three times as many articles mentioning the word "scandal" as Goldman. In the month to May 19 the quantum shifted six to one in favor of Goldman. BP has now eclipsed them both.

Now this may just be a case of regulators and politicians

REUTERS/KEVIN LAMARQUE

Protesters hold up signs behind BP America Chairman and President Lamar McKay before he testifies at the Senate Homeland Security and Governmental Affairs Committee's hearing on "Gulf Coast Catastrophe: Assessing the Nation's Response to the Deepwater Horizon Oil Spill" on Capitol Hill in Washington May 17, 2010.

– and perhaps reporters – failing to multitask. Even the most energized lawmaker can only hold one hearing at a time. But the impression left raises questions about the intent and seriousness of inquiry.

The objective in going after corporations should not be to score political points or even put a few executives behind bars. The broader public interest is better served by determining where the government's regulatory apparatus – whether designed to protect investors, car buyers or brown pelicans – fell short and how to improve it.

After all, however socially responsible a corporation may be or claim to be, it is answerable to its stockholders. That's no excuse to cut corners and undershoot the standards required by regulation and simple professionalism. But a primary concern is always going to be profits.

That's not villainy. It's just the way free markets work. By all means, rake BP, Toyota and Goldman over the coals when they have fallen short. But it's also important to ask why government oversight failed so spectacularly. Attempts to answer that question shouldn't be put on hold just because another politically opportunistic scandal comes along.

June 7, 2010

BEYOND PROTECTION

BY CHRIS HUGHES

The moment has arrived for Tony Hayward to call time on his career at BP. The UK oil major's chief executive clearly does not have the credibility with shareholders, regulators or consumers to continue in his role once the Gulf of Mexico crisis is over. BP, and Hayward's own career prospects, will be better off if he admits this simple truth today.

Hayward has made too many slips since the tragic accident on the Deepwater Horizon rig on April 20. At the lower end of the scale, he was unwise to boast of the superlative scale of BP's response as if to suggest the company was well prepared for the disaster. Worse were comments that he "wanted his life back", and the suggestion that the spill was a drop in the ocean.

These may have been the intemperate mistakes of an exhausted man. But they have helped turn the world against Hayward, and against BP, and were particularly unfortunate in view of the 11 lives lost after Deepwater exploded. The fact is that BP now admits it was not prepared for the disaster.

As a result, BP shares will be saddled with a "Hayward discount" as long as he is at the helm. President Barack Obama has said he would have sacked Hayward if he had the chance. The president should remember that his ability to interfere in BP's business is constrained by law, not to mention a duty to respect free markets. But this won't stop investors worrying about BP being sidelined in the United States.

Having supervised BP's response effort so far, Hayward is still the best person to finish the job. But that shouldn't stop him from announcing now that he will offer his resignation as soon as the well is plugged. This would also prove that stopping the flow – rather than protecting his job – is his singular aim.

The board would need to decide whether to accept his resignation when the leak is fixed. However it turns, the bloodletting should not stop there. Chairman Carl-Henric Svanberg has also been found wanting during this crisis – to the extent this invisible man is to be found anywhere. Svanberg should have stood with, not behind, his chief executive.

Add it all up, and BP has one major task – and two big jobs – to sort out this year.

June 8, 2010

BRAVE PETROLEUM

BY FIONA MAHARG-BRAVO

BP investors seem to have hit the panic button. The $76 billion drop in the UK oil major's market value since the start of the Gulf of Mexico disaster looks out of proportion to the cost of the clean-up the bill. But then again, maybe not.

Of the total fall, $10 billion reflects the 13.5 percent dip in world stock markets since the April 20 explosion. That leaves a $67 billion hit to market capitalisation.

The cost of the clean-up should account for one big chunk of that, with Credit Suisse putting BP's share of the tab at as much as $12 billion, taking Exxon Mobil's Valdez spill in 1989 as benchmark and including $4 billion of fines. Then there is the cost of paying damages to those whose livelihoods have been wrecked. That could easily cost another $12 billion. In theory, BP is on the hook for just 65 percent, but assume, for the sake of pessimism, that it pays for it all.

That still leaves $43 billion of value destruction to account for. Some of that may reflect investor panic, but there is other hard-to-quantify damage too. The biggest unknown is the government and regulatory response.

BP's business in the United States accounts for 46 percent of the company's value, according to Citigroup. Hereon, BP will have to have the highest safety standards in the industry. It may struggle for years to win new exploration licenses. And likely restrictions on deep-water exploration will hurt all drillers. Assume BP's U.S. business has lost 25 percent of its pre-spill value. Adjusted for the wider stock-market drop, that would be another $17 billion destroyed.

That still leaves a $26 billion shortfall to explain. But other outstanding risks justify a further hit to the shares. One factor would be the continuing uncertainty around when the leak will be plugged, which makes the costs open-ended. Analyst estimates of $4 billion in fines could prove hugely overoptimistic too. There is also the damaged management credibility reflecting poor handling of the crisis.

Finally, there is the outside risk of total bankruptcy. This looks far-fetched. At the end of the first quarter, BP had net debt of $25.1 billion and shareholders' equity of $105 billion. Analysts predict about $35 billion of cash generation this year, and around $40 billion next. BP could spend $35 billion on the spill response and still afford its dividend and capital expenditure plans – without breaching its self-imposed gearing limit of 30 percent.

REUTERS/LARRY DOWNING

U.S. President Barack Obama surveys damage along the Louisiana coastline at Fourchon Beach caused after a BP oil line ruptured in the Gulf of Mexico, May 28, 2010.

But the wildcard is the official investigation into the incident, which is likely to probe BP's long-term safety record hard. This could conceivably end in the confiscation of assets.

Tot it all up, and allow a margin for error, and there may well be some upside – for the brave.

June 10, 2010

DEFENDING THE INDEFENSIBLE

BY HUGO DIXON

Has BP moved from villain to undeserving victim? That's an emerging view in the UK. The environmental crisis in the Gulf of Mexico has created a financial crisis for its investors – with a plummeting share price and debt now trading at junk levels. Some Brits are offering a nationalist defence of what used to be British Petroleum.

The boss of the Institute of Directors has condemned President Barack Obama's rhetoric as "inappropriate" while the Daily Telegraph says Obama has his boot on British pensioners' throats. And Boris Johnson, the Mayor of London, described the "anti-British rhetoric" as a matter of "national concern".

These concerns seem misplaced. A disaster of this scale was bound to provoke a backlash, whatever BP's nationality. The U.S. president has put pressure on BP to suspend its dividend, sack its chief executive, pay proper compensation and come up with an updated plan for fixing the leak. None of these are out of line, given how badly the company has handled its response to the crisis.

The main blame has to sit with Tony Hayward, BP's chief executive, who has made a series of public relations gaffes. The best thing he could do for the company right now is to announce he will resign as soon as the leak is plugged.

The chairman, Carl-Henric Svanberg has also been weak. A heavier hitter, like his predecessor Peter Sutherland, might have been able to protect the company from some of the political backlash. Svanberg has been virtually invisible. The board also failed to show leadership in suspending the dividend. It will probably have to axe it anyway – but will now get no credit for doing so.

David Cameron will take up the BP issue when he speaks to Obama this weekend, according to the Financial Times. Britain's prime minister should certainly seek to protect BP from extreme measures such as confiscation of assets – as well as ensuring that there isn't any wider backlash against British industry. But Cameron can't and shouldn't defend the indefensible. If BP wants an effective defence, it must first show much more humility.

June 10, 2010

NO OPEN GOAL

BY CHRIS HUGHES AND FIONA MAHARG-BRAVO

The idea of BP being taken over by anyone would have sounded crazy before the Gulf of Mexico disaster. But it is now becoming commonplace to suggest that the UK oil major might even fall into the hands of Russia's Gazprom or Chinese oil giant Petrochina. The scale of the disaster and BP's botched handling of the situation has certainly made it vulnerable, but it is not defenceless. Almost all conceivable combinations would face political obstacles.

UK governments have traditionally been a strong advocate of open markets. But the recent takeover of Cadbury by Kraft Foods has heightened sensitivity to foreign predators – and that was only a chocolate company. The idea of a strategically important energy company falling into foreign hands would provoke an outcry – even if Vince Cable, the new coalition government's business secretary, is apparently minded not to stand in the way, according to The Times newspaper.

Look at four different scenarios. First, a takeover by Gazprom. The mere suggestion that the Russian gas group could bid for Centrica, the UK utility, triggered a political backlash four years ago. Russia has shown a willingness to use its immense energy reserves as a tool to put pressure on its neighbours. Would the UK really want to allow it to further strengthen its position in the industry?

Second, a bid by a Middle Eastern company. Countries such as Saudi Arabia and Abu Dhabi may be long-term allies of the UK. But they are both members of Opec, which has held the West to ransom in the past – and are in an unstable region of the world. Again, there are potential energy security issues in a BP takeover.

Third, an acquisition by Petrochina. China is not a major oil producer, but it is an avid consumer. There could be worries about Beijing somehow diverting scarce oil supplies to satisfy its needs rather than those of the West.

Fourth, some move by a U.S. group on BP's U.S. assets, which account for nearly half its value. Given that BP's name is now mud in America, there might be some value to be created by shifting ownership to an Exxon or a Chevron. But this could provoke howls about a political stitch-up – on the view that the White House had deliberately crushed BP's value to allow a U.S. bidder to snap up its American assets on the cheap.

What's more, these considerations just look at the potential UK political backlash. President Barack Obama would surely balk at the company falling into the control of a state that was not a U.S. ally. Chinese oil group CNOOC abandoned its $19 billion bid for Unocal in 2005 after U.S. regulatory obstacles were erected in its path.

Of course, the balance of power between China and America has shifted in the last five years. And Beijing will not have forgotten how the Bush administration tried to interest it in bailing out America's banks, notably Morgan Stanley, in October 2008. Even so, Unocal was a minnow beside BP. Controversial suitors might well think they'd have to sell its U.S. assets on to a palatable buyer.

There are, though, other options that don't face political problems. The most obvious is BP's traditional rival, Anglo-Dutch Shell. But it would be unlikely to move so long as the scale of the clean-up cost as well as any changes to regulation remained uncertain. But once everything was clear, BP probably wouldn't be so vulnerable anyway.

Finally, there could be a dawn raid. Even if a Gazprom or Petrochina would face difficulties in taking control of BP, there wouldn't be political problems in buying a stake of, say, 20 percent. The snag, though, is that they wouldn't necessarily get much for their money. A 20 percent stake wouldn't guarantee board representation or a say over strategy. That certainly was the experience of China's Chinalco when it swooped on Rio, the UK mining group.

M&A talk is likely to swirl around BP at least until it has plugged the leak in the Gulf of Mexico and found a credible new chairman and chief executive. And, in a situation as volatile as this, one can never say never. But the chances are that it will emerge with its independence intact.

June 14, 2010

BP Chairman Carl-Henric Svanberg (R), CEO Tony Hayward (L), Managing Director Bob Dudley (2nd L) and BP America Inc. Chairman Lamar McKay speak to the media after their meeting with U.S. President Barack Obama at the White House in Washington, June 16, 2010.

SVANSONG

BY CHRIS HUGHES

Well that went well. Carl-Henric Svanberg's crunch meeting with President Barack Obama has concluded with the BP chairman agreeing to the UK oil major putting $20 billion in escrow to cover claims from the Gulf of Mexico disaster. BP has also bowed to pressure to defer the dividend. The shares have reacted positively – evidence of just how badly the market thought this awkward summit would end.

BP is paying the price not just for polluting the Louisiana coastline, but for failing to take the initiative sooner. Had it made an unsolicited announcement that shareholders would receive no dividends while the well was gushing, Obama might not have become so fixated on BP's ability to pay damages. Instead, the board dithered. In the meantime, Obama has effectively taken control.

True, it's hard to imagine how Svanberg could have got the better of the president. The hope was that he might be able to agree to a smaller escrow with maybe some modest dividend allowed in return. In the end, Obama is effectively taking $20 billion from BP and telling someone else how to spend it. Once a fund is set up with a designated sum, the chances of BP shareholders seeing the money again are remote.

Champions of free markets will bleat that Obama's move is tantamount to state confiscation of private assets, the sort of thing seen only in emerging markets. But oil is an inherently politicized sector everywhere. Investors are now learning what "political risk" means.

The consolation for BP is that the man charged with overseeing how the fund is spent, Ken Feinberg, earned a reputation for straight dealing when he oversaw 9/11 compensation. His appointment should soften fears about the fund paying out spurious claims.

To the extent that this fund provides certainty, it puts a floor rather than a ceiling on the costs of this disaster. Indeed, BP says the "fund does not represent a cap on BP liabilities." Financially, it's swallowable, especially as the money is deposited over three and a half years. BP has about $15 billion of cash and committed bank lines. Ongoing cash generation and the dividend suspension can fund the balance. The company also plans to reduce capital expenditure and sell $10 billion of assets in the next 12 months.

BP could arguably have avoided this whipping had it moved quicker. The hope now must be that by caving in to Obama, the public drudging abates. We'll see.

June 16, 2010

CHAPTER 4
BP PULLS BACK FROM THE BRINK

BINARY OPTION

BY CHRISTOPHER SWANN

Rival oilmen have every reason to cast BP as a rogue. But none more so than Anadarko, its silent partner in the leaking Macondo well. If BP is proven grossly negligent, Anadarko is absolved of liability. If that doesn't happen, it could face crippling costs.

Anadarko invested in the Macondo well in December 2009 after drilling had already started. It had not a soul on the doomed rig and had not been consulted about the well design. Yet its 25 percent stake has ensured the drubbing of a lifetime. Even after accounting for the slide in peers' valuations, investors have sliced close to an extra $13 billion off Anadarko's market capitalisation, leaving it worth some $22 billion.

That middle ground, though, doesn't reveal the dilemma facing investors. The chances are, either Anadarko will eventually escape practically scot free, or its share of the bill could end up being life-threateningly large.

To bring its tab down near zero, Anadarko needs to prove the accident stemmed from "gross negligence or willful misconduct" on the part of BP. Then it can legally escape stumping up its share of the cleanup cost. That determination would also make it easier for politicians to justify lifting the deep sea drilling ban – a move that would remove another cloud hanging over Anadarko.

If instead Anadarko's darkest fears are realized, it could be on the hook for $15 billion or more, assuming the cost of the disaster tops $60 billion, as research by Raymond James suggests. That bill is not the only worry. As the largest independent explorer in the deep waters off the U.S. coast, Anadarko would be a leading casualty of an extended freeze on drilling –


REUTERS/SEAN GARDNER

Poggy fish lie dead stuck in oil in Bay Jimmy near Port Sulpher, Louisiana June 20, 2010.

and that would be more likely if, instead of BP being fingered as the only miscreant, practices across the industry were found wanting.

That could seriously stretch the company's resources. Its cash pile of $3.7 billion could easily be gobbled up, along with the expected $4.2 billion of cash flow Raymond James expects this year.

Short-term, the uncertainty will surely weigh on Anadarko. Longer-term, its shareholders will be hoping for more evidence of BP's failings. After all, the company looks much like a binary option on the UK oil giant's incompetence.

June 21, 2010

BACK PEDALLING

BY FIONA MAHARG-BRAVO

BP would rather not be selling up to $20 billion of assets because it needs to pay for a record-breaking oil spill in the Gulf of Mexico. Fortunately for the embattled UK oil and gas company its forced-seller status might not be so troublesome. BP has non-core assets that look attractive to cash-rich buyers who have already shown their appetite.

Take the 60 percent stake in Pan American Energy, an Argentina-focused oil and gas producer. It is a mature, low-growth asset that BP probably wouldn't miss. By contrast, Latin America has become a key target market for Asian oil rivals, which have been paying top dollar for assets. CNOOC, the Chinese oil giant, shelled out $3.1 billion to take an indirect stake in American Energy just three months ago. That implies BP's stake could be worth over $9 billion. In the same region, BP could sell its Colombian assets, which are also mature.

Then there are the listed stakes. BP's 1.4 percent holding in Rosneft is of questionable strategic value and could be worth $1 billion. Jettisoning a 71 percent stake in Castrol India could bring in another $1.6 billion. These may not attract as much interest as the LatAm assets – but they can be sold quickly.

BP has said it is targeting asset sales of $10 billion to help cover the $20 billion base commitment made to the U.S. government for damages from the spill. But if all goes well, these disposals could raise much more. To go further, tougher decisions will be needed.

Assets in Trinidad and Tobago are core to BP's plans to expand in liquefied natural gas. Its fields in Angola and Egypt offer growth. And while the North Sea assets are mature, they are high margin and probably wouldn't catch the eye of the Chinese. BP could also theoretically sell down its exposure to its Russian venture, TNK-BP. But it is hard to see who would want to pay a high price to enter this politically problematic relationship.

That leaves assets in the United States. BP could sell its joint ventures in the hot area of shale gas. The Gulf of Mexico deepwater exposure is, at this point, arguably worth more to another operator, but is an engine of future growth. Exiting would be an unpalatable option. Hopefully for BP, it need not come to that.

June 23, 2010

LEADERSHIP VACUUM

BY HUGO DIXON

BP should focus on finding new leadership, not a white knight. The oil giant could theoretically be a sitting duck for a hostile bid when it manages to plug the leak in the Gulf of Mexico. But the best way to avoid such an outcome is to appoint a new chairman and new chief executive – not bring in an investor via a sweetheart deal.

The chances of BP falling prey to an opportunistic bid are not that high. Even after the slide in its share price, its market capitalisation of 61 billion pounds makes it quite a mouthful. Politics would also complicate a bid from mooted suitors such as Petrochina or Gazprom. That said, the scenario is not so unlikely that it is silly for BP to man its defences. The issue, rather, is how to go about it.

Press stories in the UK last weekend suggested that BP is considering persuading a strategic investor, say from the Arabian Gulf, to take a stake. One version of this scheme – selling new shares in a cosy deal – would not be sensible. The company's position until now has been that it does not need more capital. What's more, existing shareholders would rightly be worried that their pre-emption rights were being side-stepped. Such an off-market transaction might protect incumbent management, but would not boost the share price.

Fortunately, BP doesn't seem to be going down this route. Its preference is for an investor to buy shares in the market, according to somebody familiar with its thinking. While there is nothing objectionable with this approach, it looks a bit back to front.

What BP really needs is a good investment story. That ought to be based around putting the past behind it. Plugging the leak is the essential first element. Investors will then find it easier to quantify the damage. But the second element is plugging the leadership vacuum. The crisis has exposed the inadequacies of both the company's chairman, Carl-Henric Svanberg, and the chief executive, Tony Hayward. If BP can find credible new leadership, investors will flow back – and the risk of an opportunistic takeover will fade.

July 5, 2010

DO IT BY THE BOOK

BY HUGO DIXON AND CHRIS HUGHES

BP's board must pre-empt its chief executive and chairman plotting against each other. The oil major needs change at the top to restore confidence. But does that mean firing CEO Tony Hayward, chairman Carl-Henric Svanberg or both? While the answer is uncertain, each man has an interest in saving his own skin.

The dynamics in a company which has suffered a major disaster – and where neither chairman nor CEO has covered himself in glory – can so easily become destructive. In such cases, both bosses typically conclude that there will have to be a sacrificial lamb to appease shareholders. But they normally also argue that it would be foolish to get rid of both men simultaneously. Each then often pushes his rival to fall on his sword, hoping to enjoy a stay of execution – and possibly even get the chance to be rehabilitated – as the surviving boss.

This is what happened last year at Lloyds Banking Group, after its catastrophic takeover of HBOS. Eventually, Victor Blank, the UK lender's chairman, was ousted by the government, its leading shareholder. Eric Daniels, the CEO, has survived for now – although his longevity is still in question.

Sometimes, of course, chairmen and CEOs stick together through adversity. But this doesn't always save their skins. Think of Royal Bank of Scotland following its near life-threatening acquisition of parts of rival Dutch bank ABN Amro. Fred Goodwin was ousted by the government in the midst of the financial crisis despite the strong backing of his chairman Tom McKillop, who then stepped down a few months later.

There are also cases of chairmen and CEOs falling out – but not because they have been involved in a disastrous common enterprise. A classic case concerns the previous bosses at BP – chairman Peter Sutherland and


REUTERS/JIM YOUNG

BP CEO Tony Hayward and Managing Director Bob Dudley (R) leave after their meeting with U.S. President Barack Obama at the White House, June 16, 2010.

John Browne, the CEO. Their relationship descended into open warfare. Sutherland eventually prevailed. Going back to the 1990s, David Young and James Ross – respectively chairman and CEO of Cable & Wireless – fell out spectacularly. In that case, both men had to step down.

BP today needs to turn a new leaf. Neither of its top men has handled the Gulf of Mexico crisis well. Hayward made a series of public relations blunders. Svanberg meanwhile made a mistake in keeping too low a profile early on – and in not leading the board to axe the dividend before BP became a political football in Washington. Ideally both men should go.

That leaves the question of timing. Governance 101 says that it is normally best to start with a new chairman, who can then assess the CEO and decide whether to replace him. There is no obvious reason to deviate from best practice in this case. A chairman is needed urgently not just to review Hayward but also BP's serially failing board, which let Browne stay on too long. Paul Anderson, former CEO of miner BHP Billiton and a U.S. citizen, is the obvious internal candidate to take over. Further afield, candidates could include Jac Nasser, BHP's current chairman, or even former UK premier Tony Blair.

A variation on the theme could involve Hayward being removed from his post simultaneously given his lost authority. The best solution then would probably be to appoint Bob Dudley, who has taken over long-term control of the Gulf of Mexico situation, as acting CEO while a formal search was initiated.

Whatever is decided, the one thing the board needs to ensure is that the relationship between Hayward and Svanberg does not descend into warfare. This is the last thing the company needs as speculation swirls that some other oil group – the latest name in the frame is ExxonMobil – might try to buy BP on the cheap. The prime responsibility for ensuring this doesn't happen falls to Bill Castell, the senior independent director. With the leaking well likely to be capped shortly, he and the rest of the board should resolve the leadership question rapidly.

July 12, 2010

NOT SO DEEP

BY CHRISTOPHER SWANN

The deep sea drilling party – interrupted by BP's bad behavior – should soon resume. But the festivities may be short-lived. With recent finds shrinking, pumping from the bottom of the ocean could peak as early as 2012. For oilmen struggling to replace reserves this is a sobering prospect.

The murky ocean depths have been a treasure trove of giant new fields for Big Oil in recent years. This was a crucial contribution in the increasingly difficult battle to replenish the cache of oil lost through production, one of the critical measures investors use to gauge the success of private oil drillers.

Indeed without new finds in Davy Jones' locker the Western oil majors, including BP and Chevron, collectively would not have kept pace. Between 2005 and 2008 deep-sea oil production surged by 67 percent, set against a puny 1.3 percent rise overall.

Yet even if BP caps the Macondo well soon, the golden days of deep-sea oil may already be nearing an end. New finds have dived since Brazil's bumper discoveries of 2006. And once punctured, production tends to fall rapidly from these wells. PFC Energy estimates output from the 10 biggest drillers to top out at just 9.2 million barrels a day between 2012 and 2013 – a mere 15 percent above current output – before falling again to today's level by 2015.

With as much as 90 percent of reserves locked up by state oil companies, this is a worrying outlook for independent drillers. If closely watched replacement ratios start to fall much below 100 percent Big Oil could quickly acquire the air of a sunset industry. Of course, deep-sea has not been the only fount of fresh oil recently. It has, however, typically been the best money spinner, usually offering higher margins than either oil sands or abundant but cheap shale gas.

There may be further surprises in the deep sea and peak-oil Cassandras have yet to be proven totally right. But since it generally takes around seven years from discovery to production, a near-term plateau can't be wholly discounted. This would give the whip hand back to land-based state oil giants – especially in the Middle East. It would also give Big Oil little time to find the next big thing.

July 14, 2010

TO CAP IT ALL

BY CHRISTOPHER SWANN

BP's Gulf of Mexico oil disaster knocked Goldman Sachs off the front pages. It's just the UK oil major's luck that its best news in 86 days was overshadowed by Goldman's settlement with the U.S. Securities and Exchange Commission. Few will praise BP's speed, but its initial complete capping of the well is a big step forward. Restoring credibility and relations with Uncle Sam will, however, take years.

It could still go wrong again. But if the seemingly successful test on Thursday turns into part of a longer-term solution to the leak, it will mark the end of a period that has been torture for BP – but only the beginning of a healing process for the company and its bruised shareholders. For the first time since April, there won't be live pictures of its oil gushing into U.S. waters. And the company's bill will no longer be ticking higher by the barrel. All being well, BP will get a breather from bad publicity while it works on the permanent answer – its relief wells.

The company will still face serious problems. The success of the latest cap will raise the question of why it wasn't available earlier, adding to the impression that BP was hopelessly ill-prepared for an accident. And even if not another drop leaks into the sea, BP's financial hangover will be monumental. Based on reasonable assumptions, the total bill for clean-up and damages could approach $40 billion, though some costs may be tax-deductible. And before long, investors will be clamoring to see a plan for the restoration of the company's once gold-plated dividend.

Rebuilding any kind of trust with U.S. authorities is also likely to require diplomatic skills far beyond those of Tony Hayward, the damaged BP chief executive who charmed few Americans, and the frequently invisible chairman, Carl-Henric Svanberg. Some lawmakers are working on legislation seemingly tailored specifically to exclude BP from future U.S. projects. With almost half of its pre-crisis value hinging on its U.S. businesses, BP can ill afford to be left out in the cold.

So while a sigh of relief may be in order, there's still much hard work to be done. BP has dismissed all talk of corporate change, saying it is single-mindedly focused on capping the well. It no longer has that excuse. Management change is now top of the agenda.

July 15, 2010

PRICE OF REPUTATION

BY CHRIS HUGHES

It's nearly over. Wall Street bank Goldman Sachs has settled fraud allegations with the U.S. Securities and Exchange Commission with a $550 million slap on the wrist. BP has shown it can halt the flow of oil from its bust well in the Gulf of Mexico, giving confidence to recent research that the leak could cost the UK oil group less than $30 billion.

But shareholders have paid a far heavier price for these episodes than the quantifiable damage suggests. That deficit has one obvious explanation: the cost of reputational damage.

Take Goldman. Its shares rose only modestly on Thursday's deal with the regulator, leaving its market capitalisation at $74.8 billion, 21 percent lower than its value on April 15, the last day before the SEC filed charges. Almost half of that is attributable to the fall in global equity markets, taking the MSCI World Index as a benchmark. After backing out the paltry fine, there is $9.7 billion of value destruction to explain – 11 percent of Goldman's value adjusted for falling markets.

It's a similar story at BP. The group is worth 77.6 billion pounds, 36 percent less than its value before the Gulf well blew on April 20. Adjust for the fall in global markets over the course of the spill, and back out 19 billion pounds for the latest estimate of the known costs of the clean up and compensation, and there's still 16.1 billion pounds of value destruction to account for. That is 14 percent of BP's adjusted market value.

It would be too crude to conclude from this analysis that reputation is worth about 12.5 percent of market cap, or that BP somehow has a higher "reputational beta" than Goldman. Both companies face continuing business challenges arising from the episodes, and the UK oil group's predicament is still much more uncertain than Goldman's.

But what is clear is that reputation has huge value. Companies need to guard it more vigilantly.

July 16, 2010

MORALITY ROCK, BUSINESS HARD PLACE

BY EDWARD HADAS

Corporate executives often struggle to keep their moral compass when dealing with wicked governments. The lure of profits can make them lose their bearings. But politicians who criticise corporate collusion with oppression are often guilty of rank hypocrisy. The latest American flap over BP and Libya provides a good example of both principles.

A year ago, the international political rehabilitation of Libya was well on track. The United States had pretty much made peace with the regime of Muammar Gaddafi, after the Brotherly Leader and Guide of the Revolution agreed to pay $1.8 billion to settle all terrorism-related claims in August 2008.

The UK seemed to be falling behind. BP, which was making little progress on a 2007 exploration deal, encouraged the British government to complete a prisoner-transfer agreement with Libya although it denies specifically lobbying for the release of Abdel Basset al-Megrahi, who was convicted for his role in the Lockerbie bombing.

Megrahi was indeed repatriated on Aug 20, 2009, by the Scottish authorities on compassionate grounds. And BP found its way cleared in Libya. Some American senators are now planning hearings on the matter.

New facts may emerge, but it is already clear the BP had reason to cheer Megrahi's freedom. That puts the oil and gas producer in roughly the same moral position as the son who welcomes the news of his rich father's death.

If BP were not already in trouble, it might want to run through the arguments in favour of dealing with objectionable authorities. Governments are rarely all evil, foreign investors can help the people's lot and companies aren't in the business of creating foreign policy. Besides, Libya was becoming less objectionable.

Moral purists can easily dismiss such claims, but it's hard to create a global economy without making many unpalatable compromises. Businessmen can learn how from political leaders, who often find reasons to overlook, forget or forgive.

The Macondo disaster may show that BP had unusual difficulty balancing two of its goals: safety and profits. The company's relations with Libya look much more like normal corporate practice, for better or worse.

July 19, 2010


REUTERS/LEE CELANO

A hard hat from an oil worker lies in oil from the Deepwater Horizon oil spill on East Grand Terre Island, Louisiana June 8, 2010.

RUSH JOB

BY FIONA MAHARG-BRAVO

BP is making a virtue of necessity. The UK oil and gas major has agreed to sell $7 billion of assets it won't miss to U.S. rival Apache to help fund the cost of the Gulf of Mexico disaster. While this will have a small impact on growth, BP has proved that it can get decent prices for non-core assets in spite of being a seller in a hurry.

The original idea was to include half of BP's stakes in Alaska's Prudhoe Bay fields, which still hold strategic importance for the UK group. But agreement on control and price proved elusive, according to a person familiar with the situation. BP rightly held firm. After all, it was still able to sell mature assets with mostly declining production in the United States, Canada and Egypt with a $5 billion deposit payable upfront.

None of these are a core part of BP's upstream strategy. They are arguably worth more to Apache, an expert at squeezing oil from mature fields.

Apache is paying $19.40 per barrel of oil equivalent compared to an average of $13 for recent transactions, according to Societe Generale research citing energy consultancy IHS Herold. Alternatively, the price is 2.3 times book value, more than double BP's market rating, JP Morgan says. These may not be the most reliable ways of assessing the disposals, but it's hard to say BP is destroying value.

The real cost is that the sales make it harder for BP to meet its growth targets. While the jettisoned assets accounted for less than 1 percent of BP's operating profit last year, they still represented about 2 percent of production. But given BP's predicament, that's the least of its worries right now.

Strong cashflow and existing credit lines mean BP isn't the desperate seller it is often cast as, even if it has committed to fund a $20 billion escrow for spill damages. It has said it would raise $10 billion from disposals, and has pencilled in $1.7 billion from sales in Vietnam and Pakistan. Perhaps these will not be as quick. But for now the pressure is off. Luckily for BP, there seem to be ready buyers around making the task of portfolio pruning somewhat easier.

July 21, 2010

CHAPTER 5
TURNING OVER A NEW LEAF

A BARREL HALF EMPTY

BY CHRIS HUGHES

BP's chief executive looks set to pay the appropriate price for mishandling the Gulf of Mexico disaster. But Tony Hayward's impending departure should not be seen as providing redemption for the rest of the UK oil major's board, let alone for its chairman, Carl-Henric Svanberg.

Whether through tiredness, bad luck or poor media experience, Hayward said the wrong thing on too many occasions after BP's well blew out on April 20. One such slip, saying he "wanted his life back" just weeks after the fatal accident, has now become prophetic.

Hayward became a global hate figure. It has for weeks been evident that his continuing presence at the helm of BP would obstruct the group's rehabilitation in the United States, potentially saddling the shares with a discount. While going would be the right thing, it would have been better to say weeks ago that he would step down once the well was capped and when a successor could be found.

Some will see Hayward's anticipated exit as evidence that Svanberg is belatedly showing strong leadership. But it is questionable whether the chairman's own weakened authority can be restored. He should have publicly helped Hayward fight the fallout from the disaster sooner than he did. Worse, Svanberg allowed the board to dither over the dividend even when it was clear that continuing with the payout was both politically foolish and financially irresponsible. Ideally, Svanberg would have been the first to leave, with his successor finding a new CEO.

Hayward's short tenure at the top – he has lasted less than four years – carries lessons for all bosses. The ability to handle a hostile media in a crisis is clearly as vital a skill in a CEO as management or technical capability. A constructive relationship with a supportive and weighty chairman is also critical. And the episode has shown that new brooms cannot help but inherit some of the baggage of previous management. Hayward was vulnerable largely because of BP's safety failings under his predecessor John Browne – even though he was appointed on a manifesto to fix them. It may now be for Bob Dudley, the U.S. BP executive tipped to succeed Hayward, to grapple with these challenges.

July 25, 2010

THAT'S ENOUGH

BY CHRIS HUGHES

Tony Hayward may be the world's most unpopular businessman. But the mistakes that are now ending his career at BP are those of a hapless man, not a villain. So it would be both vindictive and unjustified to pay him off with less than his contractual entitlement – however much of a stink that may cause in the United States. To the extent that Hayward's mishandling of the disaster exacerbated the fall in the UK oil major's shares by souring relations with Washington, this may be alleviated by his exit.

The vast bulk of Hayward's entitlement is his pension pot, which had a transfer value of 10.9 million pounds at the end of last year. This has been accrued over 28 years of service prior to the explosion on BP's well in Gulf of Mexico in April. The other primary component would be one year's salary, or 1.05 million pounds taking Hayward's pay last year. Nor is there any good reason to strip Hayward of the awards already granted under a three-year share-based plan, which will presently be under water in any case.

Arguably Hayward could also be entitled to any portion of his performance bonus paid for operational targets not affected by the oil spill, such as refining and marketing income. That might be worth another 700,000 pounds or so. But if Hayward wants to show that he has learnt something from this fiasco and to rebuild some of his reputation, he would be well advised to turn down any performance bonus.

Finally, there is no case for giving Hayward a discretionary top-up like that received by Fred Goodwin upon stepping down as CEO of Royal Bank of

Scotland after leading it to its near-collapse. Fortunately, such a payment does not seem to be part of Hayward's negotiations.

There may be outrage on Capitol Hill at Hayward receiving an eight-figure package. But the senators have got Hayward's head and should leave it at that.

July 26, 2010

RESULT

BY FIONA MAHARG-BRAVO

BP is attempting to slim itself back to health. The UK oil major is upping its existing disposal programme to $30 billion and looking to cut debt after taking a $32 billion charge on the Gulf of Mexico oil spill. To ram home the message that BP is changing, Tony Hayward is to step down as chief executive. It sounds decisive and radical. For Hayward's successor, Bob Dudley, the challenge is to turn this into a convincing equity story.

Taking a large hit on the disaster in one go is preferable to drips of bad news in the coming quarters. The second-quarter charge is BP's best guess of the liabilities associated with the spill. It is well below some worst-case estimates of $50 billion or more. BP assumes the costs can be written off against tax, leaving a net cost of $22 billion.

This may be a reasonable enough central scenario. But investors should remember the final costs could well be higher. BP may find it politically difficult to deduct all the costs from tax. It is also banking on not being found grossly negligent, leading to significantly lower fines under the Clean Water Act. The assumption for the amount of oil spilt – which determines fines – is also below the top end of the U.S. government estimates. Then again, the costs could also be lower if BP's partners in the stricken well assume their 35 percent share of the liability.

The wide range of outcomes may be one reason why BP is opting to retain as much financial flexibility as possible. The company is still a formidable money machine – generating nearly $9 billion in operating cashflow in the second quarter. The decision to use asset sales, rather than cashflow and debt, to pay for the bulk of the costs should cut net debt from $23 billion to as low as $10 billion over the next 18 months. This is well below BP's normal debt range. It arguably should stay that way for the foreseeable future.

The more assets BP sells, the trickier it will be to extract value. Last week's $7 billion disposal to U.S. rival Apache demonstrates BP has assets that are indeed worth more to rivals. In that deal, BP sold around 2 percent of production. If future sales are in the same proportion, BP's oil production would shrink from 3.9 million barrels per day to just over 3.5 million. That's as much as rival Shell pumps, although BP's arch-rival also has rosy growth prospects.

New BP will be smaller, but could have a more concentrated portfolio of quality assets. There are the makings of an attractive story here for equity investors – especially if a more robust balance sheet is part of the equation. But a recovering BP could also be an attractive M&A story for a stronger rival. The plan Dudley must execute is risky and no quick fix. He faces a nervous honeymoon.

July 27, 2010

ABOUT US

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ON THE COVER: Smoke billows from a controlled burn of spilled oil off the Louisiana coast in the Gulf of Mexico June 13, 2010. REUTERS/Sean Gardner

BREAKINGVIEWS