Interview with Chris Cook, Originator of the Iranian Oil Bourse

Posted by Chris Vernon on August 20, 2006 - 2:20pm in The Oil Drum: Europe
Topic: Economics/Finance
Tags: chris cook, iran, oil bourse, opec [list all tags]

Chris Cook, former director of the International Petroleum Exchange and an energy consultant, is the originator of the Iranian Oil Bourse project.

Cook's involvement in the Iranian Oil Bourse project stemmed from work he did in the late nineties on manipulation of the oil market by the intermediaries. As a result of the realisation of how the intermediaries were making the market more volatile than it needed to be, making money at both the producer and consumers expense, Cook wrote to the governor of the central bank of Iran proposing the creation of a Middle Eastern Exchange with its own benchmark price.

The Iranians liked the idea, the Saudis however couldn't support it due to US connections. After 9/11 the Saudi's withdrew their objections and in May 2004 Cook was invited to Iran's central bank to give a presentation setting out how an oil exchange might operate. Cook and his consortium got the contract to put it together. Difficulties arose however since the Oil Ministry didn't want transparency in the oil market, the current system not withstanding its flaws was making the Iranian elite lots of money.

Cook understands Peak Oil, and following his brief but highly informative off-the-cuff talk at the PowerSwitch Peak Speak 2 conference in the UK, Julian Jackson of PowerSwitch interviewed him about the Oil Bourse, and also his ideas for using a new form of business organisation, the Limited Liability Partnership as a vehicle for investment in renewable energy technologies.

I think it's interesting that Cook says nothing about the Oil Bourse being based on the Euro. In fact he actually says the Euro isn't practicable. In most peoples minds Iranian Oil Bourse = Euro, but after talking with Cook I just don't think that's the case.

Full interview below the fold.

26th July 06, London

Julian Jackson (**JJ**): I wanted to ask you, what is the current state of play with the Iranian Oil Bourse?

Chris Cook (**CC**): The current position is that there are two conflicting positions. One is the official one, or should I say semi-official one, the other is the actual facts of it, or maybe it's the difference between the apparent and the real. The problem with this has been that the sponsors of this exchange, the Oil Ministry, have resisted from the outset any real transparency. Therefore the announcements we have seen in relation to an oil exchange would be in reality a travesty of an exchange. It bears no relation to the proposition that was put forward, the feasibility study that was done, and what the President [of Iran] wanted: more transparency in the oil market.

What we are looking at is a political problem: all that has been done is a building has been bought, a legal entity has been put together, but all the nuts and bolts, the elements of an exchange, essentially there is nothing behind it at all which is worthy of the name of an exchange.

JJ: That's a bit of a shock to me - I don't speak Farsi, but I've been following as much as I can in the news, and I thought things were further advanced than that.

CC: They appear to be, but that is in fact not the case. It suits certain elements within the Oil Ministry, who have been obstructive throughout this process.

If I can go back to the beginning, in June 2001, when we wrote to the Governor of the Central Bank of Iran, pointing out that the market was being routinely manipulated by intermediaries, such as investment banks and oil traders, and this had an adverse effect on producers and consumers, particularly on countries like Iran -the big producers.

We suggested back then that not an Iranian Oil Bourse, but a Middle Eastern Exchange should be put in place, with a Gulf benchmark price.

Several years went by, a story in itself, but in April-May 2004 the consortium I'm involved with, the Wimpole Consortium, was granted the contract to put the project together. We did a major feasibility study in August 2004, which outlined what needed to be done, how it was to be done, the proposed architecture of what was to be essentially a market network, and a clearing system to go with it, integrated with the capital markets of Iran: a very holistic proposal.

JJ: How was this received in Iran?

CC: A turf war broke out between the Oil Ministry on one hand, and the Ministry for the Economy, who both felt they should have jurisdiction.

JJ: How unsurprising.

CC: This is not unique to Iran, similar battles go on in any Western democracy.

Progress was basically zero. We had to go to see the previous president [Khatami] , who then put his authority behind the project, and what little progress we did make was around the first quarter of 2005, then the project was paralysed for about a year, with the coming into power of the new administration. The new president [Ahmadinejad] appointed three different oil ministers and didn't manage to get any of them confirmed. It's only in the last three months that we have found new management taking the lead in this project.

Unfortunately this new management is taking the less transparent option. Certainly ignoring everything we have said. They are in line with Oil Ministry orthodoxy. We thought that's as far as we can go here. So we appealed in writing to the President Ahmadinejad to put the project back on track, because at the moment it is being driven into the sidings.

All we're looking at is a new sales office for the Iranian National Oil Corporation and it will lack any sort of credibility as a result.

JJ: This agrees with some people who say that the banking regulations, American sanctions, all that sort of thing, will affect it. So you are saying there are two options, a conventional exchange which you say won't get off the ground...

CC: It might have a minute domestic application, it will have no international credibility at all... and it's not intended to.

JJ: Are you saying that some people in Tehran would like it to fail then?

CC: They are certainly not in favour of any higher level of transparency in the oil market than currently exists.

<Serendipity adds a humourous sound effect: there is a huge clanging of steel pipes in the street as Chris says this>

JJ: And the core of your proposal is something quite different?

CC: It was and it is: we were looking at a truly international solution, it was never an Iranian solution in the first place, it was a middle-eastern solution, and we see that in the context of a global market, which has got worse than in June 2001, it has become more volatile, more risky and is leading to more profits at the expense of the producers and consumers, the trouble is that none of these profits are really visible to producers and consumers because of the opaque nature of the market operation.

JJ: Perhaps you could explain that a bit more for me: I've never been an oil trader, I come from an arts background, my interest has been only for a few years since I found out about Peak Oil.

CC: Sure. Oil is typically priced using what are called "Benchmarks" , and also producers and consumers manage risk, the price going up or down, by using derivatives, a form of risk management tool. The derivatives should derive from the underlying market, but using the current market architecture it is possible to generate unnecessary levels of market volatility, and in fact the entry of hedge funds into the market in a big way in the last two or three years has been responsible for a large amount of current market volatility.

The market needs to be totally reconfigured, and I don't see that happening unless there is some kind of trading disaster in the market. Which I think is inevitable, by the way.

JJ: Right. If we could go back to your original proposal idea, which as I understand it is putting producers and consumers together - you described it as a "Napster" of the oil industry?

CC: Yes, the logic of the internet is to cut out unneccessary intermediaries - disintermediation - and to connect the ultimate buyer and the ultimate seller more directly. At the moment the middlemen own the market, and set the rules to suit themselves. Profits are far higher by the middlemen than they need to be. They are making super-profits because of the way the market is. I don't begrudge intermediaries a return on capital, but I do begrudge them a ridiculous return on capital, particularly when they are using unfair or inequitable ways of trading, abuse of market information, that sort of thing, which is definitely what goes on now.

JJ: How will your proposal change that?

CC: The proposal has several aspects to it, firstly the direct connection of the participants, with a less dominant role for the intermediaries, the second relates to the nature of the instruments, and here we have some fairly simple, but new mechanisms based upon ownership of assets, as opposed to of futures contracts to take delivery of those assets. We are looking at an entirely different but simple mechanism based upon ownership of assets rather than futures based contracts to take delivery of those assets.

JJ: OK, you've got some oil, and I want to buy some, but we've never met each other or traded before, so give me an example of how this hypothetical exchange would work.

CC: There would be a simple market mechanism, perhaps a daily auction, or if there were not enough market participants to justify an auction, then some sort of price-setting mechanism, based on a benchmark set in the Persian Gulf. The producers would then have to make available quantities of oil to go into the open market. You see one of the issues has been, in particular the Saudis and the Iranians, have entered into long-term contracts on the basis in that it cannot go anywhere other than to the buyer, if you cannot take oil and sell it on if you don't need then you are not going to have a liquid market.

We need to look at having a pool of oil, or other petroleum products, available for trading. It is the existence of that pool which forms the heart of our architecture for the contract design. It's simple but it hasn't been done before.

JJ: How would I be guaranteed that if I bought 10,000 barrels of oil, it would be delivered? Or that I would actually pay you?

CC: That would be bringing in a Clearing Function - to guarantee the integrity of contracts. That function is built into the architecture which we are proposing. It won't be as now, it will be a simpler function than the one we have now.

JJ: Do you expect the volume of trading will be lower than in NYMEX or IPE?

CC: Very much so, because the intermediaries will take very much less money out, their fees will be a fraction of what they currently earn. The costs will be a fraction of what they currently are.

JJ: Costs significantly lower....

CC: And also we believe it will be possible to exclude the speculators from the market-making function. The only people who will participate in the auction which sets the benchmark price will be people who produce oil and people who consume it. Speculators would not participate in that process necessarily, although they would be able to participate in a secondary market, based upon that. This is again an innovation.

It is the participation of the intermediaries in the market today which is the tail wagging the dog.

JJ: How would you exclude speculators? This is a club - you can't come in?

CC: That is exactly how we would do it. You form a club which has different categories of member. This is at the heart of the proposal, to form an oil market trade association, whose members exclusively can enter into legally binding contracts. You can have different types of members, producer members, consumer members, and trade members. You will specify in the rules who can do what. It's not difficult.

Call it a Market User Group - as good a phrase as any.

JJ: I'd like to ask you a few more general questions. What do you think will happen if there is a reduction in petrodollars flowing back to the USA and supporting its deficit?

(Long pause)

CC: I think there are a lot of misconceptions about this. The energy component of global trade is a small fraction, by comparison with the flows of trade dollars between the USA, China and the far east for manufactured goods, so I really don't think the energy dollars are as material maybe as some people think, compared to what could happen if the Chinese, for example, decided to do something else with the dollars they get for selling their produce. My first point is Energy dollars are a small, but growing part of global trade. Second is it is not so much the currency you are selling, but what you do with the proceeds

During the first oil shock the Saudis and others who benefitted did invest their petrodollars in the States, in US assets. Now many many people, the Russians particularly, the Norwegians are talking about a euro-denominated oil bourse, are beginning to question whether they want to put their assets into a dollar-denominated debt or dollar-denominated assets. Let's face is the Americans are reluctant to let foreigners buy key US assets anyway. There aren't very many places you can invest in the US other than T-Bills.

That is definitely being questioned.

JJ: Javad Yarjani in April 2002, Head of Opec's Petroleum Marketing dept seemed in favour of a dual pricing strategy - the dollar and the euro. Are other people in OPEC supporting this?

CC: Opec have been discussing this for some considerable time but it is only the more radical members of Opec that are particularly keen on it, though that constituency is growing. For so long as the Gulf Co-operation Council members continue to peg their currencies to the dollar this is not going to change. But having said that a very large proportion of oil being produced comes from countries like Norway, Russia and Iran, so if they were to say they were going to go to the Euro then you would have a dichotomy.

Not that I think the Euro is practicable, but that's another question.

JJ: What do you think of Russia's plans for the petro-rouble? Do you think that the Russian Trading System's plans for a Urals-based oil marker are practicable?

CC: If we could just look at the Euro first - there aren't enough Euros to go around to even begin to cope with demand that would be needed if we were to start pricing in euros, and I don't think the European Central Bank would start printing those quantities, that would be almost a declaration of war by the ECB on the US. I don't see that as a practicable proposition. Other currencies I see as pretty peripheral.

I don't see any other currency other than the dollar being fit for purpose.

Having said that I think it is possible to set up a new system, I call it an Energy Clearing Union. It's not that dissimilar to a proposal the Keynes came up with at Bretton Woods: an international clearing exchange with its own currency unit, though not based on any particular commodity.

JJ: Wasn't it called the Bancor?

CC: That's exactly what he called it. I would go along with that analysis. What is needed is an energy clearing union, with a petrodollar which consists of a dollar's worth of energy, in whatever form, at the launch date. In the same way that the Euro had a launch date, when the rates were set against other currencies, so you would take a petrodollar - a US Dollar, and set it against various energy manifestations, whether it is kilowatt hours, or barrels of oil, or whatever.

And from that point on you have something that is exchangable against all other currencies, which would vary against it, that would give you the basis for a rational clearing system, I think that is an eminently practal proposition albeit one that would take a lot of work to put in place. I do not see any currency being able to compete with the dollar.

No currency issued by a central bank, if I can put it like that.

What I am proposing is a currency based upon an asset, as opposed to a claim over an asset issued by a central bank. So it's asset based, rather than deficit based.

JJ: This brings us on to your very interesting talk at Peak Speak 2 - Limited Liability Partnerships, and the Clearing Union. They both stem from the same basis, don't they?

CC: They're very much linked.

JJ: I'm still not sure I understand the Limited Liability Partnership concept- would you mind going over it again for me please?

CC: Of course. There are many ways in which individuals can bind themselves legally together in an enterprise. One of these is a partnership, where the individuals in the partnership share the risk and share the reward; the problem with that is that if one partner goes bankrupt he will bankrupt the other partners too. While most of the big professional firms were partnerships, they began to get worried about their exposure in an increasingly litigious society. So the big partnerships - lawyers, and particularly accountants, got worried about their exposure as individauls to massive claims, so they lobbied [UK] government for many years to limit their liability. And the [UK] government said: No you can get professional indemnity insurance instead. So to get around this what two of the big boys did was to pay 1 million pounds to get an Act of the Jersey Parliament [Jersey is one of the Channel Islands, and which enjoys a number of legal differences from the UK, which is why it used to be a tax haven [http://en.wikipedia.org/wiki/Jersey].

Which is the Best Parliament Money Can Lobby....

[laughter]

I didn't say Buy...

They got themselves a Jersey Limited Liability Partnership as it is called. This worried the UK government and it was [Michael] Heseltine [Conservative Minister] who said something must be done. There was the fear that big partnerships would go offshore, taking their business with them. Eventually something was done and on 6th April 2001 we got a new entity, called a Limited Liability Partnership.

Now the first thing you have to understand is that legally, it is not a Partnership

JJ: That's a bad name: it should be called Limited Liability Organisation, or something like that.

CC: Maybe it's not even an organisation. It is a corporate body which has a legal existence independent from its members. So a corporate body, like a company, can own property, can enter into contracts with people, and the members cannot lose more than they put in. So an LLP is almost identical to a company, it can do anything a company can do, but apart from that, it is a blank sheet of paper.

With an LLP you don't have Articles of Association, Memorandum of Incorporation, any nonsense like that. Literally, you don't even need a written agreement, though I don't recommend that.

JJ: I can see how much more flexible it is than a company.

CC: It is infinitely more flexible. It is essentially a new legal tool, a legal wrapper, you can wrap around assets and revenues of all types anywhere in the world. As far as the taxman is concerned it is tax transparent.

An LLP pays no tax but it's members do on the revenues or gains that flow through it. It is a partnership as far as the taxman is concerned.

[Arcane discussion of British tax law excised]

The most radical thing about it, whereas a partnership has a "joint and several liability" - so you are responsible collectively and individually, which puts a lot of people off, an LLP on the other hand has a collective responsibility but not an individual one. This is the first example anywhere of what I call an "Open Corporate". With collective, but not individual liability.

We can take this legal wrapper and use it in entirely new ways. Instead of borrowing to do things, we can bring in stakeholder-investors instead.

A case in point - sticking to the energy field - a wind turbine creates an energy flow over a period, say 20 years. We can look upon that flow, as a collective pool of production: 20 times 5 thousand megawatt-hours over a 20 year period. If we take that pool of production and we find investors on the basis we will sell to you a proportion 10%, 20% 30% of the production of this turbine in the next 20 years and we will sell you that at todays price. It is my experience in working up examples that if you sell 30% of the production you have funded the turbine, and 70% stays with the developer or the community, and it is my belief that the lion's share should remain with the community, unfortunately today it is the other way round.

JJ: But there would be no reason stopping a community, say in the Outer Hebrides with plenty of wind, getting together and forming one of these LLPs and saying: invest in us.

CC: Absolutely, and it means all the stakeholders interests are aligned. It means that the developer-partner has every interest in putting in the best quality turbine and doing the best possible work because that will maximise his return for his x percent of the production - everybody's interests are aligned - it truly is a partnership.

Just to return to the Oil Bourse for a moment, the concept would be to take this pool, to legislate for an open corporate, an LLP in Iran, or use an overseas one if they were reluctant. And create an oil pool in just this way. Who thinks oil is going to go down in the future? [Rhetorical question] We believe this would be an interesting asset-class for many investors to hedge against price-inflation in energy.

The beauty, you see, for renewables, is you are selling future production forward. Uniquely, renewables' raw material is free. That is not the case for other energies, even for nuclear. Uranium is cheap, but it is not going to get cheaper in future. You also don't know what the cost of decommissioning will be.

That is not the case with a wind turbine. It it not too difficult to build into the equation the cost of taking it down.

There are other asset-based techniques out there, a limited company for example, but a deeply defective one because all the benefits go to the shareholders, and other stakeholders get very little.

[Discusses the flaws of Trusts in Canada] This Community Energy Partnership as I call it, makes it more economic to develop renewable energy than any other class.

JJ: This is absolutely fascinating. Have any of these Energy Partnerships actually taken off?

CC: I am working on three different prototypes, and they all take time. One involves a biomass plant, one a micro-hydro plant in Norway, and the other one a tidal scheme. None of them are really past the planning phase yet, although one of them now has funding, from conventional debt-finance from Triodos Bank [a environmental/ethical bank].

This could also be a mechanism for refinancing an existing asset, go to any existing community windfarm, and say you are paying way over the odds because you borrowed from ABC.

It is a tool that Hilton Hotels used for a 350 million pound deal in the property field. The use of the LLP for capital partnerships has been done. I'm interested in working with potential users to put in place more. It's so simple and so obvious you can't believe it's never been done.

JJ: I think the concerns of investors would be: can we see a wind turbine LLP in operation.

CC: No, you can't see a wind turbine in an LLP wrapper yet, as far as I know. Somebody's got to be first.

JJ: How would an investor get his profits out?

CC: You can only do that if another investor buys you out [I think he means buys out your share of the LLP] . Or if you have bought 20 years worth of energy at todays price, if you were part of the local community, you might want to consume it.

We may see local councils injecting equity into these sort of schemes, because it is a very good way of locking in a price for energy and hedging their energy costs for many years to come. We do see stakeholders - users of energy - as being one of the key participants, and speculators being one of the lesser, though it doesn't stop people buying into it for speculative purposes. At any time you can sell on these rights, just like buying and selling shares on the stock market. If you can find a buyer there's no reason why you shouldn't. Whoever buys it can either use it [the energy] or sell it on. There is always going to be a market for consumption of energy.

[Chris speculates that LLP's become so successful that energy prices fall as there is a glut of energy on the market. This was tongue-in-cheek]

JJ: Looking at this type of project, is there any potential downside? Fraud? Anything like that?

CC: There is always the potential for fraud, someone could take the money and not build the asset, but you have that whatever legal form you use. You need to put in professional safeguards, there are certain risk of human nature that never go away, but I believe that using this model minimises the risk that will happen, because often bad behaviour happens because people feel that the existing system is unfair and they try to take advantage.

Whereas with this, I think people would not enter into it unless they felt it was fair in the first instance. Unlike the present system, where people compete, it is in people's interests to co-operate [in an LLP]. In a collaborative situation like this it will be more profitable for people to co-operate than not to.

Which is a profoundly optimistic note on which to draw to the end.

[We veer back to the IOB]

CC: The internet is about disintermediation, what I call the "napsterisation" of markets is the process that's going on. It is a napsterised peer-to-peer market network which is at the heart of the Iranian project.

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Chris Cook's Open Capital website: http://www.opencapital.net