

MUSINGS FROM THE OIL PATCH

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Note: *Musings from the Oil Patch* reflects an eclectic collection of stories and analyses dealing with issues and developments within the energy industry that I feel have potentially significant implications for executives operating oilfield service companies. The newsletter currently anticipates a semi-monthly publishing schedule, but periodically the event and news flow may dictate a more frequent schedule. As always, I welcome your comments and observations. Allen Brooks

Cape Wind Dealt Devastating Blow; Is Cape Cod Next?

Cape Wind may become the fish yanked out of the water and left to die

The politics of energy continues to confound logic. The Cape Wind project to construct this country's first offshore wind farm in Nantucket Sound between Cape Cod and Nantucket Island is being challenged again to perform a Houdini-like escape from the clutches of politicians and wealthy industrialists determined to keep their vistas pristine clear, even if it means harming the long-term economic health of the region. This time, though, it looks like Cape Wind may become the fish yanked out of the water and left to die on the shore.

We have written previously about the efforts of Representative Don Young (R-Alaska), chairman of the House Transportation Committee, to attach an amendment to the Coast Guard spending authorization bill that would ban all offshore wind farms within one and one-half miles of navigation or shipping lanes. Since Cape Wind is about one and one-third miles from the ferry routes between the Cape and Nantucket and Martha's Vineyard, the legislation would kill the project. However, the conference committee couldn't agree on the language of the amendment as it appeared to kill all potential offshore wind farm projects. Rep. Young's amendment was never passed.

The new measure would authorize either the governor of Massachusetts to reject a wind energy facility in Nantucket Sound for any reason

To break the legislative impasse, a new, more narrowly targeted measure was proposed by Senator Ted Stevens (R-Alaska), after he was called upon by Cape Wind-opponent Massachusetts Senator Ted Kennedy. The new measure would authorize either the governor of Massachusetts, or his successor, to reject a wind energy facility in Nantucket Sound for any reason, or the Coast Guard commandant to reject it if he deems it a hazard to navigation. The language is aimed directly at the Cape Wind project, and it hands the veto power to Massachusetts Governor Mitt Romney who is a

long standing opponent of the plan. The Coast Guard already has approved the Cape Wind project.

Exhibit 1. Cape Wind Farm to be Located in Nantucket Sound



Source: CIA

This new legislation, which was initially deadlocked 3-3 in the Senate conference committee, with an additional undecided vote, was passed when U.S. Senator Gordon H. Smith, Republican from Oregon, switched his vote giving majority backing to the legislation. The four in favor of the legislation include Smith, Stevens, Daniel Inouye, Democratic Senator from Hawaii and Trent Lott, Republican Senator from Mississippi. The opposition included Maine Senator Olympia Snowe (R-Maine) and Frank Lautenberg (D-New Jersey). Democratic Senator Maria Cantwell from Washington had thought she was the swing vote in the committee until Smith changed his vote. Cantwell has asked the chairman and the ranking Democrat on the Senate Energy & Natural Resources Committee, Pete Domenici (R-New Mexico) and Jeff Bingaman (D-New Mexico), respectively, to hold Senate hearings "on the federal role in siting

The amendment hands veto power over an energy project located in federal waters to a state governor

offshore alternative energy projects.” Domenici previously had sharply criticized the legislation as contradicting Congress’ commitment to producing more renewable energy.

Besides effectively killing the Cape Wind project, assuming the amended Coast Guard bill survives ratification by both the full House and Senate and is signed into law, it hands veto power over an energy project located in federal waters to a state governor. Is this the start of a precedent for fighting energy infrastructure projects? Usually all energy developments in federal waters are under the control of the Department of the Interior’s MMS. Sometimes Congress will become involved and instruct the MMS about an action it desires.

The Cape Wind project has survived five years of public and regulatory scrutiny

Barring a battle in the Senate or House, or both, over the compromise legislation, or President Bush vetoing the bill, it looks like the Cape Wind project may be dead. This is very unfortunate since the project has survived five years of public and regulatory scrutiny at a cost of \$20 million. In Massachusetts, the project’s backers had passed muster with the state’s Energy Facilities Siting Board to win approval for the wind farm’s cables in state waters. This board was established years ago and included officials from state agencies involved in energy issues. But to keep politics out of such controversial decisions as much as possible, the siting process does not allow for a gubernatorial veto. In Massachusetts, the latest poll showed support for the project by a 6 to 1 majority.

Quite possibly there have been violations of the federal lobbying laws

If the project were to be built, under normal winds, its 130 wind turbines, covering a 24-square mile area, would have produced about three-quarters of the power used by Cape Cod and the islands of Nantucket and Martha’s Vineyard at a very low cost. Today, this power is supplied by conventionally fueled power plants. This aspect of the project appears to have been ignored by opponents who largely represent wealthy family and friends with homes on the coast of Cape Cod or on Nantucket Island. The opposition included the coal and oil magnate Bill Koch. Investigative reporting by reporters for *CapeCodToday.com* appears to have uncovered questionable lobbying expenditures involving his opposition to Cape Wind. Quite possibly there have been violations of the federal lobbying laws, but only time will tell if that becomes an issue.

What was most interesting in following the Cape Wind story was a story written by Walter Brooks (no relation) of *CapeCodToday.com* about the onset of a recession on the Cape. The story was a part of the Cape Wind controversy because it addressed the issue of cheap electricity that would flow from the wind farm, which is being fought by the wealthy obstructionists, and the economic fallout from currently high energy prices.

One evening in March, Brooks noticed that there were only two other tables of diners besides himself in a large, very popular Hyannis (Cape Cod) restaurant. He commented that he had started to notice this phenomenon in other places where people spend their

This smelled like the start of a recession

discretionary income. The lack of customer activity was so pervasive that he decided to look into it, and when it started.

Brooks' research showed that the decline in this discretionary spending had begun at the start of the new year. It seemed to coincide with the arrival of electric bills for the 184,000 Cape Light Compact member/clients, which were 81% higher than the previous bill. Cape businesses experienced 88% increases. Homeowners who heat with natural gas and oil were also experiencing huge fuel bill increases, and gasoline prices had climbed by 33¢ a gallon at the pump compared to a year ago. To Brooks, this smelled like the start of a recession.

The hike in electricity rates is costing Cape Codders about \$15 million more a month

On March 8, Brooks noted two stories juxtaposed on the front page of his local paper. One discussed the local political opposition to the proposal by Rep. Young to prohibit any wind farms within 1.5 miles of shipping lanes. The other covered a plan to pump more electricity into the New England power grid at a cost to rate-payers of \$5 billion. While the two story writers didn't see any connection between the stories, Brooks did.

Based on his estimates and guesses, Brooks believes the hike in electricity rates is costing Cape Codders about \$15 million more a month. Commercial electricity costs are up by roughly \$2 million per month. His estimate of the impact of higher home heating costs is \$20 million per month and higher gasoline pump prices is costing an additional \$15 million per month. These costs total \$52 million per month, or about \$624 million a year.

Last year, Cape Codders spent about 10% of their \$10 billion of income on energy. Given his estimate of cost increases, residents will shell out about 15% of their income for energy this year. Brooks is not sure where that half billion of costs will come from, but he suspects it will mean less discretionary income. He wonders what people on fixed income, or those slightly above the poverty level, will need to give up in order to pay their energy bill. For Brooks, the problem is that wealthy, influential property owners on Cape Cod and Nantucket are blocking an environmentally friendly energy project at potentially horrific economic costs for everyone else. Talk about selfishness!

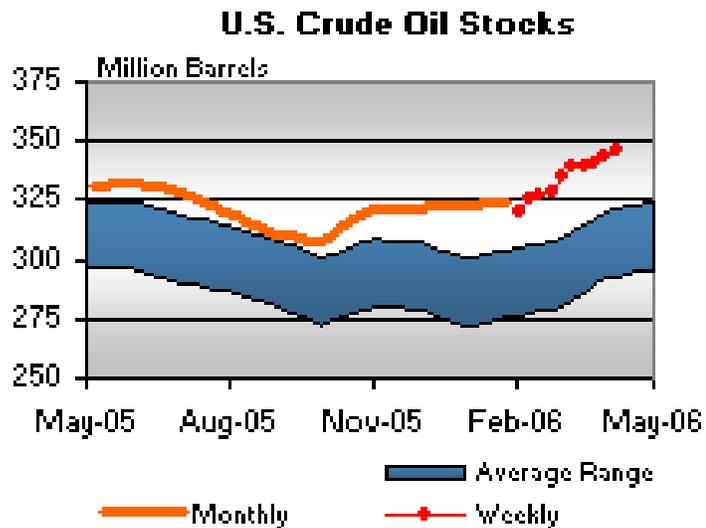
Shifting Oil Market Trends

Crude oil inventories are the greatest they have been since the week ending May 29, 1998, some eight years ago

Last week's data on crude oil and petroleum product inventories sparked an interesting debate. Crude oil inventories rose by 3.2 million barrels to 346.0 million barrels, well above the upper end of the average range for this time of year. Moreover, crude oil inventories are the greatest they have been since the week ending May 29, 1998, some eight years ago. During that week, crude oil prices averaged \$14.99, ranging between \$14.88 and \$15.21. Last Thursday, spot crude oil prices closed the week at \$69.35, down 0.25 from the seven-month high of \$69.60 reached earlier in the

week. The over \$54 per barrel increase in price over the past eight years, given similar levels of crude oil inventories, reflects the widely different perception of oil markets between then and now.

Exhibit 2. Crude Oil Stocks Are Well Above the 5-Year Average



Source: EIA

In May 1998, the world was confronting the implosion of Asian oil demand due to the regional currency crisis in the fall of 1997

In May 1998, the world was confronting the implosion of Asian oil demand as a result of the economic convulsions due to the regional currency crisis in the fall of 1997 caused by the devaluation of the Thai Bhatt. At about that same time in 1997, OPEC increased its crude oil production trying to head off what it perceived as sharply escalating oil demand that had triggered a jump in oil prices from the high teens to as much as \$22 per barrel by October. The growing Asian economic problems resulting in lower oil demand in the region, combined with increasing OPEC supplies, contributed to the build in U.S. and global crude oil inventories.

Today's oil market outlook is quite different. Global oil demand has been rising, driven by escalating Chinese and Indian demand. Projections call for demand in these two countries to continue to rise because of their developing economies. Moreover, there continues to be a string of crude oil supply disruptions – Iraq, Nigeria, Venezuela, and the Gulf of Mexico – and fear that these disruptions will continue and possibly become either more frequent or larger. Fear has become the overriding emotion impacting the crude oil market.

Speculative investment funds are piling into the crude oil futures market attempting to capitalize on the rise in oil prices

Besides the fear of rapid oil demand growth and continued oil supply disruptions, speculative investment funds are piling into the crude oil futures market attempting to capitalize on the rise in oil prices. Additionally, there is a growing fear that we are at, or have passed, the peak in global oil production that will force economic and life-style changes on the western world. There is a growing fear that

We expect world oil prices to sustain the risk premium already present in the oil price – an amount that is unknown and maybe unknowable

inflation will ravage financial holdings causing investors to seek commodities, such as crude oil, as a haven for protection. Until some of these fears are arrested, we should expect world oil prices to sustain the risk premium already present in the oil price – an amount that is unknown and maybe unknowable. If adverse demand or supply events occur, the risk premium could expand. In any case, it is not likely to shrink much in the near future. How large the premium is will only be known after the price has collapsed.

The logistics of moving crude oil and refined petroleum products to market is becoming a great challenge

There are other factors that are impacting the crude oil and petroleum market that may influence the future market price. First is the peak oil debate. As this subject has moved from an arcane academic discussion to center stage, people have begun to focus on the potential impact on their lifestyles. There has yet to be any concrete estimates of how the global economy will be impacted by peak oil. Add to peak oil, the issue of global warming, and you have a growing anxiety about consuming hydrocarbons among many people. In the mean time, we continue to consume energy at a healthy rate that is contributing to other challenges.

The logistics of moving crude oil and refined petroleum products to market is becoming a great challenge. The United States is short of adequate refining capacity relative to its petroleum consumption level. One of the ways we address that imbalance is through shipping refined petroleum products into the U.S. This requires that we utilize “clean” tankers rather than “dirty” tankers. Dirty tankers carry loads of crude oil and residual fuels, while clean tankers carry lighter products such as gasoline, diesel, No. 2 heating oil and jet fuel. Light products cannot be carried in dirty tankers because they will become contaminated and no longer meet product specifications. Since crude oil goes to refineries, it is off-loaded at fewer U.S. ports that are designed to handle larger vessels. Light petroleum products usually travel in smaller tankers because they are delivered to a much greater number of ports, most of which cannot handle large tankers.

Today, cleaning a dirty tanker for clean cargoes takes about two weeks

Prior to the tightening of pollution controls concerning the dumping of bilge water used in cleaning, it was easier for tankers to switch from dirty to clean service. Originally, oil tankers used high pressure jets of hot sea water to clean oil residue from the storage tanks, which was then dumped overboard. Over time, environmental regulations have been tightened to where tankers are not allowed to discharge any oil-contaminated water into the ocean. Today, cleaning a dirty tanker for clean cargoes takes about two weeks, using streams of crude oil to remove the sludge and residue in the storage tanks, which then must be piped out.

Softening demand in Europe and cheap freight rates have opened up a trans-Atlantic arbitrage in gasoline

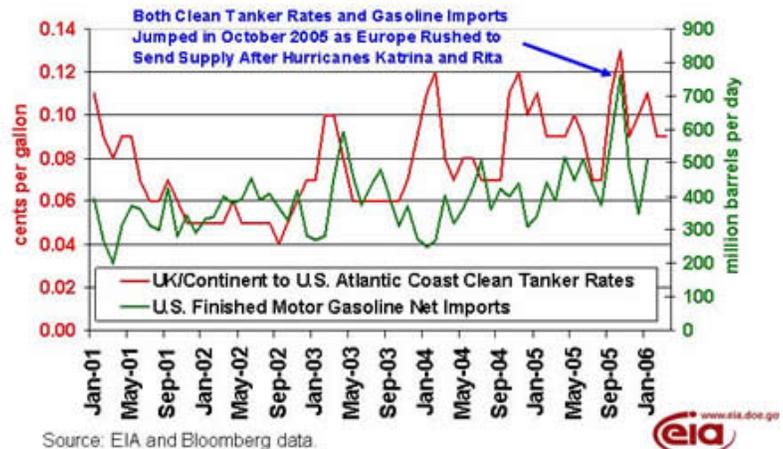
Unusually high refinery maintenance in the U.S. and Asia-Pacific this spring has pushed down freight rates to the lowest level yet this year. Softening demand in Europe and cheap freight rates have opened up a trans-Atlantic arbitrage in gasoline. If this price differential holds, gasoline imports will continue to come from Europe through the summer. Import rates and tanker rates display

Should imports of both crude oil and light products increase this summer, the increased demand for tankers could raise freight rates

an inverse relationship. Tanker tracking indicators point to the possibility that crude oil imports to the U.S. could begin to increase sometime in April. Should imports of both crude oil and light products increase this summer, the increased demand for tankers could raise freight rates.

Exhibit 3. Clean Tanker Rates and Gasoline Imports

Tanker Rates and Imports Usually Exhibit an Inverse Relationship



Source: EIA and Bloomberg data.

Source: EIA

Clarkson's Research Services said that tanker rates will decline in 2006

On a contrary note, Clarkson's Research Services Managing Director Martin Stopford recently said that tanker rates will decline in 2006 as owners take delivery of ships they began building in the prior couple of years. He forecasts a 6% expansion in tanker supply over the next three years. However, the oil trade is set to grow by only 1.5 million b/d until 2010, or about 500,000 b/d less than required to meet the fleet additions. This view was seconded in a forecast by RS Platou Director Erik Anderson. He said that additional oil production and refining capacity would grow by 2-4%, while the tanker fleet would expand by 5-6%, resulting in a decline in tanker rates in 2006-07.

There is the potential for the clean tanker market to be stronger than the overall market

While it is highly likely that tanker freight rates will be lower in 2006 than last year, there is the potential for the clean tanker market to be stronger than the overall market. This would be a reflection of the structural challenges the global petroleum market is facing after about a 20-year period of under-investment in the business. There are announced plans for expansions of several U.S. refineries, but the one proposed new refinery, should it get the go ahead, would not impact the market until 2010 or later. These expansions will have no impact on the tanker market in 2006. What may help tanker demand will be the return to service of hurricane-damaged refineries along the Gulf Coast. In the mean time, the U.S. will continue to import

more light products that will boost demand for clean tankers that should push freight rates higher.

First Road Maps, Now Cartels Are OPEC's Problem

Western consuming countries have much better (accurate) data about their energy consumption trends than did the producing countries

Several months ago, Saudi Arabia's oil minister, Ali Naimi, said at an OPEC gathering that the cartel needed a road map for future oil demand in order to justify the pace of its investment in new oil production capacity. That requirement was challenged by Claude Mandil, the head of the International Energy Agency (IEA), during the recent Petrostrategies annual oil summit in Paris. Mr. Mandil pointed out that the western consuming countries have much better (accurate) data about their energy consumption trends than did the producing countries. Thus, he concluded that the gist of the road map was already available for the producing countries to see and evaluate.

The UAE is uncertain of the cost to raise its crude oil production to 3.5 million barrels per day (b/d) from 2.5 million b/d by 2010

So with little help from the IEA and its oil-consuming members, OPEC oil ministers, attending the summit, focused instead on the problem of cost inflation impacting their capacity addition plans. According to media reports, a number of oil ministers talked about the problem of inflation in the oil patch. Qatari Oil Minister Abdullah al Attiyah said, "Our costs have tripled from two years ago, due to high (commodity) prices. And it's not just that, it is also contractors who have tripled their prices." His comments were echoed by United Arab Emirates Oil Minister Al Hamli. According to Hamli, due to higher commodity prices, the UAE is uncertain of the cost to raise its crude oil production to 3.5 million barrels per day (b/d) from 2.5 million b/d by 2010. OPEC's Secretary General even joked that OPEC had been criticized in the past for acting as a cartel, but in reality it was contractors who are acting that way and driving up costs.

So from a demand pull environment, we are seeing the first signs of a cost push scenario

The thrust of the oil ministers' message was that rising commodity prices and escalating contractor costs could imperil the much-needed investment required to boost OPEC production capacity. While the road map issue was an excuse for the slow pace of new investment in production capacity by OPEC members, the sharply higher commodity prices and contractor costs may be the excuse for OPEC to demand a higher oil price threshold for their target basket of crude oils. So from a demand pull environment, we are seeing the first signs of a cost push scenario. All this before we have truly seen the inflationary impact of high oil prices on the cost of goods and services in the major economies around the world.

Natural Gas Heating Season Ends With a Whimper

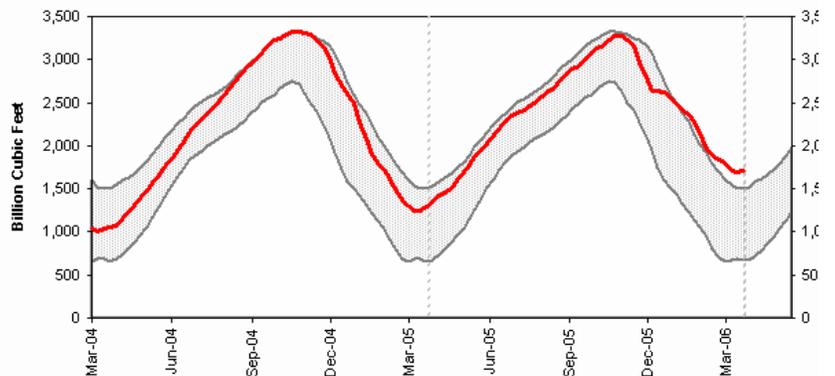
The Energy Information Agency (EIA) released natural gas storage data on April 6th that covered the week ending March 31, 2006. This is the effective end of the heating season and it saw gas storage volumes at 1.695 Trillion cubic feet (Tcf), some 447 Billion cubic feet

The gas industry now has the challenge of where to put all the gas that is likely to want, and need, to go into storage during the next few weeks

(Bcf) over last year and 654 Bcf, or 62.8% ahead of the five-year average. The March 31 week witnessed only a 10 Bcf storage withdrawal rate, substantially below the expectation of about a 19 Bcf withdrawal.

For the week ending April 7, reported on April 13, expectations initially were for an injection into storage of between 25 Bcf and 35 Bcf of gas. Those expectations were reduced to 20 Bcf to 30 Bcf two days before the release of the data. The actual result was an injection of 19 Bcf, which helped boost energy stocks early Thursday morning. The gas industry now has the challenge of where to put all the gas that is likely to want, and need, to go into storage during the next few weeks.

Exhibit 4. Natural Gas in Storage Exceeds 5-Year Average



Source: EIA

There are 393 subterranean reefs, aquifers and caverns in the United States used for storage with an estimated capacity of about 4 Tcf. The record high storage volume heading into winter was 3.327 Tcf in November 2004. If we assume the industry reaches this level again, that means about 1.632 Tcf of new storage gas will be needed. If, on the other hand, storage were to reach the theoretical maximum capacity, then 2.305 Tcf of gas could find its way back underground. Based on the required additions to reach the lower potential storage estimate, then about 54 Bcf of gas will need to be added each week. The higher capacity would allow the industry to inject about 77 Bcf of gas per week in storage.

Since the pre-Katrina shut-in on August 26, the cumulative lost-gas production totals 719 Bcf

The Minerals Management Service (MMS) estimates that the amount of shut-in natural gas production in the Gulf of Mexico due to hurricane damage has declined to 1.36 Bcf per day. Since the pre-Katrina shut-in on August 26, the cumulative lost-gas production totals 719 Bcf. Imagine the condition of the natural gas market today had this production been available this winter.

If we do not experience a seasonally warm, or “hot,” summer this year, triggering increased air conditioning load that would boost natural gas-fired electric power consumption, we can imagine a

If demand is insufficient for current consumption and desired storage injections, then the only alternative will be to shut in gas wells

scenario of gas volumes being shut in at the wellhead. Electric utility consumers of gas will be reluctant to pull gas from storage that was purchased at higher than current spot gas prices since they would be forced to recognize a loss on that gas. If demand is insufficient for current consumption and desired storage injections, then the only alternative will be to shut in gas wells. We are not sure either the commodity or stock markets are prepared for this potential since the conventional wisdom about the U.S. gas market is that every molecule that can be produced will be sold. Maybe global warming will help the gas market.

Another Forecast Calls for Less Severe Hurricane Season

The CSU 2006 forecast calls for 17 named storms, 9 hurricanes and 5 intense hurricanes, unchanged from their forecast issued in December 2005

The April 4, 2006, Colorado State University tropical storm forecast echoes all the other recently released forecasts that this hurricane season will be more active than the average 1950-2000 season, but it will not be as severe a season as last year. The CSU 2006 forecast calls for 17 named storms, 9 hurricanes and 5 intense hurricanes, unchanged from their forecast issued in December 2005.

The CSU forecast is based on a 4-5 parameter model. Based on their research, 50-60% of year-to-year and month-to-month hurricane variability can be explained by combining 4-5 semi-independent atmospheric-oceanic parameters together. They also want their model to show significant hindcast skill in application to long periods of prior data, which this model achieves.

The best analog years according to CSU are 1964, 1996, 1999 and 2003

The other consideration in preparing the forecast is to find analog years to the upcoming season the forecasters anticipate. They look for certain years in the historical record that have substantially similar global oceanic and atmospheric trends to 2006. They select among prior hurricane seasons since 1949. There are four hurricane seasons with characteristics similar to what were observed in February-March and what are projected for August-September. The best analog years according to CSU are 1964, 1996, 1999 and 2003. CSU believes that the 2006 hurricane activity will have slightly more activity than what was experienced in the average of these four years. They also believe 2006 will be a very active season in the Atlantic basin.

Exhibit 5. Analog Years for 2006 Hurricane Forecast

Year	Named Storms		Intense
	Storms	Hurricanes	Hurricanes
1964	12	6	5
1996	13	9	6
1999	12	8	5
2003	16	7	3
Mean	13.3	7.5	4.8
2006 Forecast	17	9	5

Source: Colorado State University, PPHB

They forecast major hurricane landfall along the entire U.S. coastline at 81%, against an average for the last century of 52%

The other forecast CSU participates in is calculating the probabilities for at least one major (Category 3-4-5) hurricane landfall on each of four coastal areas. They forecast major hurricane landfall along the entire U.S. coastline at 81%, against an average for the last century of 52%. For the U.S. East Coast including Peninsula Florida, the average is estimated at 64% compared to the long-term average of 31%. Along the Gulf Coast, from the Florida Panhandle to Brownsville, Texas, the estimate is 47% compared to the average of 30%. There is above-average major hurricane landfall risk in the Caribbean. One can go to <http://www.e-transit.org/hurricane> website to obtain the landfall probabilities for 11 U.S. coastal regions, 55 subregions and 205 coastal and near-coastal counties from Brownsville, Texas to Eastport, Maine. This is an interactive website.

The CSU forecasters have been investigating the potential predictability of steering current patterns likely to be present during the upcoming hurricane season could have on their landfall probabilities. They have found that by combining their Net Tropical Cyclone forecast and several April-May steering current predictors, they have improved their landfall probability scheme considerably. CSU plans to issue a revised forecast along with its documentation in its May 31 update. Improving the forecast of landfall probabilities in advance of the storms would be a major advance in the science and its applicability.

Sea temperatures have warmed by about 0.5°C over the past three decades, but that the global number of hurricanes and their intensity has not shown increases in recent years except for the Atlantic basin

Professor William Gray, the originator of the CSU hurricane forecast, has stepped back from his lead position to become a co-contributor so he can devote more time to improving the landfall probability work and examine the linkage of hurricanes and global warming. Gray does not believe in a linkage between global warming and increased hurricane activity. He points out that sea temperatures have warmed by about 0.5°C over the past three decades, but that the global number of hurricanes and their intensity has not shown increases in recent years except for the Atlantic basin. He further points out that there have been similar past periods (1940s-1950s) when the Atlantic was just as active as in recent years.

Southeast coastal residents probably do not know how fortunate they had been in the prior 38-year period of 1966-2003

In his discussion of the global warming issue, he makes two interesting points about the recent hurricane seasons. The first is that Southeast coastal residents probably do not know how fortunate they had been in the prior 38-year period of 1966-2003. During that time period, there were only 17 major hurricanes (0.45/year) that crossed the U.S. coastline. In the prior 40-year period of 1926-1965, there were 36 major hurricanes (0.90/year or twice as many) that made U.S. landfall. It is not surprising that coastal residents were not prepared for the huge upsurge in landfalling major hurricanes in 2004-2005.

Gray's second point is that it is rare to have two consecutive years with such a strong simultaneous combination of high amounts of major hurricane activity together with especially favorable steering flow currents. The historical record and the laws of statistics indicate

The historical record and the laws of statistics indicate that the probability of seeing another two consecutive hurricane seasons like 2004-2005 is very low

that the probability of seeing another two consecutive hurricane seasons like 2004-2005 is very low. Even though Gray expects the current active period of Atlantic major hurricane activity to continue for another 15-20 years, it is statistically unlikely that the coming 2006 and 2007 hurricane seasons, or the seasons that follow, will have the number of major hurricane U.S. landfall events as we saw in 2004-2005.

We are still not ruling out a huge storm hitting the East Coast that could cause significant damage and disrupt our energy markets

The media has seized upon the CSU and other hurricane forecasts that call for another very active season as a reason to be very worried this year. They have failed to focus on the mitigating key points made by highly experienced forecasters such as William Gray. No one knows what will happen this coming summer and fall, but we would be surprised if the U.S. experiences as many traumatic events as in 2005. However, we are still not ruling out a huge storm hitting the East Coast that could cause significant damage and disrupt our energy markets, which is a point both Gray and AccuWeather.com's Joe Bastardi have commented on.

Politicians Continue to Target Oil Industry

"Petroleum Industry Antitrust Act of 2006" would encourage greater scrutiny by the U.S. Justice Department and Federal Trade Commission of future oil and gas mergers

In early April, six U.S. Senators backed legislation that could spur increased federal scrutiny of future mergers between oil companies. They also want the ability for the United States government to possibly file a price-fixing lawsuit against the OPEC cartel. The proposed "Petroleum Industry Antitrust Act of 2006," sponsored by Sen. Arlen Specter (R-Pennsylvania) and Sen. Herb Kohl (D-Wisconsin), would encourage greater scrutiny by the U.S. Justice Department and Federal Trade Commission of future oil and gas mergers, and it would also allow the U.S. attorney general to sue oil producing cartels if they try to limit production or set prices. The problem with this legislation is in the details, much as it is for all legislation. In this case, it appears the details may get in the way of the intent and possibly create collateral damage to our economy.

Under present laws, a foreign government is protected from attacks under antitrust laws and other statutes

The problem areas lie with the effort to remove the prohibition against suing a sovereign government in U.S. courts. Under present laws, a foreign government is protected from attacks under antitrust laws and other statutes, although they can be sued in federal courts under very narrow and enumerated circumstances such as for having committed torture or having expropriated assets. Removing the protection for sovereign governments would make diplomatic issues into legal issues, something the U.S. government might rather not do.

The other detail problem is related to the increased merger scrutiny. The legislation would amend the Clayton Antitrust Act by adding a prohibition of oil and gas mergers that may "appreciably diminish competition." The current law allows the government to challenge any acquisition that may "substantially" lessen competition. The question would then become one of determining the difference in meaning (magnitude) between "substantially" and "appreciably."

Anyone have a Webster's Dictionary handy?

Additionally, there is a question of modifying the antitrust laws specifically for a single industry. It has been pointed out that in the 1950s the Clayton Act was modified in response to mergers among the steel industry companies, but the modification to the law was applicable to all companies in all industries. While we might think this is a problem, the recent proposal to modify generally accepted accounting principles for valuing inventories by the three largest U.S.-based oil companies as a way of extracting greater taxes from their huge stream of profits suggests that politicians care little about equity and more about political pandering.

Unfortunately, the U.S. controller general lacks the legal and economic talent to review oil and gas company mergers

The last issue with the increased merger review is that the Spector bill would add an additional government office to review oil mergers – the U.S. controller general. Unfortunately, this agency lacks the legal and economic talent to review oil and gas company mergers. That means the government would have to hire more lawyers and economists. Another full-employment act for professionals much as Sarbane-Oxley has become for auditors and accountants. All this new law would do is duplicate the staffing and review process that already exists within the Federal Trade Commission and the Department of Justice.

The first weekend in April reportedly brought some spot gasoline shortages in the Dallas, Texas area

So while the antitrust review effort cranks up, it seems the windfall profits tax movement has lost steam. But second quarter oil company earnings results due to be reported shortly will likely resurrect that movement, especially as gasoline pump prices continue to climb. The potential for spot gasoline shortages, as a result of the logistics of switching over to ethanol- rather than MTBE-based oxygenation agents to satisfy clean air emission restrictions, could further exacerbate consumer, and thus political, ire directed at the oil companies. The first weekend in April reportedly brought some spot gasoline shortages in the Dallas, Texas area. Given all these events, we doubt the energy business will escape the political spotlight anytime soon.

Energy News Bits You May Have Missed

IEA Says World Oil Demand Higher in 2004 and 2005

World Oil Demand Higher

The IEA, while cutting its global oil demand forecast for 2006 by 126,000 b/d to an increase of 1.47 million b/d, said that it has determined that oil demand growth in 2004 was 4% rather than the previously estimated 3.8%. It also said that 2005's growth was 1.3% rather than the previous 1.2% estimate. The IEA also said in its monthly energy report that "the negative effects of high oil prices are visible in most areas," principally the OECD where growth is now forecasted at well below 1%, and that there remains a "downside risk due to high prices" in their U.S. forecast.

For the first time in quite a while, the IEA is becoming more

concerned about demand growth in light of high oil prices.

Venezuela Warns About Additional Taxes on Oil Producers

Venezuela Warns About Taxes

Deputy Oil Minister Bernard Mommer told a reporter in London that Venezuela's promise to hold oil taxes on producers steady over the next five years were "not binding." According to Mommer, "The only guarantee you have is political. The government can promise you whatever they want – it's not binding."

Surprise! Surprise! The only real surprise is that a Venezuelan oil official is probably telling the truth. Do you think he will be working at that job much longer?

Russia to Export Less Oil than Expected

Russia to Export Less Oil

Claude Mandil, Executive Director of the IEA, said that Russia will be exporting less oil than previously expected over the next four years. The IEA's projections for Russian oil-supply growth were too optimistic, Mandil told the *Financial Times* in London. Mandil did not disclose the amount of reduction the IEA would factor into their future projections for Russian oil, but according to the *Financial Times*, other energy analysts have slashed their estimates by half.

We've previously speculated about Russia's ability to increase its oil production, but importantly, its economy is growing and consuming more oil, thereby restricting the volumes of oil available to be exported.

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