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## ***ENERGY RISK MANAGEMENT***

Howard Rennell, Pat Shigueta &  
Zachariah Yurch

**(212) 624-1132 (888) 885-6100**

**www.e-windham.com**

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### **ENERGY MARKET REPORT FOR JUNE 2, 2006**

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The permanent members of the UN Security Council and Germany on Friday were preparing to deliver a proposal to Iran, which included incentives to halt work that could produce nuclear weapons and threats of UN Security Council action if it refused. A European Union diplomat said EU

foreign policy chief Javier Solana was on standby to deliver the offer to Iran, pending the result of contacts with the country. The diplomat also stated that Russia and China could opt out but would not block UN sanctions that may be imposed on Iran if it refused to suspend its nuclear program. US Secretary of State Condoleezza Rice was holding out for the possibility that she would meet with Iranian officials if Iran halted its nuclear program and agreed to talks with major powers. She said Russia and China were in full support of the penalties if Iran did not halt its nuclear program. She also stated that Iran had weeks, not months to respond. The deadline is likely the Group of Eight foreign ministers meeting at the end of the month. Germany's Foreign Minister Frank-Walter Steinmeier said there were signs that the agreement reached on Iran's nuclear program would be successful. Meanwhile, China's Foreign Minister Li Zhaoxing spoke with his Iranian counterpart Manouchehr Motttahi, telling him that China supported all efforts to resolve the Iran nuclear issue through diplomatic negotiations. In response, Iran's President Mahmoud Ahmadinejad said that Iran would not abandon its right to peaceful nuclear energy despite pressure from UN Security Council members to abandon its nuclear program.

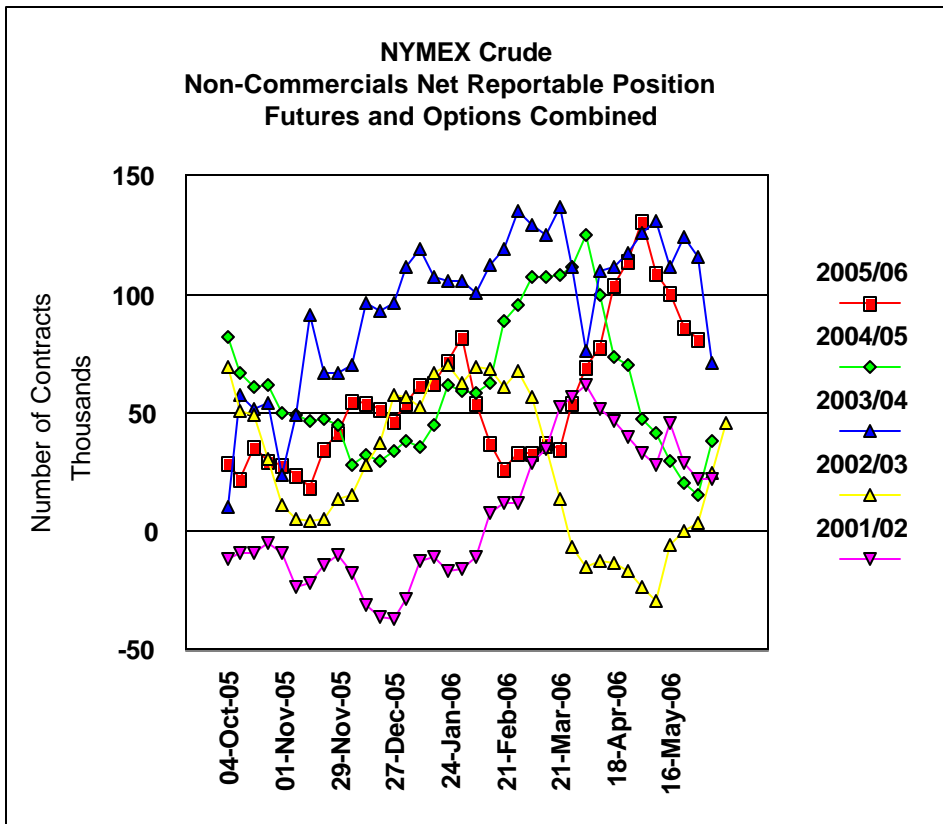
#### Market Watch

Iran's Oil Minister Kazem Vaziri Hamaneh said he expected Iran to modify in two to three months the buyback system that governs foreign energy companies operating in the country. The buyback system enables foreign companies to develop a project for a set time after which they are paid by the government in oil or revenues at market prices. However since its introduction, foreign companies have been critical of the restrictive terms the buyback system imposes, such as an inability to directly control project costs and the limited timeframe of contracts.

The US Coast Guard is urging a discussion on identifying small boats and restricting recreational vessel traffic around refineries in an effort to tighten security.

Separately, the Director of National Intelligence, John Negroponte, said Iran could have a nuclear bomb by 2010 and accused Iran of being the world's top state sponsor of terrorism. He said Iran seemed determined to develop nuclear weapons but admitted that there was no clear-cut knowledge. In regards to al-Qaeda, he said it was still the greatest security threat to the US although he claimed that Osama bin Laden was more circumscribed in his ability to act.

As expected, OPEC agreed on Thursday to leave its oil production unchanged near its full capacity, rejecting a suggested cut by Venezuela. Venezuela argued that world oil inventories were in surplus



and OPEC should consider reducing its output to prevent a fall in price. Venezuela has stated that OPEC should not let prices fall below \$50/barrel. OPEC delegates said Saudi Arabia and others would prefer a \$50-\$60 range. The biggest concern is that energy inflation could trigger a slowdown in world growth and cut oil demand. Saudi Arabia's Oil Minister Ali al-Naimi said rising interest rates would hurt demand for oil. OPEC is expected to meet in Vienna on September 11 and then in the Nigerian capital Abuja on December 14. Meanwhile, Venezuela's President Hugo Chavez accused the US of try to destroy OPEC, criticized the American way of life as a waste of energy

resources and hailed OPEC as a defender of the Third World against imperialism.

Eight foreign oil workers on an oil rig off the coast of Nigeria were abducted by gunmen. Security sources stated that 20 to 30 attackers boarded the Bulford Dolphin rig from four speed boats and abducted six workers from the UK, one from the US and one from Canada. It was not clear whether militant group, the Movement for the Emancipation of the Niger Delta was involved. Fred Olsen Energy, which owns the rig, said it had made contact with the abducted men. It also said the kidnappers were seeking negotiations but gave no details on their identity or demands.

DOE analysts said the weekly US data was likely overstating US oil demand due to the way it calculates the consumption of other oils, which account for about 25% of total demand. The DOE reported that implied demand over the last four weeks was about 960,000 bpd, up 4.8% on the year despite the higher oil prices. However half of the increase in implied demand was due to an increase in other oils being supplied to the market, while gasoline and distillate fuels posted more modest gains. The other oils category gets influenced by inventories and imports of unfinished oil and blending components from the weekly refinery report.

The chairman of the official Sunni Endowment in Southern Iraq said the proportion of Sunni Muslims in Basra has fallen from 40% to 15% following three years of forced immigration as militias targeted Sunnis. Security in Basra has deteriorated as Shia groups compete for further power in the newly formed government of Prime Minister Nuri al-Maliki. The ministry of immigration and deportees said 700 families were forced to leave Basra. Meanwhile authorities said the more than 100,000 people who fled sectarian violence are straining resources and heightening political, religious and ethnic tensions. US officials however dispute those numbers.

## Refinery News

Valero Energy Corp said it would increase its production at its 340,000 bpd Corpus Christi, Texas refinery to normal rates within 24 hours on Friday. The refinery cut its gasoline and diesel production on Thursday after an oil spill due to lightning, which ignited a fire. Repairs to the dock are expected to continue through next week. The ship channel remained closed.

Also, Valero Energy Corp said it cut its gasoline production by 50,000 bpd at its Port Arthur, Texas refinery. It reported that it started reactor repairs and catalyst reloading at a 51,000 bpd reformer unit at the plant on May 28. The work is expected to last about 10 more days. Separately, Valero Energy said a lightning strike on a transformer at its Delaware City, Delaware refinery would not have any impact on production. A lightning strike at the 180,000 bpd plant caused several units to shut or cut back due to a reduction of steam production and plant instruments.

Flint Hills Resources shut a sulfolane unit at its Corpus Christi, Texas refinery following the loss of steam supply.

Citgo is restarting a fluid catalytic cracking unit at its Corpus Christi, Texas refinery following the loss of steam from its third party supplier, Calpine.

According to the Texas Natural Resource Conservation Commission reported that ExxonMobil was restarting a sulfur conversion unit at its 563,000 bpd Baytown, Texas refinery on Friday following an overhaul.

Kinder Morgan said lightning struck a tank at an oil products terminal in Pasadena, Texas on Thursday, starting a fire that has since been extinguished. The tank was holding about 170,000 barrels of naphtha. There was no impact to supplies.

PDVSA said it was rescheduling planned maintenance on a catalytic cracking unit at its 130,000 bpd El Palito refinery until sometime after the US summer driving season. The maintenance would last about 40 days.

Saudi Aramco has sold 500,000 barrels of June loading feedstocks bound for the US.

China's main oil refineries are expected to process less crude in June from May due to routine maintenance works, keeping fuel supplies tight. While most plants are running at full capacity to take advantage of improving margins, the maintenance requirements would undercut overall production. The country's 12 major plants are expected to process 2.221 million bpd of crude in June, down 4.5% from May.

Japan's refinery maintenance season is set to cut 25% of the country's capacity at its peak in the second half of June. However Japanese refiners are unsure about gasoline import plans made earlier and are even contemplating exports. Japan's total gasoline inventory on May 27 stood at about 2.09 million kl or 13.14 million barrels, down 0.2% a week ago. The stocks were 9% lower on the year and 200,000 kl below the five year average.

### **Production News**

Shell Petroleum Development Co of Nigeria has sent a team of investigators to locate the site of an oil leak in its trunk line that has led to a shut in of 50,000 bpd. As a result of the spill, Shell shut down four of its flow stations in Nembe.

The Tanker Drivers Association of Nigeria are considering strike action if the government does not take measures to end pipeline vandalism. The association has given the government an ultimatum to

end pipeline vandalism by the end of June. It said pipeline vandalism posed a threat to the flow of refined products through the country's network of pipelines to loading depots.

According to a Reuters survey, a slow recovery from hurricane damage in the US and the effect on production from a severe winter in Russia has forced analysts to cut their forecasts for non-OPEC growth by 180,000 bpd since January. Non-OPEC suppliers, were expected to increase production by 1.12 million bpd in 2006 to 50.81 million bpd.

Venezuela plans to sign an agreement that would give India access to pump oil in the Orinoco oil belt and would also include an oil supply agreement with Indian refineries.

Russia's Energy Ministry reported that the country's oil production increased in May to 40.719 million tons or 9.63 million bpd, up from 9.6 million bpd in April. It also reported that Russia's oil exports via major ports by Transneft increased to 12.214 million tons or 2.89 million bpd.

OPEC's news agency reported that OPEC's basket of crudes fell further to \$64.84/barrel on Thursday to \$64.88/barrel on Wednesday.

### **Market Commentary**

The oil complex opened sharply higher in follow through gains seen in overnight trading. The markets were well supported following Thursday's reports of cuts in refinery operations in Corpus Christi, Texas due to heavy rains and lightning as well the problems in Nigeria, as eight foreign oil workers were abducted from an oil rig. This followed Thursday's report of a further production shut in by Shell Nigeria. The crude market opened up 81 cents at its low of 71.15. The market remained supported amid the news and traded to 72.00, where it held some resistance. However the market later breached that level and extended its gains to over \$2.30 as it rallied to a high of 72.70 ahead of the close. It settled up \$1.99 at 72.33. Volume in the crude market was lighter with 173,000 lots booked on the day. The gasoline market also opened up 2.28 cents at 215.00, its intraday low. It was well supported amid the refinery problems. The gasoline market rallied to a high of 221.00 late in the session. It retraced some of its gains and settled up 7.03 cents at 219.75. Meanwhile, the heating oil market opened up 2.93 cents at 200.00 and posted a low of 199.70 early in the session. The market however never looked back and remained well supported by the strength in the gasoline market. It rallied to a high of 203.50 ahead of the close. The market later retraced some of its gains and settled up 4.38 cents at 201.45. Volumes in the product markets were also light with 28,000 lots booked in the gasoline market and 34,000 lots booked in the heating oil market.

The latest Commitment of Traders report showed that non-commercials in the crude market cut their net long positions by 6,143 contracts to 48,457

<b>Technical Analysis</b>		
	<b>Levels</b>	<b>Explanation</b>
<b>CL</b> Resistance 72.33, up \$1.99 Support	72.75 to 72.95	Remaining gap (May 15th)
	72.70	Friday's high
	71.60, 71.15	Friday's low
<b>HO</b> Resistance 201.45, up 4.38 cents Support	70.05, 69.90, 69.80, 68.40	Previous lows
	204.70, 205.00 to 206.30	Previous high, Remaining gap(May 15th)
	203.50	Friday's high
<b>HU</b> Resistance 219.75, up 7.03 cents Support	200.75, 199.70	Friday's low
	195.00, 192.50 to 191.81	Previous low, Remaining gap (April 10th)
	221.40, 222.50, 223.00	Previous highs
	221.00	Friday's high
	218.50, 215.00	Friday's low
	210.88, 207.75, 206.25	38% and 50% retracement(194.50 and 221.00), Previous low

contracts in the week ending May 30<sup>th</sup>. The combined futures and option report also showed that non-commercials cut their net longs by 5,194 contracts to 81,149 contracts on the week. Meanwhile non-commercials in the product markets increased their net long positions. Non-commercials in the gasoline market increased their net long position by 4,730 to 13,379 contracts while non-commercials in the heating oil market increased their net long positions by 2,306 contracts to 6,248 contracts.

The oil market is seen remaining supported amid the refinery problems and continuing problems in Nigeria. The market will remain concerned about Iran's nuclear program after world powers agreed on a proposal aimed at halting Iran's nuclear program while Iranian officials continue to state that the country would continue with its uranium enrichment. The oil market is seen finding support at 71.60 and 71.15. More distant support is seen at 70.05, 69.90-69.80 and 68.40. Meanwhile, resistance is seen at 72.70 followed by its gap from 72.75 to 72.95.