



## ***ENERGY RISK MANAGEMENT***

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### **ENERGY MARKET REPORT FOR OCTOBER 3, 2006**

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The US said the international community would have to impose sanctions if Iran did not halt its uranium enrichment program. R. Nicholas Burns, undersecretary of state for political affairs said the UN Security Council would insist on a clear answer to its demand that Iran suspend its enrichment activity. He said that Secretary of State Condoleezza Rice and her five counterparts agreed on September 18 that the first week of October would be the deadline for Iran to agree to a halt in its nuclear program. The White House said US President George W. Bush and Russia's President Vladimir Putin agreed in a telephone conversation on Monday on the need for unity in pressuring Iran. The Secretary of Russia's Security Council, Igor Ivanov, said Russia believed a dispute over Iran's nuclear program should be resolved by negotiations. A senior British official said the six world powers were

#### **Market Watch**

According to a Bloomberg News survey, crude oil prices are expected to average \$58/barrel in 2006 and \$64/barrel in 2007, up \$2/barrel from a previous estimate at the end of the second quarter.

A Reuters survey showed that the US oil price is expected to average \$67.90/barrel in 2006 and fall to \$64.21/barrel in 2007. The deepest cut was by the Center for Global Studies while lowered its US oil price forecast for next year by more than \$10/barrel to \$54.50 even with an assumption that OPEC would cut its output by 1 million bpd.

Colorado State University's hurricane forecaster, William Gray, said the Atlantic hurricane season would produce just two more tropical storms and no more major hurricanes due to El Nino conditions in the Pacific. The season has seen nine tropical storms, of which five reached hurricane strength. He forecast that the season would produce a total of 11 tropical storms of which six would be hurricanes.

Citgo Petroleum Corp on Monday criticized calls for a boycott on gasoline following Venezuelan President Hugo Chavez's attacks on US President George W. Bush at the UN. Citgo said the calls run counter to the principles of a free market economy. It said the boycott campaign ignores the implications such action would have on American businesses and the American public.

The IntercontinentalExchange said volume and commissions reached record levels during September. Average daily volume for ICE futures totaled 447,795 contracts in September, up 135.6% on the year. It said average daily commissions in ICE's over the counter segment increased by 115.8% on the year to \$805,681.

The NYMEX announced that it would list two daily options on the spot crude oil futures and natural gas futures starting Monday, October 9. The crude daily options contract would be listed on the NYMEX Clearport clearing platform with crude oil as the underlying futures contract. The contract size would be 1,000 barrels and the underlying margin level set at \$3,000. For floor trades, in addition to the crude oil contract, the WTI bullet swap contract can also be traded in appropriate ratios with the options contract. The size of the natural gas daily options contract will be 10,000 million British thermal units and the underlying margin level set at \$8,000. The contract listings is set to begin with the November 2006 contract month and daily options contracts will be listed for only one day.

According to a report by the Information Resources Inc, which tracks shopping trends, US consumers spent an estimated \$535 more on gasoline in the past year.

preparing to draft UN sanctions against Iran given the failure of high level talks to yield a promise to halt its nuclear program. EU foreign policy chief Javier Solana warned Iran that talks could not go on forever. He said a telephone conversation on Monday with Iran's top nuclear negotiator Ali Larijani was constructive but produced no breakthrough in the standoff. UN diplomats later stated that the UN Security Council would begin focusing on sanctions against Iran next week. The diplomats spoke on condition of anonymity, citing an agreement not to publicly pronounce the talks dead before talks set for Wednesday between EU foreign policy chief Javier Solana and Iran's nuclear negotiator Ali Larijani. The foreign ministers of the five permanent Security Council members and Germany are scheduled to meet on Friday. The Security Council could meet as early as Monday to start work on a resolution. Meanwhile, a senior Iranian official said suspending its uranium enrichment would not solve the nuclear standoff. The deputy head of Iran's Atomic Energy Organization, Mohammad Saeedi, instead suggested that France could invest in Iran's nuclear industry, enabling it to supervise Iran's nuclear work. French Foreign Ministry spokesman Jean-Baptiste Mattei said he was surprised by the idea. He said any proposal should wait until after negotiations are under way and added that the current priority was talks between Iran's nuclear negotiator and the EU's foreign policy chief.

OPEC President Edmund Daukoru called on other OPEC members to join Nigeria in reducing oil production. Venezuela's Oil Minister Rafael Ramirez said the country proceeded with its output cut of 50,000 bpd on Sunday. Meanwhile, Algeria's Energy and Mines Minister Chakib Khelil said oil prices have fallen due to geopolitics. However he said prices would recover in the summer of 2007. Separately, Qatar's Oil Minister Abdullah al-Attiyah said that Qatar was watching the steep fall in oil prices. However he declined to comment on whether Qatar would cut its output.

A senior Iraqi oil official said Venezuela's announcement of a unilateral production cut to increase falling prices is impractical as prices are set to increase once the winter starts. Venezuela announced last week its plan to cut its output by 50,000 bpd starting October 1 while Nigeria is also expected to cut its output by 5% or 120,000 bpd. The Iraqi official said he did not expect Saudi Arabia to cut its output.

The Government Accountability Office said the US DOE's decision to fill the SPR to capacity from the end of 2001 to 2005 without regard to price may have cost an extra \$590 million than it would have had the agency employed a more cost sensitive method. Critics have stated that filling the SPR helped push prices higher because it took supply off the market. However experts convened by the GAO concluded that the price increases due to the government's decision to fill the SPR was minimal. The experts agreed that a dollar cost averaging method would have saved about \$590 million. The approach would involve the DOE acquiring a steady dollar value of oil per time period instead of a relatively steady volume. The GAO suggested that the DOE should consider allowing oil producers to delay scheduled deliveries to the SPR when supply and demand are in tight balance and request additional oil to pay for the privilege of delaying delivery. It recommended that the DOE conduct a new review to examine the maximum amount of heavy oil that should be held. It also recommended that the DOE periodically reassess the size of the SPR in light of changing oil supply and demand in the US and the world.

### **Refinery News**

According to a report filed with the Texas Commission on Environmental Quality, maintenance performed early Tuesday in complex 1 of the West Plant at Valero Energy Corp's Corpus Christi, Texas refinery caused emissions.

ConocoPhillips is expected to reduce operations at its 140,000 bpd fluid catalytic cracking unit late Tuesday at its 238,000 bpd Bayway, NJ refinery to facilitate three weeks of unplanned work on the unit's economizer.

Lyondell-Citgo reported a brief hydrodesulfurization unit compressor shutdown Monday at its 270,000 bpd Houston, Texas refinery.

A PDVSA official said its El Palito refinery was still suffering problems a month after a power outage forced the refinery to shut some units. He said the 54,000 bpd fluid catalytic cracking unit should resume full operations in about a week. Separately, PDVSA was performing maintenance on the fluid catalytic cracking unit at the Amuay refinery.

Japan's Cosmo Oil Co said the current operating rate at its Chiba refinery was about 90%. The refinery has been processing 220,000 bpd of oil as two of its secondary units are still shut. Its 80,000 bpd Sakai refinery has been processing crude at 60% of its capacity, as one of its secondary units has been shut for repair work. Its 120,000 bpd Sakaide refinery has also been operating at a lower rate of 100,000 bpd following the shutdown of a secondary unit. The unit is expected to restart on October 9 following the completion of an inspection.

Russia's Energy Ministry reported that Russian refineries processed 4.46 million bpd in August, down from 4.48 million bpd in July. It reported that fuel oil exports fell by 1.7% on the month to 3.124 million tons in August while gasoline exports fell by 34.6% to 449,000 tons. Its gas oil exports fell by 8.8% to 2.954 million tons.

Former Soviet Union gas oil exports from Black Sea and Baltic ports in September increased to 3.05 million tons from 2.94 million tons the previous month. Gas oil shipments from Black Sea ports increased by 57,000 tons to 1.16 million tons in September while shipments from the Baltic ports increased by 54,000 tons to 1.89 million tons.

Kazakhstan said it may start work next year on an extension of its oil export pipeline to China and plans to double the pipeline's annual capacity to 20 million tons or 400,000 bpd. The pipeline started supplying China in May with oil from the Kumkol oilfield in southern Kazakhstan and is fed by another link whose flow has been reversed to take deliveries of crude from Russia to the north.

France's Energy Ministry reported that the country's oil product consumption in August fell by 5.8% year on year to 7.6 million tons due to a fall in heating oil demand. Heating oil demand fell by 30% year on year to 1.01 million tons compared to an 8% fall in the last 12 months.

### **Production News**

Shell said about 25 Nigerians working for a contractor to Royal Dutch Shell were abducted during an attack on a convoy of boats supplying oilfields on Monday. It said at least 15 soldiers were killed when about 70 militants attacked the barges transporting fuel and other supplies to Shell facilities in the Cawthorne Channel. Shell said the attack did not affect production. Shell later reported that militants holding the workers hostages released nine of their captives on Tuesday.

ConocoPhillips said it expected third quarter oil and gas production to be down about 5% on the quarter due to problems at the Prudhoe Bay field. It also stated that planned seasonal maintenance at operations in Britain and Venezuela also impacted production.

According to a Reuters survey, OPEC's oil production fell by 380,000 bpd in September to 29.47 million bpd. Output from the OPEC-10 stood at 27.43 million bpd in September, down from 27.81 million bpd in August. Output is likely to continue to fall in October following the announcement that Nigeria and Venezuela would cut its production. Nigeria's output in September fell by 240,000 bpd

following a pipeline leak that disrupted exports from the Bonny oilfield. Saudi Arabia cut its output by 100,000 bpd in September to 9.1 million bpd.

PDVSA stated that Venezuela increased its production to 3.27 million bpd in 2005, up from 3.15 million bpd in 2004. Venezuela said its current output stood at 3.3 million bpd.

An official at the National Iranian Oil Co said oil exports in October are expected to fall on the month as bad weather may disrupt loadings at its main Gulf terminal. Iran's oil exports are expected to fall to 2.4 million bpd in October from 2.5 million bpd in September.

Japan's Trade Minister Akira Amari said negotiations on its contract to develop the Azadegan oilfield were entering the final stage. He said he expected talks to end within a month.

Japan's Arabian Oil Co said it would continue providing technical assistance to Iraq under a new agreement with the country's oil ministry. Under the agreement, Arabian Oil and Iraq would jointly set up a development plan for the Tuba oil field in southern Iraq. Arabian Oil would also help with the technology for upgrading heavy crude oil to produce lighter products.

Royal Dutch Shell, Mitsui & Co and Mitsubishi Corp are scheduled to meet this week to discuss how to respond to Russia after it ordered a halt to the Sakhalin-2 oil project due to environmental concerns.

Ecuador's central bank reported that the country exported 1.42 million barrels of crude in July, up 29% on the year. Its export revenue in July totaled \$68.95 million, up 68% on the year.

OPEC's news agency reported that OPEC's basket of crudes fell by 15 cents/barrel to \$57.23/barrel, down from Friday's revised level of \$57.38/barrel.

### **Market Commentary**

The oil market gapped lower from 60.90 to 59.70 as the market continued to dismiss reports that Nigeria and Venezuela cut their production starting October 1. The market continued its downward trend as the output cuts are expected to have little impact unless other OPEC members, such as Saudi Arabia followed suit. The market partially backfilled its gap as it posted a high of 60.10. However the market remained pressured and traded to 58.85, where it held some support before it settled in a sideways trading pattern. The market also remained pressured as talks between the EU and Iran are expected to continue after their talks on Monday failed to produce a breakthrough in the standoff over Iran's nuclear program. The market later breached its support and sold off to a low of 58.60 in a late

about of selling on the close. It settled down \$2.35 at 58.68. It is the lowest settlement since mid-February. Volume in the crude market was better with 168,000 lots

		Levels	Explanation
CL	<b>Resistance</b>	62.70	Previous high
	58.68, down \$2.35	59.45, 60.10 to 60.90	Remaining gap (October 3rd)
	<b>Support</b>	58.60	Tuesday's low
HO	<b>Resistance</b>	175.40	Previous high
	165.39, down 4.79 cents	166.00, 167.75 to 170.00	Remaining gap (October 3rd)
	<b>Support</b>	164.50	Tuesday's low
HU	<b>Resistance</b>	156.00	Previous high
	145.67, down 5.2 cents	147.25, 149.00 to 150.50	Remaining gap (October 3rd)
	<b>Support</b>	145.50	Tuesday's low
		144.80, 144.75, 143.40, 138.50	Previous lows

booked on the day. The gasoline market also gapped lower from 150.50 to 147.00 in follow through selling seen in overnight trading. The market partially backfilled its gap as it posted a high of 149.00. However it retraced its gains and sold off to a low of 145.50. The market later traded mostly sideways and settled down 5.2 cents at 145.67. Meanwhile, the heating oil market also settled down 4.79 cents at 165.39 after it gapped down from 170.00 to 166.50 on the opening. The market posted a high of 167.75 before it continued to sell off to a low of 164.50 ahead of the close. Volumes in the product markets remained light with 9,000 lots booked in the gasoline market and 37,000 lots booked in the heating oil market.

NYMEX Petroleum Options Most Active Strike for October 3, 2006									
Symbol	Month	Year	Call/Put	Strike	Exp Date	Settle	Prev Settle	Volume	IV
GO	12	6	P	2	11/27/2006	0.508	0.4615	300	46.45
GO	11	6	P	1.95	10/26/2006	0.4933	0.4414	200	59.68
GO	11	6	C	1.66	10/26/2006	0.007	0.012	100	39.99
GO	11	6	P	1.54	10/26/2006	0.1085	0.073	100	38.76
LO	12	6	P	55	11/14/2006	0.77	0.41	6,656	32.71
LO	6	7	P	60	05/17/2007	3.24	2.63	4,550	27.71
LO	11	6	P	55	10/17/2006	0.38	0.12	3,489	35.74
LO	12	6	P	58	11/14/2006	1.58	0.89	3,446	31.14
LO	1	7	P	50	12/14/2006	0.33	0.17	3,390	33.56
LO	11	6	P	57	10/17/2006	0.86	0.31	3,150	34.55
LO	12	6	C	63	11/14/2006	1.35	2.12	3,080	30.92
LO	12	6	C	80	11/14/2006	0.02	0.03	2,911	34.78
LO	12	6	P	62.5	11/14/2006	3.95	2.52	2,800	31.11
LO	1	7	P	55	12/14/2006	0.99	0.6	2,673	30.96
LO	11	6	P	56	10/17/2006	0.58	0.2	2,672	35.09
LO	1	7	P	58	12/14/2006	1.77	1.15	2,606	29.65
LO	1	7	C	85	12/14/2006	0.05	0.07	2,501	33.53
LO	12	6	P	50	11/14/2006	0.21	0.1	2,383	36.65
LO	12	6	C	65	11/14/2006	0.85	1.43	2,362	31.03
LO	12	6	P	51	11/14/2006	0.28	0.13	2,225	35.97
LO	6	7	P	72	05/17/2007	9.75	8.35	2,000	27.29
OB	4	7	P	2	03/27/2007	0.2863	0.2576	490	33.47
OB	5	7	C	1.8	04/25/2007	0.1597	0.1851	340	28.86
OB	4	7	C	2.1	03/27/2007	0.059	0.0745	300	32.36
OB	5	7	C	1.96	04/25/2007	0.1037	0.1195	290	29.93
OB	5	7	P	1.74	04/25/2007	0.1108	0.0977	150	28.97
OH	1	7	P	1.75	12/26/2006	0.0844	0.0668	1,026	28.45
OH	1	7	C	2	12/26/2006	0.0349	0.0455	1,025	32.22
OH	1	7	C	2.7	12/26/2006	0.0039	0.0051	354	44.14
OH	1	7	C	2.75	12/26/2006	0.0036		250	45.07
OH	4	7	C	1.84	03/27/2007	0.1182		165	27.74
OH	4	7	P	2	03/27/2007	0.2612	0.235	165	29.57
OH	12	6	C	2.1	11/27/2006	0.0087	0.013	100	36.30
OH	11	6	C	2	10/26/2006	0.0009	0.0023	100	35.07

The oil market on Wednesday will likely remain pressured amid the expected builds in product stocks. The weekly petroleum stock reports are expected to show draws in crude stocks of slightly more than 500,000 barrels, while gasoline and distillate stocks are expected to build by about 1 million barrels and 1.3 million barrels, respectively. The market will however remain concerned over the talks between the EU and Iran, which are expected to continue on Wednesday. The market's losses will be limited if there is further talk of the UN Security Council meeting to begin work on a resolution. The

market is seen finding support at its low of 58.60 followed by its previous lows of 57.55, 57.30 and 56.90. Meanwhile resistance is seen at 59.45 followed by its gap from 60.10 to 60.90. More distant resistance is seen at 62.70.

Options today saw the first wave of out of the money puts coming into the money. Over 24,000 lots of put open interest, which started the day out of the money was in the money by the close of the day. Option short covering pressure though has just started as the December contract approaches the \$60.00 strike at which there is some 47,337 open positions coming into today. In fact the first four contract months appear will have nearly 84,000 lots of put open interest that is within \$1.50 of tonight's settlement prices. Even a partial short covering of these positions in the coming days could accelerate and price sell off.