



## ***ENERGY RISK MANAGEMENT***

Howard Rennell, Pat Shigueta,  
Zachariah Yurch & Karen Palladino  
**(212) 624-1132 (888) 885-6100**

**[www.e-windham.com](http://www.e-windham.com)**

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### **ENERGY MARKET REPORT FOR OCTOBER 16, 2007**

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Iraq's Vice President Tareq al-Hashemi arrived in Turkey in an attempt to convince Turkey not to stage a cross border offensive to fight separatist Kurdish rebels based in Iraq. He was scheduled to meet with Turkey's Prime Minister Recep Tayyip Erdogan and other senior officials. An Iraqi government official said Iraq authorities intend to expel guerillas of the separatist Kurdistan Workers' Party from Iraqi territory. Turkey's parliament is expected to give the government its approval on Wednesday to send troops into Iraq to hunt down Kurdish separatists blamed for the recent escalation of violence. Iraq said it wanted the Turkish government to pursue a diplomatic solution to end the crisis. Turkey's Prime Minister said the country hoped it

would not be forced to resort to military action, even if the motion gained approval in parliament. The US has urged Turkey not to enter Iraq, fearing that unilateral Turkish military action could destabilize the Kurdish region in the north. Meanwhile, analysts stated that a Turkish military strike on Iraqi Kurdistan could jeopardize a planned increase in oil flows through key pipelines in the region. An

#### **Market Watch**

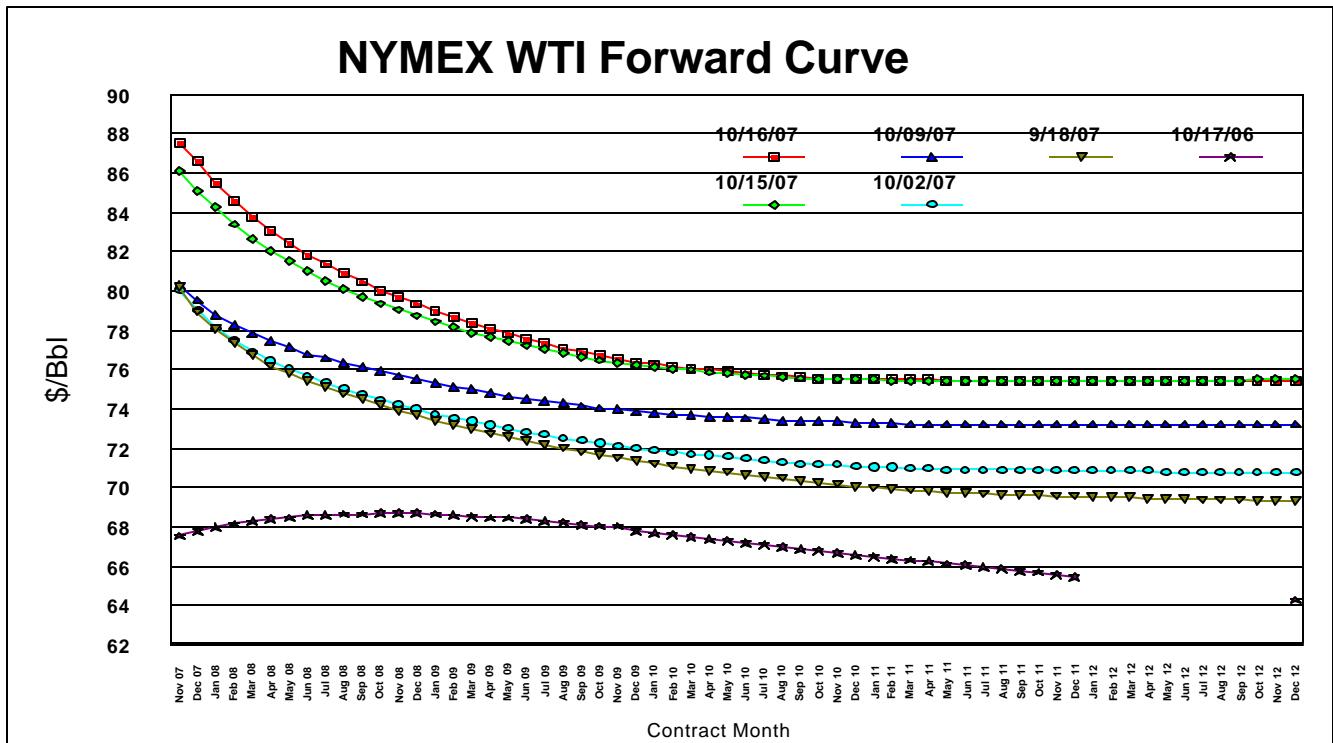
According to MasterCard Advisors, US retail gasoline demand increased for the third consecutive week to 9.699 million bpd in the week ending October 12, up 1.7% on the week. Gasoline demand was up 3% on the year. It also reported that the average US retail gasoline price fell by 2 cents to \$2.76/gallon.

BP Plc's chief executive Tony Hayward said he saw the lack of capacity as a reason behind the rally in oil prices.

Petroecuador warned foreign oil companies that they had two weeks to pay the government \$317 million in what the government says are unpaid debts from a windfall royalty approved in 2006. It said the debt stemmed from the royalty that forced oil companies to hand over at least 50% of extra oil revenues generated above a set benchmark price in their contracts. Petroecuador said companies that failed to comply with their debts could face legal actions. It said the companies included China's Andes Petroleum, US owned City Oriente and Brazil's Petrobras.

A Federal Reserve report showed that US industrial production increased by 0.1% in September as expected. However August's production change was revised down to unchanged from a previously reported 0.2% gain. On a quarterly basis, industrial production increased by 4% over the July-September period.

The NYMEX said it would raise the margin requirements for its crude oil and related futures contracts beginning at the close of business on Wednesday. Margins for the November 2007 crude oil, crude oil calendar swap and crude oil financial futures contracts would increase to \$5,400 from \$4,050 for customers. Margins for all other months would increase to \$4,725 from \$4,050 for customers.



estimated 600,000-700,000 bpd of Azeri crude currently flows through the Baku-Tblisi-Ceyhan pipeline. A rebel Kurdish group reiterated a threat to attack the BP Plc-led Baku-Tblisi-Ceyhan pipeline.

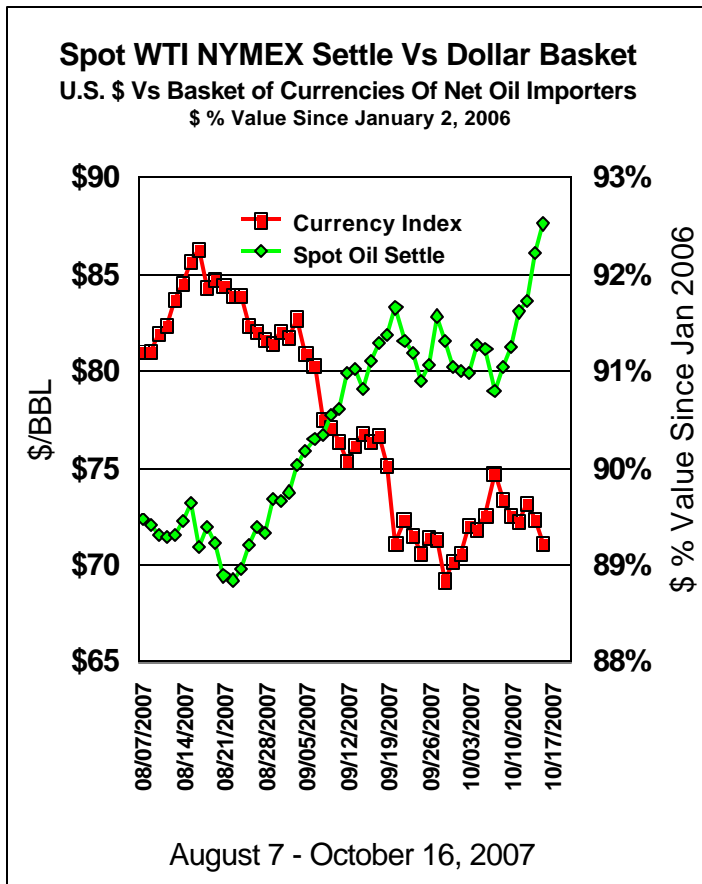
Russia, Iran and other Caspian Sea countries warned outside countries on Tuesday against using their territories to launch military action. The declaration at the end of the summit did not name any countries but it was a clear reference to long standing rumors that the US may be planning to use Azerbaijan as a staging ground for any possible military action against Iran. The countries also offered a sign of support for Iran's disputed nuclear program, stressing that any country that is a signatory to the Nuclear Nonproliferation Treaty can carry out research and can use nuclear energy for peaceful means. However the countries failed to reach an agreement on ways to divide the Caspian Sea's energy resources. Iran has insisted that each coastal country receive an equal portion of the seabed. Russia, Azerbaijan and Kazakhstan have been seeking the division based on the length of each nation's shoreline, which would give Iran a smaller share.

White House press secretary Dana Perino said the Bush administration was keeping a close watch on energy prices. She said energy prices were too high.

A senior EIA official said the tight world oil market needs another increase in OPEC production to help lower prices. He said OPEC had the most spare production capacity to provide the additional supply. In regards to the Turkish situation, the EIA official said any oil pipeline shipments disrupted by a Turkish troop incursion into northern Iraq could be replaced by other oil producers.

The IEA said the current rally in oil prices was a reflection of the tight world supply and demand balance. The head of the IEA's oil market division stopped short of calling on OPEC to increase production beyond the additional 500,000 bpd it would produce starting November.

Delegates from two OPEC countries in the Middle East said they were not aware of any discussions suggesting a further production increase. A delegate said the world oil market was well supplied. He



said OPEC would provide more oil if customers requested an increase however he added that customers were not requesting more supplies. OPEC's Secretary General Abdalla Salem el-Badri said OPEC believed current record oil prices were too high and added that there was no plan to increase its oil production beyond what it already agreed to increase starting in November. He said fundamentals were not supporting the current high prices and that the market was well supplied. Separately, an Iranian OPEC delegate said Iran was not in direct consultation with other members of OPEC to increase supply. Libya's National Oil Corp chairman Shokri Ghanem also expressed similar sentiment. He said he did not see a need for OPEC to raise its oil output further to lower record oil prices and called on consumer countries to cut fuel taxes. He said there were no plans for an emergency meeting to discuss record oil prices. He said oil prices were driven by geopolitical factors. Indonesia's OPEC governor, Maizar Rahman said world oil supplies are adequate and added that there was no justification for a price surge to a new record of \$88/barrel. He

said the market fundamentals are in balance.

### Refinery News

A power outage at Valero's Corpus Christi, Texas refinery on Sunday shut a boiler at the East Plant's fluid catalytic cracking unit that resulted in a reduction of the feed rate into the unit. In a report filed with the Texas Commission on Environmental Quality, it stated that the boiler was restarted as quickly as possible.

Separately, Valero Energy Corp said some processing units at its 285,000 bpd refinery in Aruba was restarted. The refinery was shut in early October due to a power outage.

Operations at ConocoPhillips' 247,000 bpd Sweeny, Texas refinery are expected to return to normal by the end of the week. Crude oil throughput at the refinery was reduced by an unspecified amount on October 9 to facilitate unplanned maintenance at the plant's D-104 coke drum.

PDVSA has so far failed to restart its catalytic cracking unit and alkylation units at its El Palito refinery after it shut the units on October 3 as a preventive measure due to a power outage.

Finland's Neste Oil said that a fire started at its refinery in Naantali. It said it would not impact production or inflict significant costs.

India's Reliance Petroleum Ltd, which is building a 580,000 bpd refinery, has spent \$5.6 billion as of September 30. Work on the refinery at Jamnagar is 70% complete and is expected to be commissioned before December 2008.

Japan's Showa Shell Sekiyu KK said it restarted a 45,000 bpd fuel oil desulphurisation unit after an unplanned shutdown in mid-September due to a technical problem.

Traders stated that low water cargo surcharges have been imposed for cargo shipping on parts of the Rhine river in central and southern Germany and on the Danube river in the south following a fall in water levels. Water levels near Koblenz and Mainz in southern Germany along with Colonge in central Germany have fallen below the minimum that vessels need to sail fully laden.

**Production News**

US ethanol production capacity increased about 30% since the start of the year to more than 6.9 million gallons/year. Production capacity has increased to 6.92 billion gallons/year.

Trade sources stated that Angola's crude oil production is expected to increase above 2 million bpd for the first time in December as new fields come online and others increase their output. Angola is expected to export nearly all of its oil production as it consumes about 62,000 bpd domestically.

Russia's Energy Minister Viktor Khristenko has notified the EU's Energy Commissioner Andris Piebalgs that it is unlikely to reopen the stretch of the Druzhba pipeline. Russia said reopening the pipeline was unlikely to be economically viable.

The first shipment of ExxonMobil's new Mondo crude in Angola is expected to load at the end of December. The offshore terminal is seen shipping about 500,000 barrels on December 30-31.

Russia's Surgutneftegas said it had the potential to increase its oil production to 2 million bpd from the current stagnant 1.3 million bpd due to its massive reserves.

OPEC's news agency reported that OPEC's basket of crudes increased further to \$78.76/barrel on Monday from Friday's \$77.62/barrel level.

**Market Commentary**

Furthering its gains, crude oil traded higher for the sixth straight day in a row. Lingerin concern over a Turkish invasion into Iraq was still at the forefront of this move higher but was also magnified by supply concerns and an influx of speculative buying. With demand from China and India still strong and with continued weakness of the U.S. dollar, there doesn't appear to be an end to higher prices in sight. With the November contact going off



the board next week we would focus our attention on the December contract. Upon examination of the December/January spread depicted on this page, it appears that this spread is setting up to test the top of the upward channel that began in late July. We would consider buying this spread and look for a test of the top of this channel, which comes into today at 1.36. Should this channel be broken another buy opportunity will present itself. Another spread we have been examining closely is the Dec/RedDec spread. This spread tends to peak at the end of September in to the middle of October and then weakens. Although these are unusual times in the market, this spread has really taken off and is now at its highest level ever. Should the market start to come off, we believe that this spread will be hit hard. Open interest was off by 20,330 on Monday, which we believe is due to profit taking, given the fact that the prior two days showed a build of 70,000 +. Total open interest in crude oil is 1,488,406 down 20,330, November 163,536 down 13,622 and December 378,371 down 14,414. Support for December, comes in at 83.50, 83.00, 82.00, 80.80 and 79.00. Resistance is set and 89.00. It is interesting to note that there is a large amount of open interest in the November 88 calls and 90 calls of 10,368 lots and 11,164 lots, respectively ahead of option expiration on Wednesday. Meanwhile, the RBOB and heating oil markets ended the session up 1.62 cents at 217.37 and up 3.15 cents at 233.87, respectively. The RBOB market posted its high of 220.19 in overnight trading before some profit taking pushed the market to its low of 214.49 earlier today. The market however bounced off its low and traded mostly sideways as traders positioned themselves ahead of the release of the DOE report on Wednesday. The heating oil market posted a low of 229.24 early in the session before it bounced off that level and rallied back to test its overnight low of 233.90. The market breached that level and posted a high of 234.01 ahead of the close amid the expectations that the inventory reports will show small draws in distillate stocks. On Wednesday, even if the reports show builds in crude and gasoline stocks, the markets are seen trending higher as the crude market remains supported ahead of the November crude option expiration. The RBOB market is seen finding support at 216.10, 214.49, 212.95, 210.20 and 208.22. Meanwhile resistance is seen at 220.19, 222.00, 223.92, 224.08 and 228.30.

|           |                       | <b>Explanation</b>                       |   |
|-----------|-----------------------|--|---|
| <b>CL</b> | <b>Resistance</b>     | 89.00                                    |   |
|           | 87.61, up \$1.48      | 86.92                                    | Tuesday's high(Dec)                                   |
|           | <b>Support</b>        | 86.75, 85.08                             | Tuesday's low(Dec)                                    |
|           |                       | 83.50, 83.00, 82.53, 82.00, 80.80, 79.00 | Previous lows   |
| <b>HO</b> | <b>Resistance</b>     | 235.72                                   | Basis trendline                                       |
|           | 233.87, up 3.15 cents | 234.01                                   | Tuesday's high  |
|           | <b>Support</b>        | 231.70, 230.50, 229.24                   | Tuesday's low   |
|           |                       | 224.40, 223.22, 221.72                   | Previous lows   |
| <b>RB</b> | <b>Resistance</b>     | 222.00, 223.92, 224.08, 228.30           | Previous high, 62%(245.04 and 184.52), Previous highs |
|           | 217.37, up 1.62 cents | 220.19                                   | Tuesday's high  |
|           | <b>Support</b>        | 216.10, 214.49                           | Tuesday's low   |
|           |                       | 212.95, 210.20, 208.22                   | Previous low  |