

Energy Intelligence Briefing

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August Maintenance, Broken Gas Line Bolster North Sea

LONDON -- The crude oil futures market made a stab at challenging the \$78.65 record high set last August with the August ICE Brent contract touching \$78.40 on its Jul. 16 expiry day. The front-month contract over the past month has traded a whopping \$9 range from a \$69.40 low on Jun. 27 to its Jul. 16 high. The rally was supported by both simmering geopolitical tension and an influx of speculative money, but the futures strength found an echo in the physical market, where planned and unplanned outages during August may amount to as much as 470,000 barrels per day.

Some insist that as much as \$10 of the current price strength is directly attributable to "the funds." That seems credible as according to the US Commodities and Futures Trading Commission's (CFTC) most recent report, the net length of Nymex speculative crude oil futures and options positions on Jul. 10 set a new record at 141,444 contracts -- or 141.44 million barrels. Some of this money may prove flighty when faced with the inevitable downward correction, but anecdotal evidence suggests that a large proportion is being invested for the longer term. Opec's constant reiteration that it has no intention of increasing supplies is also seen as price supportive. The producer organization claims that high prices are a function of tense geopolitics and refinery restraints, not lack of crude. Opec's assertions notwithstanding, the fact that Brent now is backwardated -- with prompt barrels more expensive than deferred ones -- well into 2008 is a clear indication of expected tightening crude fundamentals.

Meanwhile, physical differentials are propped up by tightening North Sea supplies because of maintenance and by the closure of the Central Area Transmission System (Cats) pipeline after a ship's anchor on Jul. 1 damaged the concrete casing of the line used to transport associated gas from oil fields to mainland Britain. Oil fields affected by the Cats closure contribute to both Ekofisk and Forties systems, with consequences for both volume and quality. Initial reactions presupposed that contributing fields would have to shut down, but according to consultants Consilience Energy Advisory Group (CEAG) that is not necessarily the case. "Some can reinject the gas and enhance the oil lift and that might actually boost oil production," says CEAG head Liz Bossley. "Others can get temporary waivers to

North Sea Loadings For July And August

	Std.	August		July		Prices	
		Cargo	No.	Vol.†	No.	Vol.†	August
Norway							
Statfjord	855	6	5.13	10	8.55	Dtd+\$2.70	Dtd+\$1.65
Oseberg	600	10.6	6.40	11	6.60	Dtd+\$1.90	Dtd+\$1.65
Gullfaks	855	9	7.70	13	11.12	Dtd+\$2.75	Dtd+\$1.80
Troll	600	10.2	6.15	9.3	5.60	Dtd+\$1.75	Dtd+80¢
Ekofisk	600	25	15.05	22.16	13.30	Dtd+\$1.65	Dtd+\$1.10
UK							
Forties	600	23	13.80	32	19.20	Dtd+55¢	Dtd-10¢
Brent	600	10.8	6.50	5	5.60	\$77.40	\$72.85
Flotta	650	3	1.95	3	1.95	Dtd-\$1.30	Dtd-\$2.00
Total	--	--	62.68	--	71.92		--
'000 b/d			2,022		2,320		

†million bbl.

flare or vent the gas." She adds that only the field operators can come up with meaningful numbers about what is and what is not producing as a result of the Cats closure. This information is regarded as commercially sensitive, but Bossley estimates that overall about 100,000 b/d will be shut in. Industry sources say that the necessary repairs will take weeks.

However, it is not only quantity that is an issue. Reduced production will also affect the quality of the two systems' crude. Forties Blend -- which will suffer a deterioration in quality as maintenance increases the proportion of medium, sour Buzzard in the mix -- is now operating a deescalator clause of 40¢ per barrel for every 0.1% sulfur above the base standard of 0.6%. However, proposals that would have provided an automatic price adjustment for unexpected events like Cats are still under consideration. CEAG has proposed that the industry agree to Brent reference quality and price escalators and deescalators that would apply to all fields in the Brent-Forties-Oseberg-Ekofisk (BFOE) complex of contracts and price quotations used in the pricing methodology for dated Brent, the pricing benchmark for most of the internationally traded spot market crudes as well as a number of grades delivered on term contracts. Pricing service Platts plans to revisit the subject during a period of consultation and review of various pricing proposals beginning in September.

Cats aside, North Sea August production will be hit hard by maintenance shutdowns. The August schedules show the eight principal Norwegian and UK crude oil systems declining by 298,000 b/d, with other fields outside the systems said to be

subtracting a further 75,000 b/d or so. In the UK sector, Forties leads the decline with a drop of 174,000 b/d, followed by Norway's Statfjord and Gullfaks systems with a loss of 110,000 b/d each. Ekofisk -- which underwent heavy maintenance in June -- Brent and Troll all saw increased loadings in August compared to July. As always, field operators stress that the programs are indicative and subject to revision for operational reasons. For the first half of the year, the eight systems covered represented nearly 57% of total Norwegian and around 63% of UK crude oil production as well.

Brent, Forties, Oseberg and Ekofisk, the four crudes that make up the BFOE parcel of crudes underlying dated Brent, showed a combined decline of 2.85 million bbl, or 4.75 standard 600,000 bbl cargoes. The combined BFOE schedule for August works out at 41.85 million bbl, or 69.75 standard cargoes, compared with 44.17 million bbl, or 74.5 cargoes, for the July schedule.

The combination of tighter supplies and uncertainty has firmed up North Sea differentials, by up to \$1 for some offshore grades against a backdrop of North Sea freight rates that have firmed 10 World Scale points since the end of June. Norwegian Statfjord was recently offered at an ambitious dated Brent plus \$3/bbl, but at press time was assessed at plus \$2.70. Dated Brent itself was assessed at September BFOE plus \$1.75, or the equivalent of September Brent futures plus \$1.85.

However, the high crude prices are squeezing margins; an incremental barrel of Brent currently makes a \$2 loss in a simple Northwest European refinery compared with a 10¢ profit averaged over the past two weeks. The same barrel makes a \$1.30 profit in a cracking plant and a \$2 profit in a US Gulf cracker. West African grades are reportedly holding steady, with Bonny Light and Qua Iboe assessed around dated Brent plus \$2.80. But there are indications that Asian demand for West African barrels is waning because of the high dated Brent price.

By Axel Busch