

Are Energy Markets In For Storm-Tossed Season?

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As if the energy markets weren't jittery enough: Sunday marks the start of the first hurricane season in the era of \$100-plus oil.

Although severe storms rarely hit until July, market experts say the approaching prospect of major summer storms already is contributing to the skyward push of oil and natural-gas prices. Once a hurricane actually begins traveling through the tropics, prices could spike higher as investors begin buying on fears of supply disruptions to oil facilities in the Gulf of Mexico.

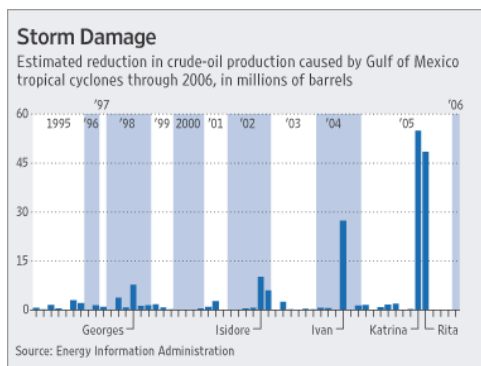
"We're all wound up tight as a drum," said Guy Gleichmann, president of United Strategic Investors Group, a commodities brokerage in Hollywood, Fla.

The Gulf of Mexico accounts for a quarter of U.S. crude-oil production and 14% of its natural-gas production. The hurricane-vulnerable Gulf Coast is also home to about a third of the nation's refinery capacity. Hurricane damage to production and transportation systems could drive up gasoline prices for months, and higher energy costs could mean higher bills for summer electricity and winter heating.

That is what happened in 2005, when hurricanes Katrina and Rita battered oil platforms, tore drilling rigs from their moorings and shut down coastal refineries for weeks. Crude-oil prices spiked 30% to \$70.80 a barrel as Katrina came ashore, from \$54.60 at the start of hurricane season. With oil currently trading around \$130 a barrel, a runup on a similar scale would push prices close to \$170 a barrel.

Barring catastrophic damage to oil infrastructure, though, the impact on oil prices is likely to be short term. U.S. oil production resumed quickly after Katrina and Rita, and imports helped sustain inventories.

Natural gas may be more vulnerable, as the market is more dependent on domestic production. If a hurricane curtails natural-gas production for more than a few days, it could cut into supplies being stored for winter heating, leading to further price increases. When customers turned on their radiators in December 2005, prices peaked above \$15 per million British thermal units, which remains the record. This year has the potential to bring even more pain to consumers; in 2005, natural gas began the hurricane season at \$6.789 per million BTUs, compared with Wednesday's close of \$11.995.



The complex network of offshore platforms, pipelines and other infrastructure makes natural-gas production particularly vulnerable in the Gulf of Mexico. Case in point: Independence Hub, a massive offshore natural-gas platform that funnels close to a billion cubic feet per day of gas to the U.S. market, has been offline since April because of a pipeline leak. Repairs initially estimated to take less than a month now won't be finished until June.

"It's a demonstration of how fragile the infrastructure is, and how delicate the supply-demand balance is," said Dan McSpirit, an analyst with BMO Capital Markets in Denver.

Oil and natural-gas producers escaped 2006 and 2007 without any significant hurricane damage. That allowed them to build up supplies of oil and, in particular, natural gas, helping to keep prices more stable for consumers. Gas prices rose in each of the past two winters but never approached their 2005 high. Natural gas

generates about 40% of U.S. electricity and heats about a quarter of the nation's homes.

Going into the summer storm season, data from the U.S. Energy Information Administration show that a cold winter already has drained natural-gas inventories to 16% below last year's level.

"The problem with this summer is we're sort of on a knife's edge anyway," says Jefferies & Co. analyst Subash Chandra.

The National Oceanic and Atmospheric Administration last week said there is a 65% chance of an above-average hurricane season, and predicted 12 to 16 named storms, including two to five major hurricanes of Category 3 or above. Experts caution there is no way to know where storms will hit or whether they will disrupt oil and gas operations. For example, last year's 15 hurricanes -- with two reaching the most intense Category 5 -- had almost no impact on oil production.

Oil and natural-gas producers say they have taken advantage of the two-year lull to improve their hurricane readiness. Offshore, they have raised standards for securing oil platforms and drilling rigs to reduce the damage hurricanes would cause, while onshore they have set up satellite offices and taken other steps so they can more quickly bring operations back online once a storm moves away.

"We are much better prepared than we were three years ago," said Walter Cruickshank, deputy director of the Minerals Management Service, the federal agency that oversees the offshore oil and gas industry.