US recommends strategic reserve changes

Report calls for more flexibility, infrastructure upgrades

Washington—The Obama administration is seeking more flexibility from Congress to authorize releases from the US Strategic Petroleum Reserve to more nimbly head off price shocks from supply disruptions.

In a report issued Tuesday, the administration noted that current law only allows the president to order a release after a supply disruption has already occurred, while the ability to tap the reserve in anticipation of outages would be more effective in stabilizing oil markets.

“In today’s fast-moving and globalized energy markets, the president should not have to wait until higher fuel prices have already damaged the US economy before the SPR can be used without restrictions,” the Quadrennial Energy Review stated.

But the highly anticipated QER contains no announcements about the future of the SPR, which has been under the microscope over the past few years, as the shale revolution has dramatically changed crude flows in the US and the Obama administration has openly talked about rethinking the mission of the Arab oil embargo-era facilities.

As expected, the administration’s QER also contains no announcements about the future of the SPR, which has been under the microscope over the past few years, as the shale revolution has dramatically changed crude flows in the US and the Obama administration has openly talked about rethinking the mission of the Arab oil embargo-era facilities.

Notably, the QER, compiled after a months-long interagency assessment of the US’ energy assets and infrastructure, does not call for any changes to the size or location of the SPR, nor does it recommend creating additional refined product reserves, as some observers had anticipated.

It suggests that Congress provide more funding to upgrade the SPR’s infrastructure and that the US Department of Energy continue to study the scope and configuration of the SPR.

It does recommend preserving the SPR, instead of eliminating it, as some have advocated in light of booming US oil production that has reduced imports.

“In spite of the changes in the US oil profile, the US economy will remain vulnerable to future international oil supply disruptions without the protection afforded by the SPR,” the QER states.

The Senate Energy and Natural Resources Committee is scheduled to hold a hearing on the QER April 28, with Energy Secretary (continued on page 6)

Central Asia becomes test case for gas-to-liquids

London—Former Soviet Central Asia is emerging as a focus for developers of the next generation of small-scale gas-to-liquids projects, as hopes of a North American GTL boom fade.

The past few weeks have seen two new projects advance, with UK company Compact GTL, chaired by ex-BP chief Tony Hayward, unveiling plans for a plant in Kazakhstan’s northwestern region of Aktobe, and an agreement on a project in Turkmenistan involving South Korea’s Hyundai Engineering and Construction and LG International.

The announcements follow another GTL project already under development in Turkmenistan that brings together Japan’s Kawan-saki Heavy Industries, Turkish building company Ronesans and Danish engineering and petrochemical company Haldor Topsoe.

In addition, South Africa’s Sasol remains formally committed to a larger, 38,000 b/d GTL project in Uzbekistan, although progress has been slow. The projects are advancements on GTL technology first developed in 1920s Germany and taken up in the post-war period by Apartheid-era South Africa.

Until recently a number of companies were talking about using cheap shale gas to build the next generation of GTL projects in North America. Shell was enthused by its 140,000 b/d Pearl GTL project in Qatar, which reached full production in late-2012, but in January 2014 the company dropped plans for another such plant on the US Gulf Coast. It cited high costs and uncertainty about gas prices in the long term.

Sasol said this January it was delaying a proposed 96,000 b/d GTL plant planned in Louisiana due to the collapse in oil prices.

Compact GTL chief executive Edmund Buckley says the fall in North American trans-

(continued on page 7)
Malaysia to import higher grade 97 RON

Plans roll out of 50 ppm 97 RON gasoline in September

Singapore—Malaysia will likely import low-sulfur gasoline to meet a new nationwide mandate to move to the Euro 4M specification for the 97 RON grade in September, sources said Tuesday.

“The mandate is now for Euro 4M to be introduced in September, only for 97 RON,” a market source said.

This was confirmed by a government official. Another source close to state-owned Petronas said the company “currently lacks the capacity” to produce Euro 4 across the board, explaining why the new specifications have not been introduced for other fuels.

Malaysia’s standard for fuels is currently Euro 2M, although there was originally a plan to shift to the Euro 4 equivalent standard for diesel and gasoline from June this year. The Euro 4M standard will cap sulfur content at 50 ppm, down from 500 ppm under Euro 2M.

The government official said there is currently no plan to mandate a move to Euro 4M for other fuels, although oil companies would be encouraged to adopt the new standard.

The sources said a switch for 97 RON gasoline would likely only impact about 5% of Malaysia’s current gasoline demand.

China's March gasoil exports surge to 5-month high

Singapore—China’s gasoil exports in March surged to a five-month high of 300,000 mt, although the volumes were 11.8% lower than the same month last year, data from the General Administration of Customs showed Tuesday.

Outflows of the fuel last month brought total first-quarter exports to 480,000 mt, a 54.3% decline over Q1 last year.

Since the second half of last year, China’s gasoil exports had been on a steady downward trend as domestic demand gradually picked up. Outflows fell to a 16-month low of just 70,000 mt in January this year, before rebounding to 120,000 mt in February.

Meanwhile, China also imported 230,000 mt of gasoil in March, the highest inflow in a single month since December 2011, and nearly half of total imports for the whole of 2014. Total first-quarter gasoil imports nearly doubled from the same period last year to 270,000 mt.

This means net gasoil exports in March this year totaled 70,000 mt, tumbling 79.4% year on year, with year-to-date net exports falling 76.9% year on year to 210,000 mt.

Meanwhile, China imported gasoil for the second month running in March, bringing in 36,000 mt, following imports of 93,000 mt in February. China typically does not import motor gasoline, although demand has been strong since the start of the year.

Gasoil exports on the other hand, rose 13% from a year earlier to 610,000 mt in March, bringing first-quarter exports to 1.15 million mt. This, however, was a 6.5% decline from the first three months of last year.

Overall net exports of gasoil in March rose 6.3% year on year to 574,000 mt, while net exports during the first quarter slumped 17% year on year to 1.02 million mt, the data also showed.

China’s oil product output rose in March compared with a year earlier, with the exception of naphtha and fuel oil, detailed data from the National Bureau of Statistics showed late last week. — Song Yen Ling

Price not fixed

Putrajaya has not said how much Euro 4M 97 RON gasoil will cost, although it will likely be a premium to the current Euro 2M price, the government source said. In addition, 97 RON gasoil is also subject to a new 6% goods and services tax that kicked in April 1. Diesel, 95 RON gasoline and LPG are currently exempt from the GST.

The current price of 97 RON gasoil is RM2.25/liter (62 cents/liter), including GST. Diesel is priced at RM1.95/liter while 95 RON gasoil is priced at RM1.95/liter.

The market source said to move to Euro 4M 97 RON gasoil, an MR0.10-MR0.15/liter increase to the current Euro 2M price would be acceptable.

Fuel prices in Malaysia are currently set by the government on the first of every month based on the previous month’s average of Mean of Platts Singapore assessments for the respective fuels.

Euro 5M timeline

The sources said the timeline for Euro 5M implementation will also continue to move in tandem with the startup of Petronas’ new 300,000 b/d RAPID refinery in Johor, which is currently scheduled for 2019.

Meanwhile, BHPetrol and Petronas currently already retail some Euro 5 diesel in the southern state of Johor, although both companies have recently received government approval to expand distribution to the Klang Valley—comprising Kuala Lumpur and surrounding areas—further north in peninsular Malaysia, said the government source.

“There is demand in the Klang Valley because there are a lot of diesel cars there,” the market source added.

BHPetrol started selling Euro 5 diesel in Johor last year to serve commercial vehicles that regularly commute to neighboring Singapore, where the diesel standard is Euro 5. — Song Yen Ling

China’s January-March petroleum output

<table>
<thead>
<tr>
<th>Product</th>
<th>Jan-Mar 2015</th>
<th>Jan-Mar 2014</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crude oil</td>
<td>52,245</td>
<td>51,518</td>
<td>1.4</td>
</tr>
<tr>
<td>Crude throughput</td>
<td>127,390</td>
<td>122,232</td>
<td>4.2</td>
</tr>
<tr>
<td>LPG</td>
<td>6,775</td>
<td>6,278</td>
<td>7.9</td>
</tr>
<tr>
<td>Naphtha</td>
<td>7,081</td>
<td>7,642</td>
<td>-7.4</td>
</tr>
<tr>
<td>Gasoline</td>
<td>28,695</td>
<td>26,845</td>
<td>6.9</td>
</tr>
<tr>
<td>Jet/kerosene</td>
<td>8,668</td>
<td>7,034</td>
<td>23.2</td>
</tr>
<tr>
<td>Gasoil</td>
<td>43,832</td>
<td>42,842</td>
<td>2.3</td>
</tr>
<tr>
<td>Fuel oil</td>
<td>5,939</td>
<td>6,278</td>
<td>-5.4</td>
</tr>
<tr>
<td>Natural gas (Bom)</td>
<td>33,64</td>
<td>32,179</td>
<td>4.5</td>
</tr>
</tbody>
</table>

Key Oil Product Yields*

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Gasoline</td>
<td>22.53%</td>
<td>21.96%</td>
<td>Gasoil</td>
<td>34.41%</td>
<td>35.05%</td>
</tr>
<tr>
<td>Jet/kerosene</td>
<td>6.80%</td>
<td>5.75%</td>
<td>Fuel oil</td>
<td>4.66%</td>
<td>5.14%</td>
</tr>
</tbody>
</table>

Unit: ‘000 mt unless stated otherwise
*Platts calculations
Source: China’s National Bureau of Statistics
Lukoil sees Iraqi oil growth slowing

**Russian operator warns of price threat to further gains**

*Abu Dhabi*—The growth in Iraq’s oil production capacity is expected to slow this year if low global crude oil prices persist, a senior executive at an international oil company working in the country said Tuesday.

“Unless there is a significant increase in oil prices, you won’t see any major increases [in oil production capacity],” said Gati al-Jebouri, senior vice president at Russia’s Lukoil Overseas, which is developing the West Qurna-2 oil field in the south of the country.

Jebouri, speaking on the sidelines of the Middle East Petroleum and Gas Conference in Abu Dhabi, estimated that Iraq was spending as much as 25% of its budget on paying fees and cost recovery to its international partners, which he called an unsustainable level.

Under Iraq’s current technical service contracts, the federal budget was the major loser from falling oil prices, Jebouri said, while it was relatively stable for oil companies.

Payback oil to international contractors in May will total 26.2 million barrels (845,000 b/d), including 22 million barrels (710,000 b/d) of anticipated exports from southern terminals and 4.2 million barrels (135,000 b/d) from Ceyhan. This is around 28% of total exports.

Each year, the oil companies meet with the oil ministry to have their planned work programs approved, setting out their capital spending plans on the basis of what Iraq could afford to finance, Jebouri explained.

“Cash flows change significantly at high prices,” said Jebouri. With oil prices at more than $100/barrel, the proportion paid in cost recovery and fees is around 16%, but this could rise as high as 48% in a much lower price environment. This would be a major strain on the government, as seen in recent payment backlogs from the oil ministry.

“I personally believe Iraq could lift production to 6 million b/d by 2017, but this is on the assumption of an increase in oil prices,” Jebouri said.

The oil ministry itself hopes to increase total production capacity to around 9 million b/d by the end of 2017, from around 3.5 million b/d currently.

Lukoil has lifted its production capacity at West Qurna-2 to 400,000 b/d, since the end of the year. Current production is around 350,000 b/d, although it varied from day to day because of “Iraq’s desire to maintain a stable export blend,” Jebouri said.

**Basrah heavy oil**

Earlier this month, Iraq’s State Oil Marketing Organization announced its official selling price formulas for May liftings of its new Basrah Heavy export crude grade. This paved the way for future liftings, although no barrels are scheduled for the coming month.

This follows a similar move last month for April liftings, which was the first time that SOMO set OSPs for Basrah Heavy.

The new blend will have a relatively high viscosity, API less than 24 degrees. For exports to be possible, Iraq will have to make some major changes to its infrastructure, including pipelines, pumping and storage, Jebouri said.

“The plan is to use one of the SPMs [single point moorings located in the Gulf]. They hope to get this ready in the next two months. Whether this is possible is another matter,” he added.

Iraqi marketing experts say SOMO’s dedication of Basrah Heavy to IOC contractors and its decision to dedicate one of its Gulf terminal SPMs to such loadings was an attempt to preserve the quality of Basrah crude supplied to other lifters. Such a move could improve SOMO’s competitiveness, especially in the tight east Asia markets. — *Adil Mirza, Tamsin Carlisle*

**Chevron warns of possible halt to Wafra output**

*London*—Chevron warned Tuesday that it may have to halt oil production at the onshore Wafra field in the neutral zone between Saudi Arabia and Kuwait due to a number of logistical challenges, though the US major said it is working to resolve the problems.

Wafra, which produces around 200,000 b/d, is operated by Wafra Joint Operations, a joint venture between state-owned Kuwait Gulf Oil Company and Saudi Arabian Chevron.

The Chevron unit operates the Saudi government’s 50% interest in Wafra and two other onshore oil fields in the so-called Partitioned Neutral Zone.

But in the past few months Chevron has reportedly faced difficulties securing work permits from the Kuwaiti authorities for its expatriate staff.

Kuwait’s Al-Qabas newspaper reported that Chevron would halt production at the field on May 13 if the issues were not resolved.

Without confirming the deadline, a Chevron spokeswoman said Tuesday: “Current difficulties in securing work permits and materials may impact the company’s ability to safely continue production.” “Efforts continue with all appropriate parties to resolve the issue,” she added.

Late last year it first emerged that Chevron employees were having problems with their work permits and that the Kuwaiti authorities were refusing to renew existing permits or issue new ones.

**Saudia/ Kuwait stand-off**

The warning over Wafra follows the closure of another field in the neutral zone—the offshore Khafji field—in October last year. If Wafra output is shut in, it would raise to 500,000 b/d the volume of crude normally shared equally by Saudi Arabia and Kuwait off the market.

Saudi Arabia unilaterally closed Khafji, which produces around 300,000 b/d, citing environmental concerns, while Kuwait said the field had been shut by the Saudis for “technical reasons.” But analysts say they believe the decision by Saudi Arabia to close Khafji signals deeper problems between the two major Persian Gulf oil exporters.

Traditionally the neighbors have been close political allies in the region as well as within OPEC but analysts have pointed to a number of oil-related bones of contention between the two.

These include: Kuwait’s proposed use of land formerly leased to Saudi Arabia to build its long-planned 615,000 b/d al-Zour oil refinery; concerns that further development at Khafji could have negative consequences for oil recovery from Saudi Arabia’s giant Safaniyah offshore field to which Khafji is joined; a lack of cooperation on gas-flaring policy; and Kuwaiti delays in issuing work visas for foreign personnel hired to operate onshore PNZ oil production on behalf of Saudi Aramco. — *Stuart Elliott*

**ADNOC confident of hitting 3.5 million b/d capacity**

*Abu Dhabi*—The UAE should reach its long-held 3.5 million b/d oil production capacity target in late 2017 or early 2018 and is taking steps to ensure the higher output level will be sustainable, a senior Abu Dhabi National Oil Company official said Tuesday.

Offshore, production has already started from new wells drilled from artificial islands to tap the giant Upper Zakum field, and two new oil fields—Nasr and Umm Lulu—have in the past year been brought on stream, the offshore division manager of ADNOC’s exploration and production directorate, Qasem al-Kayoumi, told reporters on the sidelines of the Middle East Petroleum and Gas Conference in Abu Dhabi.

Abu Dhabi is currently producing about 2.8 million b/d from its three major oil concessions, which include two offshore and one onshore, Kayoumi told conference delegates.

Smaller offshore fields will supply the remaining new output capacity and help maintain total output capacity at the target level, he said. — *Tamsin Carlisle, Adal Mirza*
More life seen in Europe’s refining uptick

Credit Suisse raises forecasts on EU margins

London—Credit Suisse Tuesday raised its forecasts for refining margins across Europe and Finnish refiner Neste Oil lifted it earnings guidance in the latest signs that the sector’s recent margins kick could prove more robust than first thought.

- Neste reverses call on earnings growth
- Capacity glut still hangs over sector

Dire margins in Europe’s over-supplied refining sector recovered sharply in late 2014 as tumbling global crude prices outpaced slipping fuel prices at the pumps.

But despite a near-40% rebound in oil prices since mid-January, European refining margins have continued to climb helped by stronger-than-expected demand for gasoline and other fuels. Market watchers point to a marked demand response to lower fuel prices and opportunistic product buying to fill stocks.

A spate of refinery outages in both North and South America in addition to cold weather in the Northern Hemisphere has also helped lift refining earnings.

Benchmark Brent cracking margins averaged $6/barrel during the first quarter and currently stand at $6.49/b, according to Platts data.

Indicator margins in Northwest Europe are now expected to average nearly $8/b this year, up from about $5/b in 2014 and close to the average in the so-called “Golden Age” of European refining from 2004 to 2008, according to a Credit Suisse report.

The European margin indicator is also seen remaining above the $5/b average in 2009-14 until the end of the decade, the bank said. For Singapore, the bank also raised its average margin forecast by a more modest $0.50/b to around $11/b, according to Credit Suisse charts.

“The demand response to lower prices (most notably in the OECD, and even in Europe) has taken us by surprise,” the report said.

European demand for oil could see a rare uptick year-on-year in the current quarter, according to the IEA. In Germany, Europe’s biggest fuel market, gasoline demand has picked up sharply supported by economic growth, cheaper prices and rising domestic real incomes.

Neste earnings win

Raising its first quarter earnings estimates for most European oil majors and refiners across the board, the bank said the strong product cracks and a lower cost burden for refiners to fuel their own plants would help sustain stronger margins.

Finnish refiner and leading renewable diesel producer Neste said Tuesday it now expects its 2015 operating profit to outperform last year’s result due to “the current market outlook for the remainder of the year.”

Previously Neste said it expected its full-year operating earnings to remain robust, but end the year probably lower than the Euro583 million ($623 million) reached in 2014.

Neste, which received a boost for its biodiesel business last year from a favorable US ruling on tax credits, has two conventional refineries in Finland with a combined capacity of 306,000 b/d.

Margin boost ‘unsustainable’

But Credit Suisse said, although European margins may stay higher for a while longer, they are ultimately unsustainable at current levels due to an estimated 1 million b/d of remaining surplus refining capacity in the region.

As a result, European margins will likely narrow in the second half of 2015, it said, as crude prices are expected to begin a supply-led recovery and China may pick up the pace of adding to its strategic oil reserves.

The seasonal decline in Middle East gasoil demand will also likely free up more supply for export, it said.

“We do not think that they (margins) are sustainable and continue to view 2015 as a year of two halves,” the bank said.

The outlook for global refining balances has also tightened in recent months, according to Credit Suisse, with more capacity closures being announced and further plant expansions being deferred.

European refiners, which have been forced to shut more than 2 million b/d of capacity in the region since 2009, received scant relief over the structural supply overhang in the sector last week with Total’s long-awaited announcement of its refining plans.

The French oil major, Europe’s biggest refiner, said it will close only the smaller of its two loss-making French plants which were been threatened with closure. — Robert Perkins

Norway hints at state aid for Johan Castberg field

Statoil said last year the existing resource base did not stack up for full development and it needed more time to find a new development concept.

But the Norwegian government wants full development, waving aside the shorter term commercial questions in favor of new major infrastructure that would be a springboard for new discoveries and fields and a new frontier oil province and provide more jobs as well as economic benefits.

Analysts said the minister’s announcement now made a green light for the Castberg project more a probability than a possibility.

“The government wanted to develop in infrastructure in the area that could be shared with other licenses,” said Carnegie analyst Kjetil Bakken.

“The state wants to act as an intermediary to support the project to make it happen.”

Separately, Statoil announced Tuesday cooperation deal to pool key data on the remote between companies in the Barents that had already made discoveries or who held operating licenses in the area.

Statoil said it and Italy’s Eni, Swedish group Lundin Petroleum, OMV of Austria and French group GDF SUEZ would collaborate on solving operational tasks tied to exploration in the Barents Sea.

The project, called BaSEC, Barents Sea Exploration Collaboration, will initially last for three years.

The companies involved in BaSEC aim to find common solutions for operations in the Barents Sea, Statoil said.

This would happen through sharing of operational data, cost-effective solutions, more collaboration and increased coordination. — Patrick McLoughlin
Medvedev concedes external factors will ‘test’ Moscow

Moscow—Russia is producing enough crude to meet both domestic and export demand, but Moscow will have to adapt to a “different” economic reality if oil prices remain low and the pressure of international sanctions persists, the country’s Prime Minister Dmitry Medvedev said Tuesday.

- Low prices, sanctions still a threat
- Analysts expect oil industry deterioration

Russia has managed to keep its crude production high despite the plunge in prices and international sanctions—output in March hit a new post-Soviet era high of 10.71 million b/d.

But forecasts from the industry and analysts see output falling later in the year given the double whammy of lower prices and sanctions, which include a ban on transferring certain oil drilling technologies to Russia and effectively block Russian companies’ access to Western financial markets.

Medvedev, speaking to the Russian Duma, said Russia had already learned to live with the low oil price and sanctions, and production had been resistant to the external pressures.

"[Russia’s] crude output has stabilized at about 527 million mt, a slight increase," he said. “This level is enough to meet domestic demand and ensure export supplies," he said.

But, Medvedev said, Russia “should have no illusions” about the future if the damaging external factors persist.

“It is not just a short-term crisis. If external pressure continues to grow, and oil prices remain at extremely low levels for a long time, we will have to develop in a different economic reality that will test us thoroughly," he said.

Medvedev estimated that restrictions imposed by the sanctions had cost the state Eur25 billion (about $27 billion based on the current exchange rate) last year, or 1.5% of Russia’s GDP.

This negative effect could be multiplied several times in 2015 as the country comes under pressure from multiple factors, he said.

“For the first time in Russia’s… Soviet and post-Soviet history, the country has come under the effect of two external shocks simultaneously, the sharp oil price fall and the sanctions pressure," Medvedev said.

“We have never faced such a compilation of challenges," he said, adding that “the negative tendency persists this year.”

Russia’s GDP fell 2% in January-March this year, dragged lower by the global oil price slide, the ruble’s fall, and inflation at 1.6% in Russia, he said.

Production forecasts

In its latest monthly oil market report, the International Energy Agency said Russian production was expected to fall by 100,000 b/d year on year in 2015 “with structural declines exacerbated by Western sanctions targeting financing and technology needed to reverse declines and boost production for the year.”

Ed Morse, global head of commodity research at Citigroup in Abu Dhabi on Tuesday, said there had been “a lot of controversy” about the extent to which Russian oil production was expected to fall this year.

The controversy, he said, was “not over whether it will drop, but the degree of the drop.”

He said that among the banking analytical community, the figure seemed to be a drop of 100,000 b/d by the end of the year.

"The pressure is certainly there," he said. “Sanctions add to it. But the state of the industry, or the competency of the industry as a whole has deteriorated, particularly on brownfield projects.”

Russian President Vladimir Putin said last week he did not expect Western sanctions against Russia to be removed any time soon.

The list of companies under sanctions includes oil and gas majors such as state-run Rosneft and Transneft as well as private companies Lukoil and Novatek.

Russia’s economy ministry has revised its forecast for the year, reducing its 2015 average oil price to $50/b from $60/b in its previous forecast, business daily Kommersant reported earlier in the day.

The ministry expects oil prices to recover to $80/b by 2018. — Nastassia Astrasheuskaya, with Adal Mirza in Dubai

EU set to file Gazprom antitrust charges

London—The European Commission was widely reported Tuesday to be about to file anti-trust charges against Russian producer Gazprom relating to its gas sales activities in eastern Europe, following a probe that began in late 2012.

- Gazprom could face major fines
- Oil-link, spot gas price connection

Newspapers including the UK’s Financial Times expect European competition commissioner Margrethe Vestager to issue a formal statement of objections outlining charges of illegal abuse of dominant market position as early as Wednesday.

The former Danish economy minister, who took office in November, already last Wednesday opened up a battle against Google, alleging that the US technology giant was abusing its dominant position in internet search.

Filing a case against Gazprom would come after a period of very tense relations between Europe and Russia, following Russia’s takeover of the Crimea early last year, and the fighting in eastern Ukraine throughout 2014.

But Vestager said last week, commenting on the Google case, that “competition investigations are independent from politics and commercial interests.”

She said: “We will be exclusively guided by the facts, the evidence and by the EU’s antitrust rules.”

Punishments for companies that break competition rules can include fines of up to 10% of annual revenue.

EU chief spokesman Margaritis Schinas Tuesday refused to comment on the reports. He told reporters in Brussels that the European Commission does not comment on any pending competition case.

Gas company raids

The case began in September 2011 when the EC carried out dawn raids on a number of European gas companies to study their contracts with Gazprom.

After a year of reviewing the evidence, the EC on September 5, 2012, announced the launch of a formal investigation into Gazprom’s operations in central and east European gas markets.

Countries covered by the probe were: Poland, the Czech Republic, Slovakia, Hungary, Bulgaria, Estonia, Lithuania and Latvia.

The EC said it was studying three potential anti-competitive practices.

It was looking at whether Gazprom divided gas markets by hindering the free flow of gas across member states. It was also investigating whether Gazprom prevented the diversification of supply, and finally, whether it imposed unfair prices on customers by linking the price of gas to oil.

In the wake of the 2008 global financial crisis, European gas prices remained low, on weak local demand and due to the boost to global gas supplies from US shale gas and new LNG production.

But oil prices rebounded rapidly on strong international demand, and amid Middle East turmoil, such as the Arab Spring. This left companies buying gas at oil-linked prices paying high prices compared with those on spot deals.

Eastern European markets, with little access to the spot-trading hubs of western Europe, or to new sources of global LNG, were particularly dependent on Russia’s oil-linked deals.

Europe’s gas networks traditionally flowed from east to west, requiring infrastructure investment to boost flows of spot gas from west to east. — Alex Frolow
US recommends strategic reserve changes

...from page 1

Ernest Moniz expected to provide more details on the report, which also includes chapters on natural gas infrastructure, the US electrical grid, North American cross-border energy integration and workforce training.

Crude flows in focus

Releases from the SPR—and non-releases, as it were—have been fodder for political criticism, with Democrats sometimes clamoring for releases during times of high gasoline prices and Republicans and the oil industry slamming such moves as harming national security and interfering with US crude markets.

The QER noted that the growth in US oil production has shifted much of the oil flows in the country, as Midcontinent refineries are now largely being served by Bakken and Canadian crude, instead of crude shipped north from the Gulf Coast.

The report suggests changes in US maritime shipping, but doesn’t mention the Jones Act

In addition, Bakken crude is being railed to the East and West Coasts, while Gulf Coast refineries are seeing significant new volumes from the Eagle Ford and Permian basins.

With many pipelines now moving large volumes of oil to the Gulf Coast, already aging SPR infrastructure, traditionally designed to bring crude to inland refineries, has not kept pace with the changes, the QER said.

“New patterns of oil supply and demand among US oil producers and refineries, along with associated changes in the US midstream, have significantly reduced the ability of the SPR to distribute incremental volumes of oil during [a] possible future oil supply interruption,” the QER stated.

It estimated that the SPR would need $1.5 billion to $2 billion in infrastructure upgrades, including dedicated marine loading dock capacity, which would allow more efficient transfers onto vessels and prevent congestion at nearby ports.

Product reserves studied

The SPR was created in the wake of the 1973 oil embargo and an International Energy Agency agreement for consuming nations to stockpile the equivalent of 90 days of net imports of petroleum.

It consists of 62 salt caverns in Louisiana and Texas and currently holds 691 million barrels of crude.

In a report released in late 2014, the DOE, which manages the SPR, said that limited access to pipeline capacity, storage and even to US-flagged vessels have complicated crude deliveries from the SPR.

That report looked at lessons learned from the March test sale of nearly 5 million barrels of sour crude oil from SPR storage sites in West Hackberry, Louisiana, and Big Hill in Winnie, Texas.

That test sale generated $495 million, which helped fund a gasoline reserve at three sites: 700,000 barrels in the New York Harbor area, 200,000 barrels in the Boston area and 100,000 barrels in Portland, Maine.

In addition, the US has a heating oil reserve in the Northeast with 1 million barrels of ultra low-sulfur diesel.

DOE is assessing the need for potential refined product reserves in the Southeast and on the West Coast, and the QER recommends further study.

“DOE should undertake updated cost-benefit analyses for all regions of the United States that have been identified as vulnerable to fuel supply disruptions to inform subsequent decisions on the possible need for additional regional product reserves,” the QER states.

The QER did not address the Jones Act, a law that requires all seaborne shipments of goods between US ports be carried on vessels owned and operated by US citizens.

The act has been a point of contention for the oil industry, which says it restricts commerce, due to the relative shortage of US-flagged ships.

The QER does recommend that the Department of Transportation undertake a study of domestic shipping in light of energy security, as US shipbuilders have averaged just seven new ships per year.

“The security implications are evident in the inextricable linkage between energy and maritime commerce, as recent changes require moving oil in new ways,” the QER says.

It also recommends further study and statistics gathering on crude-by-rail movements, as well as monitoring of propane storage and exports to prevent supply crunches, such as happened in the winter of 2013-14, when the upper Midwest saw propane price spikes due to pipeline reversals and heavy agricultural use during the fall. — Herman Wang

Baker Hughes sees unfavorable drilling conditions

New York—Unfavorable conditions for drilling oil wells onshore and in shallow water will continue to keep rig counts low during the second quarter, Baker Hughes said Tuesday.

Drilling rig counts have fallen sharply in tandem with the global price of oil. NYMEX front-month crude settled at $55.26/barrel Tuesday, down $52/b since June 20 as the recent surge in North American production has resulted in high global crude oil inventories.

In the first quarter, Baker Hughes reported a 21% drop in its US rig count to 880 rigs, driven by a sharp drop in onshore and shallow-water operations in the Gulf of Mexico where quarterly rig counts dropped 30% year on year.

The company said its North American oil and gas rig count halved year on year, dropping more than 1,000 rigs so far this year, and it is just beginning to see “significant” rig count declines internationally.

“Looking out to the second quarter, we expect unfavorable market conditions to persist,” Baker Hughes said in its first quarter earnings statement. “North America and international rig counts are projected to continue declining across most onshore and shallow water markets, which would further intensify the oversupply of oilfield services.”

Baker Hughes, which is on schedule to be acquired by fellow oil services company Halliburton in the second half of this year, projects the North American oil and gas rig count in the second quarter to decline by about 350 rigs, or 30%, compared to the first quarter.

Baker Hughes’ Canadian operations saw a “pronounced drop” in activity as customers decided to stop operations earlier than normal, cutting first quarter rig counts by 40%.

As the quarter progresses, the pace of rig count declines is anticipated to slow, the company said.

Well productivity could delay recovery

However, even if the pace of declining rig counts begins to slow, that does not mean production will slow enough in the second quarter to cut record levels of crude stocks, which would give markets the needed price signal to ramp up production and drilling activity.

One factor overhanging the recovery of drilling is the number of unfinished wells in inventory, which can be completed and put on production quickly if market conditions change.

“In the United States, some customers are electing to defer completions altogether, and we estimate that as many as 20% of the recent wells being drilled have been placed in inventory to be completed at a later date,” Baker Hughes said.

Many of these wells placed on hold are in fast-growing shale or tight oil plays in the US. Producers there in particular are “high grading,” or focusing their exploration efforts on specific locations to provide them the best return for their drilling dollar.

“Even with a 50% cut in rig count from the October 14 peak, oil production should continue to grow even before the effects of productivity gains and high grading kick in,” said Citi’s Edward Morse in a research note. — Janet McGuirty
Central Asia becomes test case for gas-to-liquids

...from page 1

port fuel prices has added to doubts about GTL projects there. By contrast in Kazakhstan, a vast, resource-rich country with a weak refining and fuel distribution system, conditions are right for small-scale plants that meet local needs, he says.

Central Asia may not score highly in rankings of places to do business, but in certain contexts gas can be obtained almost for free.

With world oil prices as low as $50/b, “you have to get gas for free,” Buckley said, describing US GTL projects, at least outside Alaska, as “a fool’s game.”

Despite being a major crude exporter, Kazakhstan “imports significant amounts of diesel,” he added. “They have short refining capacity, their refining capacity is old—there’s definitely a market.”

Compact GTL has already built a miniature demonstration plant in Brazil. Its proposed plant in Kazakhstan, with capacity of just 2,500 b/d, is far smaller than those in Qatar or those proposed for North America. It is a joint project with China’s Sinopec, which produces oil and gas in Aktobe region, and state-owned KazMunaiGaz, and will be a showcase for potential small-scale projects elsewhere that convert gas to diesel, Buckley says.

He highlights the fuel quality issues that persist in Kazakhstan and says that despite the government’s efforts to keep down prices, real prices in the country’s fragmented local markets are competitive. About 30% of fuel on the Kazakh market is imported from Azerbaijan or Russia, the company estimates.

Buckley expects to achieve retail prices of about 95 US cents/liter in the company’s baijan or Russia, the company estimates.

The project is not just based around 95 US cents/liter for the company’s baijan or Russia, the company estimates.

For an export pipeline across the Caspian to west of the Caspian Sea, is also advancing

Uncompleted wells may affect price volatility: CEO

Houston—Drilling wells but deferring completions may be a factor in oil price volatility in the next several years and potentially delay the industry’s recovery, ConocoPhillips CEO Ryan Lance said Monday.

Even as signs are at hand that prices may be on the verge of rising, with estimated official oil production levels showing signs of flattening or slight declines, the industry has the potential to quickly bring online large volumes of crude production, which could tamp down prices.

“As we look forward over the next few years, we see a more volatile world,” Lance said during a news conference the opening of

GTL technology: a long, expensive journey

- GTL technology uses the Fischer-Tropsch process invented in 1925 to convert carbon monoxide and hydrogen to liquid hydrocarbons, including synthetic diesel, aviation fuel and specialist lubricants.
- GTL is seen as a way of adding commercial value where gas is abundantly available, or as a way of harnessing gas associated with oil production in remote locations where the gas would otherwise be flared.
- Shell has pioneered commercial projects in Bintulu, Malaysia, and at the world’s largest facility, Pearl GTL, in Qatar, which cost $18.5 billion to build and has the capacity to produce 140,000 b/d of synthetic products, using 1.6 Bcf/d of gas.
- South Africa’s Sasol is another sector leader, with the 34,000 b/d Oryx GTL plant, also in Qatar.
- Chevron and Sasol’s 32,400 b/d Escravos GTL project in Nigeria was originally expected to be up and running in 2011, but is still ramping up.
- Shell and Sasol have considered projects in North America, but been deterred by uncertainty about the long-term trajectory of gas prices, as well as higher labor costs than in the Middle East.
- Shell says advances in catalysts and other improvements to synthesis reactors should improve the economics, but amid a general slow-down in spending, such projects appear less of a priority for the major at current oil prices.
- Ownership of the complex intellectual property involved in GTL projects has been hotly disputed in a variety of court cases, with Shell and UK developer Compact GTL among those to have contested rights.

- ownership of the complex intellectual property involved in GTL projects has been hotly contested rights.
- Shell and UK developer Compact GTL among those to have contested rights.

— Nick Coleman

IHS CERAWeek in Houston.

“If you get a price signal, you’ll see more supply come on,” Lance said. “That certainly has the opportunity to exacerbate the problem depending on where demand is.”

Company backlogs of drilled but uncompleted wells, sometimes referred to as DUCs, have become common in recent months because oil producers are reluctant to produce oil into a relatively low-priced market. However, they have drilled them because that is the least expensive part of well costs—about 25%—while completions make up about 75%.

Many in industry have become increasingly concerned that operators could start to complete a large backlog of several thousand industry wells if prices begin to rise to $60-$65/barrel.

“As we look forward over the next few years, we see a more volatile world,” Lance said. “If $80-$90 [per barrel] comes back, there’s a good chance that $50-$60 comes back as well because of” operators opening the production spigots as oil prices begin to ascend.

Meanwhile, Lance noted that operators are seeing 20%-30% reductions in their well costs compared with 2014 peaks and appeared to be optimistic that industry signals are heading toward an eventual recovery. He noted refineries are coming out of turnaround, ramping up their capacity, and this should bring down high storage inventories at the Cushing, Oklahoma, oil hub and elsewhere.

These events should lead to slowing in second-half 2015 of US production growth, he added, which has galloped ahead in recent years and contributed to a global oversupply starting last year. — Starr Spencer

ments around the Caspian to add value to their resource-dependent economies and reduce reliance on export pipelines. Azerbaijan, to the west of the Caspian Sea, is also advancing plans for a vast refining and petrochemicals complex to offset declining crude production.

Gas-rich Turkmenistan is keen to diversify beyond China as the main market for its gas, while it hesitates over a long-discussed plan for an export pipeline across the Caspian to Azerbaijan and western markets. The latest Turkmen GTL project, to be built by Hyundai Engineering & Construction and LG International, is expected to convert 3.5 Bcm/year of natural gas into gasoil, kerosene and naphtha—the quantities have still to be decided. However Turkmenistan’s other GTL project, involving Kawasaki Heavy Industries and Hal dor Topsoe, is already under construction, and reflects the idea that starting small may be best. It will produce just 15,500 b/d of synthetic gasoline, serving mainly the modest needs of the capital city, Ashgabat. — Nick Coleman
Oil futures close lower on expectation of stock hike

New York—Oil futures weakened Tuesday, with the NYMEX May crude contract down $1.12 to $55.26/b on expiration, as the likelihood of continued increases in US stockpiles weighed on prices.

ICE June Brent settled down $1.37 at $62.08/b.

NYMEX May ULSD ended 2.39 cents lower at $1.8532/gal. NYMEX May RBOB closed down 4.34 cents at $1.8881/gal.

US commercial crude stocks, already at a record-high 483.7 million barrels, are expected to have added another 2.6 million barrels last week, a survey of analysts showed Monday. Refinery activity has been strong, with crude runs topping 16 million b/d the week ended April 10, but high run rates also run the risk of overriding gasoline demand, CHS Hedging analyst Tony Headrick said.

“We are in a low price environment at the pump and the US is arguably doing well economically. It’s about trying to find a balance between increased production and demand picking up,” Headrick said.

The market is also keeping a close eye on the deteriorating security situation in Yemen. The US military said Tuesday it was monitoring a convoy of Iranian cargo ships off the coast of Yemen after dispatching warships from the carrier group USS Theodore Roosevelt to join other naval vessels in the area, USA Today reported.

White House spokesman Josh Earnest said Monday the US is concerned about Iran supplying weapons and offering support to Houthi rebels in Yemen.

Saudi Arabia security forces are on high alert, after the Interior Ministry warned of possible terrorist attacks against the kingdom’s oil infrastructure and popular shopping malls. Even with Tuesday’s decrease, crude futures have been stable the last five sessions after rising steadily from mid-March. Front-month NYMEX crude topped $55/b in April for the first time since December and has remained above that level, though Tuesday’s intraday low sunk to just $55.01/b.

Changes in perception, especially regarding demand, fueled higher crude prices, Energy Aspects said this week in a research note.

“The strength in demand growth is finally becoming accepted, which comes hand in hand with the realization that the total crude overhang is not nearly as big as many initially thought,” Energy Aspects said this week in a research note.

Signs of US production declines and the realization more Iranian barrels are unlikely to return soon all suggest the market could even become tight in the next six months, the consultancy said.

The danger now is that prices overreact, considering global crude stocks—growing around 1.7 million b/d in the second quarter—must be drawn down before the market can tighten, Energy Aspects said. — Geoffrey Craig

---

Argentine officials eye YPF-Gazprom partnership

Buenos Aires—Argentina’s state-run energy company YPF is expected to make advances this week in a potential partnership with Russia’s Gazprom for developing natural gas in the South American country, Argentine Planning Minister Julio De Vido said Tuesday.

“YPF has huge potential and Russia has important expertise in the field of gas,” De Vido said in a statement from Moscow, where he is traveling on an official trade mission this week.

De Vido, the country’s leading energy strategist, said YPF CEO Miguel Galuccio is due to travel to Moscow after speaking Tuesday at the IHS Energy CERAWeek conference in Houston.

YPF and Gazprom “will try to look for joint investments,” De Vido said.

He added similar deals could be reached with Russia’s Lukoil and Rosneft for oil projects in Argentina.

Argentine President Cristina Fernandez de Kirchner is leading the Wednesday-Friday trade mission, with De Vido doing preparatory work before her arrival. Fernandez de Kirchner is due to meet with Russian President Vladimir Putin.

Her administration has said that oil and electricity will be main topics of the bilateral talks. — Charles Newbery
Going into its 7th year, Benposium empowers you with proprietary, comprehensive and forward-looking energy market fundamental analysis as only Bentek can deliver. The objective of Benposium remains unchanged: to explore the most important aspects of the natural gas, crude oil, NGL, and LNG markets in North America, while providing information and insights to help you stay ahead of the curve. Join key industry executives, analysts, traders, producers, end-users and investors for an in-depth look at shifting energy market dynamics and how these developments will shape the energy landscape over the next five years — and beyond.

**Key Questions to Be Answered at Benposium 2015:**

- What is the outlook for plays such as the Marcellus, Utica, Permian, Eagle Ford, and Bakken in the low-price environment? Which plays are in jeopardy?

- How will the energy sector persevere through the dramatic price changes in oil, natural gas, and NGLs?

- Will demand for oil, natural gas, and NGLs respond sufficiently to mitigate oversupply?

- How drastic will Marcellus gas production impact Midcontinent, Southeast, and West producers?

- How much will associated gas production increase even with declines in drilling activity?

- Will exports such as condensate, LNG, and LPGs be the savior to burgeoning North America supply?

- What should market participants expect, and need to be prepared for, in the next five years?