

## MUSINGS FROM THE OIL PATCH

December 28, 2005

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**Note:** *Musings from the Oil Patch* reflects an eclectic collection of stories and analyses dealing with issues and developments within the energy industry that I feel have potentially significant implications for executives operating oilfield service companies. The newsletter currently anticipates a semi-monthly publishing schedule, but periodically the event and news flow may dictate a more frequent schedule. As always, I welcome your comments and observations. Allen Brooks

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## Energy Thoughts Based on December Events

### **Many events and trends will shape the outlook for energy in 2006**

December in the U.S. is always an interesting month, both politically and economically. During the last month of the year, we are often engaged in trying to tie up loose ends and gaining a perspective on the outlook for the next year. This December has been no different as there have been several major events and meetings to factor into the mix. For example, in Montreal, Canada there was the global environment meeting dealing with the Kyoto Protocol, while in Washington we had the once-a-decade conference on ageing. Factor in the political hysteria we call policy-making in Washington, the election in Iraq, the latest message from al-Qaeda and economic and monetary concerns, and you have one huge mish-mash of events. Let's see if we can draw on different insights to make some sense of this potpourri of events and issues.

### **Montreal delegates began to truly understand that the United States was not going to be a party to Kyoto**

At the Montreal Conference of Parties representing the countries that have signed the Kyoto Protocol, the mood was one of consternation as the delegates began to truly understand that the United States was not going to be a party to this process. The difference between the public and private views of European delegates became clearer as the conference progressed. Publicly, they began to focus on 2009 and the next U.S. president as they admitted that the Bush Administration was not going to join the process. Maybe the next U.S. president will be more willing to join, but in criticizing Bush, they fail to mention that Bill Clinton didn't even try to take the Kyoto treaty to the U.S. Senate for ratification since it had previously voted 95-0 to reject any greenhouse emission restrictions. However, the statement by the primary environmental lobbying movement at the conference more accurately reflected their private views. That statement said, "Parties should ignore the U.S. and keep their eyes on the prize: elaboration of a more effective Kyoto Protocol that leads to greater emissions reductions."

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**Most signatory countries will have reduced their greenhouse-gas emissions by 2012, but they will have fallen short of their Kyoto targets**

The way forward for controlling emissions will be more complex than previously thought, but will ultimately reflect two tracks – the Kyoto process and the U.S. process. Under the former, the first commitment period for Kyoto expires in 2012. Most signatory countries will have reduced their greenhouse-gas emissions by then, but they will have fallen short of their Kyoto targets. The shortfalls will reflect the difficulty most countries have with the economic, and therefore social and political, fallout from the draconian measures required to meet these targets. The Kyoto process will begin to focus on the next phase of restrictions, recognizing that the challenge will be even greater. In order to try to set the new restrictions, they will first have to grapple with the magnitude of the emission restrictions needed to offset the climate model predictions of 2-3 degree warming by 2050. Targets for cutting emissions by 50%-60% may appear stark, but they will make the potential for attaining an 8-10% reduction appear easy.

**The U.S. process will not require anyone to agree to an absolute emission reduction, or to agree to specific targets or timetables**

Under the U.S. process, in early 2006, the United States, China and India, the three largest greenhouse-gas emitters, will be joined by Japan and Australia in an effort to determine how to harness technology to reduce the carbon intensity of production. This process will not require anyone to agree to an absolute emission reduction, or to agree to specific targets or timetables. However, it will lead to industrial alliances designed to reduce the amount of greenhouse-gas emitted per unit of GDP. These alliances could lead to significant changes in the energy infrastructure of the U.S., China and India that might produce a dramatic reduction in emissions versus the business-as-usual approach.

**The potential for environmentalists and industrialists to embrace legislation such as the 2005 McCain-Lieberman Climate Stewardship Act appears to be growing**

In the interim, U.S. environmental groups have been working to get state and local emission policies enacted that are beginning to create a regulatory maze for industrial companies. One need only consider the efforts that have been waged against the automobile industry in places such as California and the Northeast, with Rhode Island becoming the latest state to enact more restrictive vehicle emission standards for 2009 model automobiles. This regulatory maze, coupled with the tighter environmental restrictions of the European Union countries, is beginning to force U.S. manufacturers to consider seeking some alternative solution. Whether that solution would be executive or legislative is unclear. However, the potential for environmentalists and industrialists to embrace legislation such as the 2005 McCain-Lieberman Climate Stewardship Act appears to be growing. (Consider this political scenario. With McCain having gained the initiative on terrorism, and Lieberman gaining on support for an Iraq victory, and both gaining stature on environmental and economic issues, Lieberman switches parties and the two team up to head the 2008 Republican ticket.)

For the environmentalists to gain further support, they will have to make some concessions. They were recently successful in battling to block a provision in the Defense appropriations bill that would have allowed drilling in the Alaskan National Wildlife Refuge (ANWR). The price for winning this battle may be that they have to

become supporters of increased nuclear power, LNG and even clean-coal to meet America's future energy needs. This comes at the same time the American consumer is beginning to adjust his attitude toward energy use and vehicle selection. These events are happening just as the U.S. has reached an inflection point in its views on climate change, oil use and efficiency and transportation.

The decadal White House conference on ageing in the United States dealt with the challenges of how our economy will meet the needs and wants of the Baby Boomer generation as it reaches retirement. Our ageing economy will become increasingly challenged to grow in the face of labor shortages and escalating economic and medical costs. How we can generate economic growth rates that support these needs, in the face of potentially higher energy costs, remains to be determined.

**The significance of the airing of a two-month old al Qaeda tape has been debated, but only recently have analysts begun to think of alternative explanations**

While these long-term trends are beginning to emerge, a more immediate issue may be determining the significance of the early December playing by Al Jazeera of a videotape containing comments from al Qaeda's number two leader, Aymen al-Zawahiri. Portions of the tape were played in September when the tape was initially sent to Al Jazeera, but the full tape was not played until December 7. The significance of the airing of a two-month old tape has been debated, but only recently have analysts begun to think of alternative explanations. The most significant theory is that the tape's exhortation to attack the oil industry may have actually been a message directed at U.S. operatives rather than at those in the Middle East. On the tape, al-Zawahiri says, "I call on mujahideen to concentrate their attacks on Muslims' stolen oil, from which most of the revenues go to the enemies of Islam, while most of what they leave is seized by the thieves who rule our countries."

**It is possible that the comments were really directed at a sleeper operation or jihadist sympathizers in the United States**

The statement did not say exactly where the oil infrastructure was that is to be targeted. It was quickly assumed that al Qaeda followers would attempt to carry out this mandate where they could easily do so; meaning within their local reach, namely the Middle East. However, it is possible that the comments were really directed at a sleeper operation or jihadist sympathizers in the United States. It is interesting to contemplate the timing of this signal to potential U.S. operatives just as the debate over extending the Patriot Act was heating up in Washington. Is this why the parts of the two-month old tape never before shown were televised?

Even though there has not been a terrorist attack in the United States since Sept. 11, this does not mean that al Qaeda capabilities have been totally eliminated. If this exhortation is directed at the United States, then the potential for Houston to be the target has to be re-examined. Not only is Houston home to the country's largest energy complex (along the Houston Ship Channel), that if significantly damaged could have a major impact on our energy supplies, it is home to the operational management of most of the major international oil companies including Saudi Aramco. Houston energy sites have been identified as having been targets of terrorist

**Our advice for the new year is to pay attention to the changing mindset toward energy in this country**

surveillance. There reportedly is credible evidence of an al Qaeda sleeper cell in Houston. Additionally, Houston was used by the terrorist cell led by Shiekh Omar Abdel-Rahman, the Blind Sheikh, who instigated the 1993 bombing of the World Trade Center in New York. As a result of the investigation of this terrorist act and its perpetrators, many Houston ties with terrorists were uncovered.

The events of December 2005 have set the stage for an interesting 2006. We still contend that the fallout from Hurricanes Katrina and Rita mark a watershed in U.S. energy markets. The defeat of ANWR drilling, while appearing to be just a continuation of our normal environmental movement battles, may mark a watershed point, which could lead to our embracing alternative energy sources for meeting our future energy needs. While we may be altering our thinking about our sources of future energy supply, and even the amount of energy we may need in the future, increasingly we are hearing expressed comments and attitudes within the oil and gas industry that remind us of the rhetoric of the late 1970s and early 1980s that was blind to the eroding fundamentals underlying the business. We hope we are not about to repeat that disastrous period in our history. Our advice for the new year is to pay attention to the changing mindset toward energy in this country.

## OPEC and China Try to Make A Deal

**China is the second-largest energy market behind the United States, and OPEC members are leading exporters to the country**

Sheik Ahmad Fahd al-Ahmad al-Sabah, Kuwait energy and oil minister and president of the Organization of Oil Exporting Countries (OPEC), is leading a delegation of OPEC members to China this week for talks about how to strengthen their relations. China is the second-largest energy market behind the United States, and OPEC members are leading exporters to the country. Based on statistics from the Customs General Administration in Beijing, China imported 800,000 barrels per day (b/d) this year from Saudi Arabia, Iran and Indonesia, the largest OPEC suppliers. Russia, Angola, Oman and the Sudan are the largest non-OPEC oil suppliers to China.

**One way for OPEC to strengthen its position in China may be to commit to build additional refineries there**

China is forecast to need over 3 million b/d of imported oil in 2006 to keep its economy humming. OPEC wants to make sure that it retains its leading exporter role as the future growth of the Chinese market will become increasingly more important for OPEC's output as growing Canadian oil sands exports gain an increased share of the U.S. energy market. One way for OPEC to strengthen its position in China may be to commit to build additional refineries there.

In 2001, Saudi Aramco, the world's largest oil company based on production volumes, agreed to expand a refinery in Fujian Province owned by China Petroleum & Chemical (Sinopec) and ExxonMobil at a cost of \$3.5 billion. In addition, in 2003, Saudi Arabia awarded oil exploration licenses to Sinopec at the time it opened up areas of its country to western oil company exploration. Recently, Kuwait

**If the members of OPEC are prepared to use their checkbooks, they can assure themselves of secure and growing markets for their oil output**

and China have agreed to develop a refinery complex near Guangzhou with a capacity of 200,000-400,000 b/d of gasoline and other fuels. The refinery, estimated to cost over \$5 billion, will utilize Kuwait oil for its feedstock.

If the members of OPEC are prepared to use their checkbooks, which are overflowing with cash with global oil prices in the \$55-\$65 per barrel range, to build refineries in China, they can assure themselves of secure and growing markets for their oil output. Those assurances should support sustained investment in new production capacity in these OPEC countries that would benefit the world's oil supply outlook. We will see what agreements and assurances the Sheik and his entourage bring home from their China visit and whether they translate into an investment upturn.

## Oil Traders and Short-term Memory

**The U.S. economic news has been pretty good with positive inflation results and less weakness in the housing and automotive sectors than originally anticipated**

It has been interesting to watch the gyrations in crude oil prices over the past two months in response to changing weather and economic conditions. The U.S. economic news has been pretty good with positive inflation results and less weakness in the housing and automotive sectors than originally anticipated. However, concerns about the health of the U.S. housing market and its possible impact on further consumer spending growth continue to haunt economic prognosticators. At the same time, economic news from abroad has also been quite positive. The upwardly revised Chinese economic figures, coupled with signs of resurgence in economic growth in Germany and Japan, have provided economists comfort in their positive outlooks for a healthy global economy in 2006.

**These price movements seem to have come almost as a surprise, even though winter is an annual event**

What appears to have moved crude oil and natural gas futures prices has been the weather in the northeastern and central regions of the United States. What has been most interesting is that these price movements seem to have come almost as a surprise, even though winter is an annual event. Now the degree of winter weather and the exact timing may vary from year to year, but winter always seems to come eventually. This year is no different.

AccuWeather is predicting a colder than normal winter season for a portion of the upper northern region of the country this winter, but it anticipates about normal winter weather for the rest of the country. The forecast is based somewhat on analogs winter temperatures in years with above-average hurricane activity such as experienced this year. Those years have generally produced cooler-than-normal winter temperatures and especially for the month of March.

Exhibit 1. AccuWeather Winter Forecast



Source: AccuWeather.com

**The initial NWS forecast called for warmer-than-normal temperatures this winter for most of the country**

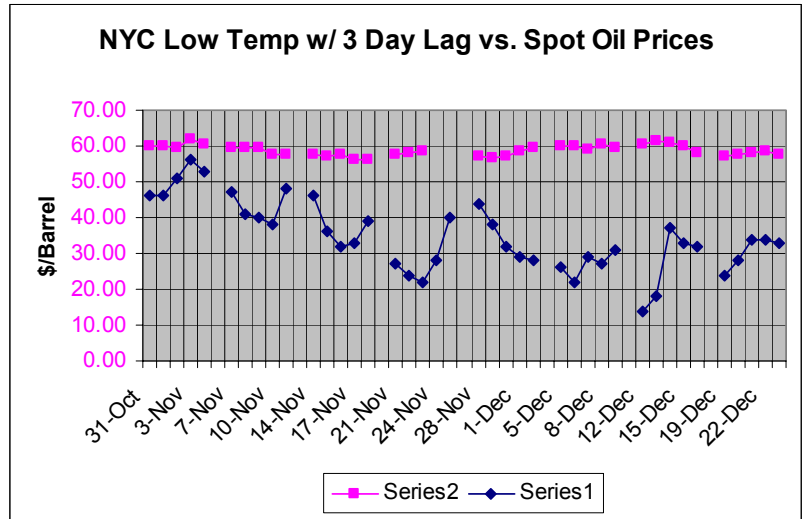
The AccuWeather forecast was initially in line with the first revised forecast from the National Weather Service (NWS), which operates under the auspices of the National Oceanic and Atmospheric Administration (NOAA). The initial NWS forecast called for warmer-than-normal temperatures this winter for most of the country, but now they see a greater area where temperatures will fluctuate around normal. The government weather service doesn't actually prepare a forecast, but rather provides probabilities of temperatures being above- or below-normal, or merely normal.

**Even though natural gas inventories remain very healthy, futures traders are worried that these reserves will prove inadequate if we experience a polar winter such as we did in 1989**

What has been interesting has been the build in crude oil inventories in the past few weeks, along with a general rise in petroleum product inventories, despite a slightly colder start to the winter season. While crude oil and petroleum product futures prices have bounced around during the past 60 days, the trend in natural gas prices has reflected a strong upward bias. This rise is the result of a lack of alternative energy sources combined with the fallout from the hurricanes that have shut in a substantial volume of Gulf of Mexico gas production. Even though natural gas inventories remain very healthy, futures traders are worried that these reserves will prove inadequate if we experience a polar winter such as we did in 1989.

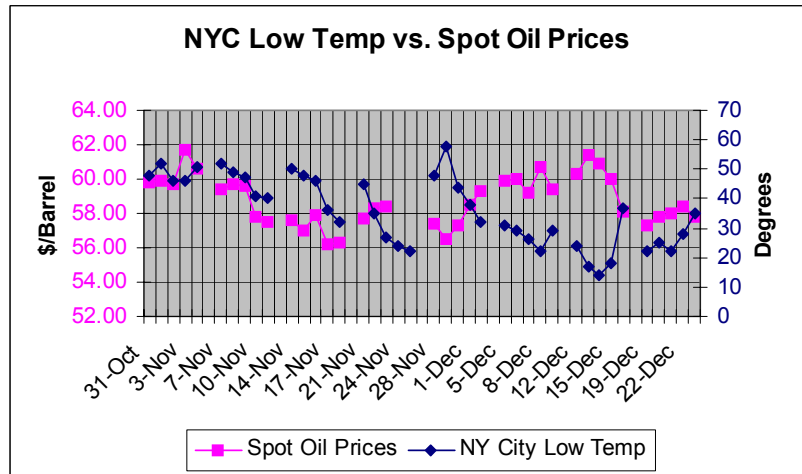
We thought it would be interesting to plot the movement of spot crude oil prices against the low temperature readings for New York City as a measure of the impact winter weather is having on commodity prices. Recognizing that traders are attempting to anticipate future energy demand, we lagged the actual temperatures and the forecast for the last week to see if the fit between price movements and temperatures was better. While not perfect, the three-day temperature lag appears to show a stronger correlation than the mere plot of price and temperature, as shown by the two charts below.

**Exhibit 2. Temperatures Correlate Well With 3 Day Lag**



Source: EIA; PPHB

**Exhibit 3. Temperatures vs. Spot Oil Prices**



Source: EIA; PPHB

**Bastardi sees the month of March as having colder-than-normal temperatures that could surprise energy investors and traders**

According to meteorologist Joe Bastardi of AccuWeather, through December 20, there had only been four days of above-normal temperatures in New York City since November 17. That performance has helped to boost energy futures prices. Bastardi is predicting additional colder-than-normal temperatures for the northeast region this winter with only brief periods of warming trends. Most significantly, he sees the month of March as having colder-than-normal temperatures. This result, he believes, could surprise energy investors and traders and lead to higher energy prices as both oil and gas storage volumes fall to critically low levels.

On the other hand, a new three-month forecast from WSI, an affiliate of Energy Security Analysis, Inc. (ESAI) of Andover, Massachusetts, calls for generally warmer-than-normal temperatures for most of the

**So how is it that we can have two well-regarded weather forecasters coming to opposite conclusions about this winter's weather**

country. Specifically, WSI sees a warmer January for the Northeast, Southeast, South Central and Southwest regions of the country. It expects the North Central and Northwest regions to be colder than normal. In February, WSI predicts cooler-than-normal temperatures for the North Central and Northwest regions, but warmer everywhere else. EASI believes the increased natural gas demand from the North Central states will be offset by the warmer temperatures everywhere else.

Very significantly, WSI sees warmer-than-normal temperatures everywhere but in the Southwest region for the month of March. As a result, EASI foresees end-of-winter natural gas storage levels much higher than presently anticipated that would likely send gas prices crashing. So how is it that we can have two well-regarded weather forecasters coming to opposite conclusions about this winter's weather, and especially the weather for March producing diametrically opposite conclusions for natural gas traders and investors? Both forecasters look at the current weather conditions, the weather patterns that are developing and then search for historical analogs to develop their forecasts. Obviously, each has come to a different conclusion about which analog years to use in modeling their winter weather forecasts. The direction of energy prices over the next several months, and the success of energy investors and commodity traders, will depend on whether they pick the correct forecast.

## Clean Air or Global Warming

**A reduction in haze from human causes may accelerate warming of the earth's atmosphere**

An article in Nature magazine presents a potential Hobson's choice for people: A reduction in haze from human causes may accelerate warming of the earth's atmosphere. The pollutants in the air act to absorb and scatter sunlight reducing the impact on warming of the earth's atmosphere. According to Jim Coakley, a professor of atmospheric sciences at Oregon State University in Corvallis, Oregon, in a telephone interview with Bloomberg News, "If people clean up the air, more warming will come blazing through." Dr. Coakley, the Nobel Laureate, was asked by Nature to write a commentary about the study.

**The cooling effect of the hazing was stronger than many scientists believed**

The study was performed by a group of scientists working for government agencies in Britain and the United States. The findings were made after adding satellite-based measurements of haze to computer models estimating the consequences of industrial emissions of aerosols, or airborne particles. What they found was that the cooling effect of the hazing was stronger than many scientists believed. The cooling offsets about one-third of the warming from the use of fossil fuels and other manmade causes.

The new estimate of the cooling effect of haze is at the high end of ranges cited by the Intergovernmental Panel on Climate Change, the study group formed by the United Nations Environment Program and

**Further warming may mean that within decades, summers will be about a month longer than they are now**

the World Meteorological Organization. According to the researchers, "Consequently, continued aerosol emission controls may lead to a stronger warming than current model predictions."

According to Dr. Coakley, global temperatures are already about seven-tenths of a degree Fahrenheit higher than they were in the 1980s. Further warming may mean that within decades, summers will be about a month longer than they are now. There are a number of implications for energy from the lengthening of summer. By definition, winter would be shorter reducing heating demand. On the other hand, in warmer regions where air conditioning is used, the longer season could mean more energy demand. In the face of higher energy costs, people are generally more able to tolerate warmer temperatures rather than colder ones, so we might expect the net energy impact to be a reduction in consumption. Additionally, the longer growing season global warming would bring might lead to increased fertilizer and farming energy needs. There are numerous other energy impacts from this changed weather pattern that we have not enumerated. However, it is interesting, and important, to contemplate the net energy impact of global warming.

## A Larger China Economy May Explain Energy Demand

**Based on the revised figures, China's economy is now the sixth largest**

Last week the National Bureau of Statistics announced a revision to its estimate of the size of the Chinese economy. Based on the revised figures, the Chinese economy at the end of 2004 is now estimated to have been 15.988 trillion yuan, or \$1.932 trillion based on a year-end exchange rate of 8.276 yuan to the dollar, or 16.8% larger than prior estimates. This makes China the sixth largest economy trailing Italy. Given exchange rate movements and relative economic growth rates in 2005 (China's economy is expected to grow by 9%), economists calculate that China will grow to be the fourth largest economy, passing Italy and the United Kingdom. As the fourth largest economy, China will trail only the United States, Japan and Germany. The game now for economists is to speculate on when the Chinese economy will pass each of those countries. Current estimates are that by 2050, China will become the largest economy in the world.

**The service sector accounts for 40.7% of GDP in contrast to the prior assumption of a 31.9% weighting**

The new Chinese economy estimate was developed following the first economic census performed in decades. The year-long survey was performed by 13 million data-gatherers, or one in every hundred Chinese. The statistics suggest that the service sector (real estate, transportation and restaurants, etc.) accounts for 40.7% of Gross Domestic Product (GDP) in contrast to the prior assumption of a 31.9% weighting. On the other hand, the manufacturing sector's importance was reduced to 46.2% from its prior 52.9% weighting. The agriculture and related activities sector was lowered to 13.1% from its prior weighting of 15.2%.

The understanding that the makeup of the Chinese economy is

**The sustainability of growth of the Chinese economy is now more assured with the larger service sector**

different from previous beliefs has altered certain perceptions about the future challenges the economy faces. First, almost the entire increase in the size of the Chinese economy was accounted for by the service sector. This has important implications for job growth. Second, economists now believe the Chinese economy faces less risk of overheating because the impact of certain risk measures such as the ratio of bad loans to GDP have improved. Third, the sustainability of growth of the Chinese economy is now more assured with the larger service sector. Since the economy is now less reliant on export-oriented industries, the government may let the value of the yuan float higher against foreign currencies with less fear of damage to the economy.

**China will depend less on ever-faster industrial output, with its increased energy and raw material demands, to sustain 9%+ annual GDP growth rates**

Two other conclusions come from the new economic statistics. One is that the significant growth in energy consumption over the past several years may be explained by the growth of the service sector and its electricity needs that were under-supplied because of the lag in construction of new power and hydroelectric plants. The better supply/demand balance in the electricity sector may reduce diesel oil demand. Second, China will depend less on ever-faster industrial output, with its increased energy and raw material demands, to sustain 9%+ annual GDP growth rates. Based on these two conclusions, we would expect Chinese energy demand growth in the future to moderate from the 15% pace experienced in 2004. Whether the 2% growth projected for this year will become more the norm remains to be seen, but we suspect the 5.3% growth forecast by OPEC in 2006 may prove to be within the range of future yearly growth expectations.

## Russia – Looking for Respect

**There is speculation that Russian oil policy changes are imminent in an effort to boost the country's future production growth rate**

After a number of years of demonstrating above average oil production growth, Russia's oil production growth has slowed considerably in 2005 from the 9%-11% growth experienced in the 2001-2004 period. Based on the latest statistics, Russian production increased from 9.19 million b/d in 2004 to 9.42 million b/d this year, or an increase of 2.5%. Projections call for oil production growth to increase by only 1.3% in 2006, spurring speculation that Russian oil policy changes are imminent in an effort to boost the country's future production growth rate. Those changes reportedly will provide new incentives designed to stimulate new exploration instead of continued redevelopment of existing fields as has been the recent practice. In other words, Russia will begin emphasizing Greenfield exploration over Brownfield development.

The lower oil production growth rate in 2005 and 2006 is largely attributable to the fallout from the political turmoil surrounding the dismantling of Yukos last year, as the Russian government undertook the re-nationalization of its oil and gas industry. This re-nationalization has been undertaken to strengthen the power of Russian President Vladimir Putin.

**Gazprom became the Russian gas powerhouse, and an agent of political influence via its Western European supply deals**

When Putin began to gather political strength, he tacitly allowed certain Russian businessmen to amass huge ownership positions in important companies in the economy as long as they agreed not to challenge him politically. With these positions, the businessmen saw their wealth explode as investors bid up the stock prices of their companies. Buoyed by their newfound wealth, some of these Russian oligarchs began to flex their political muscle in direct disregard of their prior agreement with the government to remain non-political. As they became more outspoken and threatened the current Russian leadership, political and economic retaliation became more likely. The most high-profile response to the threat from these oligarchs was the income tax evasion and fraud charges leveled against Mikhail Khodorkovsky, the head of OAO Yukos (YUKOY.PK-OTC). Not only did Khodorkovsky wind up being sentenced to a Siberian jail for eight years, but the prize asset of his company was confiscated and sold to a local, state-controlled Russian oil company.

As Russia's energy re-nationalization efforts moved forward, the plan for the creation of two powerful companies – one for oil and the other for gas – emerged. Gazprom (OGZPF.PK-OTC) became the Russian gas powerhouse, and an agent of political influence via its Western European supply deals. Meanwhile, state-owned OAO Rosneft mushroomed into a major oil company by the timely purchase of the principal Siberian oil-producing assets of Yukos under questionable legal maneuvering and a questionable auction. With these two vehicles in place to carry forward Russia's energy/political strategy, Putin turned to the issue of how best to provide each company with legitimacy.

That effort has recently emerged. Gazprom was already a publicly traded company with the government owning over 50%. Through recent maneuvering, the Putin government was able to engineer an increase in its control over Gazprom and enacted legislation that should ease restrictions on western investor ownership in the company. Fundamentally, Gazprom is moving forward with its effort to become the dominant natural gas supplier to Western Europe.

**Exhibit 4. Russia to Europe Gas Pipeline**



Source: Gazprom

**To improve Gazprom's image, former German Chancellor Gerhard Schröder was appointed as chairman of the supervisory board of Northern European Gas Pipeline Company**

Important in this effort is the construction of a pipeline between Gryazoveta, Russia and Greifswald, Germany to supply gas to Germany, the Netherlands and possibly even to the UK. To improve Gazprom's image in this regard, former German Chancellor Gerhard Schröder was appointed as chairman of the supervisory board of Northern European Gas Pipeline Company, the owner of this pipeline, which in turn is controlled by Gazprom. Many eyebrows have been raised about this appointment, given Schröder's political support for the project while in office and the timing of his appointment immediately following his defeat as the head of Germany.

**To give Rosneft, which is contemplating an IPO in 2006, equal political standing, Putin reportedly offered the chairmanship to former U.S. Commerce Secretary Donald Evans**

In order to give Rosneft, which is contemplating an initial public offering in 2006, equal political standing, Putin reportedly offered the chairmanship to former U.S. Commerce Secretary Donald Evans, a long-time Texas oil-man and close friend and advisor to President George W. Bush. Reports were that Evans considered the position, but ultimately turned it down. While we don't know for sure, but based on our past dealings with Mr. Evans, we suspect he saw the offer as merely an attempt to use his own stature and his close association with President Bush as a tacit endorsement of the legitimacy of Rosneft.

Mr. Putin is trying to cap off a successful 2005 by providing high-level global credibility to his two energy firms before they march forward in furtherance of his geopolitical aims. For example, there was another meeting in Moscow between Gazprom and France's Gaz de France to discuss closer working arrangements to foster increased Russian gas use in Europe. The two companies have agreed to further cooperate on LNG projects, developing re-gasification capacity on the U.S. East Coast and shipping LNG to North America.

**The Evans job offer rejection means that Putin will need to find another high-profile executive for Rosneft**

A tight oil and gas supply market should give the two Russian oil and gas companies increased bargaining power in world markets, adding to the financial and political war chests of Putin and the country. The Evans job offer rejection means that Putin will need to find another high-profile executive for Rosneft, especially as it moves toward an IPO. We are sure there are candidates out there, but probably none with the political stature that Evans would have brought. Stay tuned for the next announcement, but understand that it will not paper over the questionable legal maneuvers used to build Rosneft, or Putin's ambitions for the company.

## Is a Gulf of Mexico Tsunami a Concern?

In early December, officials from the NOAA National Weather Service went to Hawaii to praise the local civil defense team for completing a set of rigorous warning and evacuation criteria necessary to earn the distinction for the entire state of being TsunamiReady and StormReady. Hawaii U.S. Senator Daniel K.

**Hawaii has experienced more tsunami threats than any other state in the union**

Inouye said, "It is with great pride that we announce Hawaii as the first TsunamiReady state in America."

Hawaii has experienced more tsunami threats than any other state in the union. Today, everyone is more familiar with the tremendous damage a tsunami can deliver following the Dec. 26, 2004, storm that leveled many areas in the Indian Ocean region, killing an estimated 230,000 people. The horrific damage done by Hurricane Katrina to the U.S. Gulf Coast has further reinforced the view of the damage that Mother Nature can deliver in a short time.

Hawaii has been hit by several tsunamis in the past. The fury of a tsunami is shown in this picture of a tsunami breaking over Pier No. 1 in Hilo Harbor in 1946. The man in the foreground of the picture (under the arrow) became one of the 159 fatalities in the Hawaiian Islands from that tsunami. The picture was taken from the *Brigham Victory*, which was in Hilo Harbor at the time of the tsunami. The ship was caught by the waves and tossed about, but was able to use its own power to avoid the reefs and get past the breakwater to the open sea.

#### **Exhibit 5. Hawaii 1946 Tsunami**

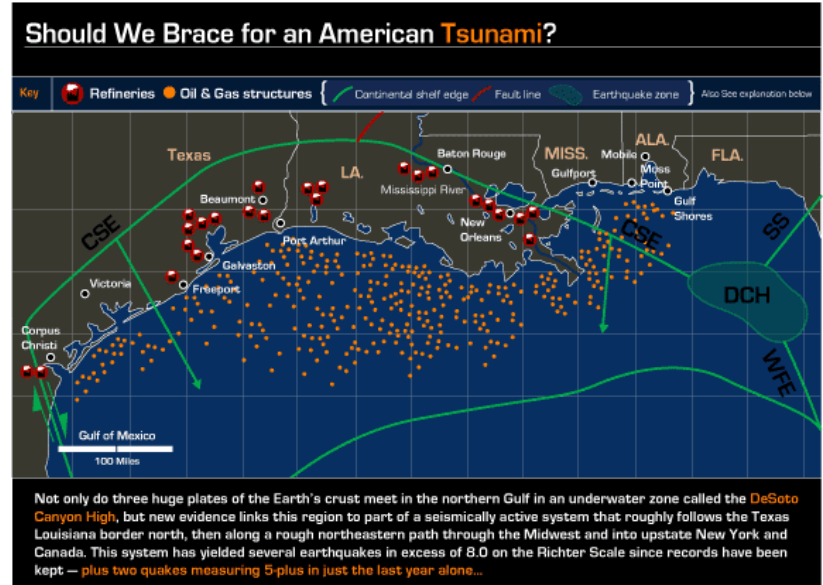


Source: NOAA

**How prepared are the other coastal regions of the United States?**

In Hawaii, the civil defense organization has established an emergency operations center in every county, a statewide siren system, placed evacuation maps in the phone books, conducts regular drills and has created public education programs, all designed to prepare the state and its citizens for a possible tsunami. But how prepared are the other coastal regions of the United States? Plans are underway to prepare the West Coast states for a possible tsunami, including a potential ocean warning system. On the East Coast, the belief is that any event that could create a tsunami is too remote and the wave would take days to reach the coast so that preparation requirements are minimal.

## Exhibit 6. Gulf of Mexico Tsunami Potential



Source: NOAA

**What about the possibility of a tsunami hitting the Gulf Coast?**

What about the possibility of a tsunami hitting the Gulf Coast? A former Texaco scientist has been studying the potential for a tsunami to hit the Gulf Coast as the result of an earthquake caused by the shifting of the three plates that come together in the DeSoto Canyon region of the Gulf of Mexico. While the odds of this event are not considered high, the risk does exist. Whether the damage inflicted by a tsunami generated from a DeSoto Canyon earthquake would be greater than that inflicted by either a Category 4 or Category 5 hurricane hitting the Gulf Coast is debatable. All we really know is that nature's phenomena are likely to continue to inflict damage on our Gulf Coast oil and gas infrastructure, which will further strain our energy supply situation and help sustain higher than historic commodity prices.

**Is The Pain of Separation Too Great?**

**According to an SEC filing, Lee Raymond has agreed to assist ExxonMobil in the transitioning of major strategic corporate relationships**

On December 16, ExxonMobil (XOM-NYSE) and its retiring chairman, Lee Raymond, spun a new deal to keep him involved in the company's affairs. According to an SEC filing, Mr. Raymond has agreed to assist in the transitioning of major strategic corporate relationships and to participate in external activities and events as requested by ExxonMobil's new Chairman in exchange for a fee of \$1 million, payable in a single installment in December 2006, plus reimbursement of Mr. Raymond's reasonable expenses incurred in providing such services.

In addition to this portion of the agreement, ExxonMobil will provide protective services to Mr. Raymond and his wife for a two-year period. This service will consist of providing a security system at Mr.

Raymond's home, personal security people, a car and personal security driver and the use of ExxonMobil or chartered aircraft for ExxonMobil business and personal travel. Mr. Raymond will reimburse ExxonMobil for personal use of the automobile and planes in accordance with IRS regulations. This agreement and provision of services is in addition to the normal retirement benefits earned by Mr. Raymond and additional services usually provided to former chairmen of the company such as provision of an office and secretarial support.

**We do wonder about the transition services he needs to perform, given that he had already extended his retirement date by one year to facilitate a smooth management succession**

While we do not begrudge Mr. Raymond his million dollars, we do wonder about the transition services he needs to perform for ExxonMobil, given that he had already extended his retirement date by one year to facilitate a smooth management succession. Was this payment really about services to be rendered or did it reflect Mr. Raymond's reluctance to yield the influence associated with one of the most powerful corporate jobs in the world?

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