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WTI Contango Trade May Dwindle on Storage Surge: Energy Markets
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(Run {BMAP 33424 <GO>} for map of Cushing.)

By Aaron Clark

Nov. 10 (Bloomberg) -- The longest period of contango in the U.S. oil market may end as storage capacity expands by more than a quarter at Cushing, Oklahoma, the biggest U.S. crude- trading hub.

West Texas Intermediate oil for delivery next month traded at \$1.86 a barrel less than the six-month contract on the New York Mercantile Exchange yesterday, compared with \$9.88 a barrel in May. The contango, in which prompt oil is cheaper than later delivery, has averaged \$2.70 during the past five years.

Nymex futures nearest to expiration have traded below next- month contracts since November 2008 as oil stored in Cushing more than doubled. Companies have announced plans to build about 14 million barrels of tanks by the end of 2011. That would boost capacity as much as 27 percent, based on an estimated 51 million to 52 million of existing storage according to Bob Levin, a managing director at CME Group, the owner of Nymex.

The additional storage "limits the opportunity for contango," said Stephen Schork, the president of the Schork Group Inc. in Villanova, Pennsylvania. "If you do have that ability now to put those barrels into storage, you will see a return back to fundamentals."

Oil supplies at Cushing were 31.8 million barrels as of Nov. 5, according to the Energy Department, down from a record- high 37.9 million in May. Most companies assume operational capacity is about 80 percent of total capacity, said Michael Shore, a Nymex spokesman. Operational capacity is less because some oils can't be mixed and pipeline shipments require extra tank space.

WTI 'Pressure'

"Whenever inventory levels have been high, relative to the capacity, what that's done is put pressure on the front-month pricing," said Jeffrey Dietert, an analyst with Simmons & Co. International in Houston.

Plains All American Pipeline LP has announced projects adding about 5.4 million barrels in Cushing. The Gavilon Group LLC said in June it plans to build 4 million barrels of tanks by the third quarter of 2011. Magellan Midstream Partners LP, which acquired 7.8 million barrels of Cushing storage from BP Plc in July, said in September it's building another 4.25 million barrels of storage by the end of 2011.

With new capacity, "you decrease the opportunity to squeeze the market," said Carl Larry, president of Oil Outlooks & Opinions LLC in Houston. "When you add more storage, you take away that play."

Pipeline Hub

Cushing, located about 54 miles (87 km) northeast of Oklahoma City, receives oil from West Texas and Oklahoma, as well as domestic and foreign crude from the Gulf Coast and oil sands from Canada. Oil is transported from Cushing primarily to refineries in the Midwest. Cushing was established in 1983 as the Nymex contract's delivery point because of its existing storage and pipelines, according to Shore.

Additional space may help align West Texas Intermediate, or WTI, with other global benchmarks such as Brent, the pricing basis for two-thirds of the world's oil, said Amrita Sen, a London-based oil analyst at Barclays Capital.

WTI traded at \$1.15 less than Brent on the London-based ICE Futures exchange yesterday, from \$5.71 a barrel in May. In the five years through 2008, it averaged \$1.26 more than Brent.

Additional tanks will lower prices for consumers, said Kent Bayazitoglu, an analyst with Gelber & Associates, an energy- trading consulting company in Houston. It will also increase pipeline capacity because of added delivery options, helping refiners process crude from North Dakota's Bakken field and the Alberta oil sands, he said.

Keystone Extension

TransCanada Corp. anticipates the extension to Cushing of its Keystone pipeline that now runs from Hardisty, Alberta, to Wood River and Patoka, Illinois, to be in service in the first quarter of 2011, Ken Murchie, a director of pipeline development, said in September. The Calgary-based company expects the final leg of the pipe, which will connect Cushing to the Gulf Coast, to be completed by early 2013, pending regulatory approvals.

Canada, the largest U.S. crude supplier, may increase production 21 percent to 3.29 million barrels a day in 2015 from 2.72 million in 2009, the Canadian Association of Petroleum Producers said in June. North Dakota oil output jumped 33 percent from January to 314,000 barrels a day in June, according to the Energy Department in Washington.

"The big question is: Are all the people who take these storage commitments going to be happy a year from now?" said Andy Lipow, president of Lipow Oil Associates LLC in Houston. "Or are they just going to be paying a storage fee per month and not be able to make any money?"

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