

Oil May Rise as BP Shutdown Shows Industry Distress (Update1)

By Tom Cahill and Sonja Franklin

Aug. 21 (Bloomberg) -- BP Plc's shutdown of the largest U.S. oil field may be the first of many, as decaying pipelines threaten to add 20 percent to energy prices in the next decade.

"We'll look back on this event as the Pearl Harbor Day in energy," said Matthew Simmons, chairman of energy investment bank Simmons & Co. International in Houston. The chance that the leaks and corrosion found at Prudhoe Bay by BP, Europe's second-largest oil company, are an isolated occurrence is "zero," said Simmons, who's writing a book on aging oil infrastructure.

A growing minority of analysts, oil executives and government officials say the current system for producing and transporting crude will be unable to deliver the energy needed in the next 10 years. Repairs and replacement of pipes, valves and refineries will help push oil to \$93 a barrel by 2015, from a high of \$72.08 today, says Barclays Capital analyst Kevin Norrish in London, the most accurate price forecaster in a survey by Bloomberg News last year.

Internal corrosion is the biggest reason for pipeline spills in the U.S. this year, causing 16 percent of all accidents through Aug. 9, according to U.S. Department of Transportation's Office of Pipeline Safety. Since 1990, the portion of oil lost because the inside of a pipe has been eaten away has grown to 78 percent [*Ed: 7.8 percent*] from 4.7 percent, with 68,624 barrels spilled this year, the agency said.

'Incredible' Neglect

London-based BP's admission that some pipes in Prudhoe Bay hadn't been inspected internally for corrosion in more than a decade was "incredible," said oil analyst Charles Maxwell at Weeden & Co. "They are in deep trouble." BP may face criminal charges in the U.S. over an oil spill in Alaska in March, which prompted inspections that found the Prudhoe Bay corrosion.

Repair of the oil-production facilities built in the 1970s is part of the \$6 trillion that needs to be spent by 2030 to meet global oil and gas needs, according to the Paris-based International Energy Agency.

Record oil prices are encouraging producers throughout Europe and the U.S. to keep old rigs running rather than shut them down. BP's leaky pipeline, built to last 25 years, is now in its 29th year. The average pipeline in the U.S. is about 50 years old, according to NACE International, formerly the National Association of Corrosion Engineers.

"What we have is an entire generation of oil infrastructure that more or less came on stream at the same time," said Deborah White, an analyst at Societe Generale in Paris, who helped plan the Prudhoe Bay field development in the 1970s. "It's now all of a certain age, fragile, and can't be pushed quite as hard."

Norway's Leaks

In the Norwegian North Sea, 8 percent of wells have weaknesses that disrupt production, according to a study for the nation's Petroleum Safety Authority.

A similar amount of offshore oil and gas output probably is being lost worldwide because of faulty wells, said Jan Andreassen, an author of the Norwegian study. Russia's pipeline monopoly, OAO Transneft, estimates its program to improve its pipeline system will take almost three decades to complete.

Oil consumers depend more than ever on regions such as Alaska and the North Sea that were developed in the 1970s, after the Arab oil embargo led the U.S. and Europe to seek alternative supplies. Oil prices have more than doubled in the past three years as demand accelerated.

Benchmark New York crude oil futures jumped 3 percent on the day BP revealed the extent of corrosion in the Prudhoe Bay pipeline, which caused leaks and ate away as much as 81 percent of the steel. They fell 4.3 percent last week to \$70.14 a barrel on the New York Mercantile Exchange.

North Sea Shutdowns

Stavanger, Norway-based Statoil ASA, the country's largest oil and gas provider, said production this year may be as much as 25,000 barrels a day below forecast because of extensive maintenance and lower output from older North Sea fields. Andreassen's study, published in June, found that 18 percent of 406 wells tested in Norway's section of the North Sea had weaknesses and 8 percent had faults that demanded they be shut.

“This is a subject people don't like to talk about,” he said in an Aug. 16 phone interview. “This is not particular to Norway. This is an industry problem.”

The U.K. and Norway combined pump 4 million barrels a day, most from the North Sea, more than every OPEC member except Saudi Arabia.

BP increased its training for management and monitoring of North Sea wells, Jan Erik Geirmo, a spokesman for the company's Norwegian subsidiary, said in an Aug. 18 e-mail. Andy Corrigan, a spokesman for Royal Dutch Shell Plc of The Hague, said maintenance spending has been “stepped up significantly in recent years.” He wasn't more specific.

'Fragile' Pipes

“Corrosion is a complicated business,” said Lois Epstein, senior engineer and oil industry specialist at Cook Inlet Keeper, an environmental group in Anchorage, Alaska. Programs to detect and prevent corrosion can keep it in check, she said. “It can be done well, and they weren't doing it well,” she said of BP.

The company had judged that internal surveillance wasn't needed because the pipelines on Alaska's frozen North Slope are above ground, allowing for direct inspection.

“We thought it was an adequate program,” BP America President Robert Malone told a press conference in Anchorage on Aug. 7. “Clearly it is not.” BP said it spent \$72 million combating corrosion in North Slope pipes this year, up from \$60 million in 2005.

Proper Maintenance

A U.S. grand jury is investigating the pipeline spill BP discovered in March, which dumped about 270,000 gallons of crude oil onto Alaska's tundra, according to an e-mail BP Alaska President Steve Marshall sent to employees.

Decades-old pipelines can be productive and safe "with proper corrosion control maintenance," said Cliff Johnson, director of public affairs for NACE International in Houston. "That's not a problem."

BP employees reported the company to criminal investigators at the U.S. Environmental Protection Agency, accusing it of intentionally misrepresenting data relating to its Alaskan pipeline network to indicate its pipelines were in better shape than they were, the Financial Times reported today, citing an unidentified worker at Prudhoe Bay.

"We are aware of these claims and have a process in place to look into every concern that comes our way, given enough specificity to direct us to a place to look for answers," Robert Wine, a BP spokesman in London, said today by phone.

U.S. pipelines nationwide may be subject to increased inspections or maintenance requirements as BP's failings in Alaska attract the attention of regulators and lawmakers.

'Chronic Neglect'

The shutdown showed "chronic neglect," Joe Barton, the Texas Republican who chairs the U.S. House Energy and Commerce Committee, said in an Aug. 11 letter to BP Chief Executive Officer John Browne. He has scheduled a hearing on the matter next month.

Oil companies may end up spending more as they combat corrosion, patch pipelines and try to extend the life of wells, according to Tina Vital, an energy analyst at Standard & Poor's in New York, who worked as a refinery engineer for Exxon Mobil Corp. in the early 1980s.

BP said on July 25 that it will spend between \$15.5 billion and \$16 billion this year on maintenance and new oil and gas projects, up from a previous forecast of \$15 billion. Browne at the same time cut his production forecast by about 2.3 percent.

Shell in February said its capital spending will rise 27 percent this year to \$19 billion. The company, the world's second-largest oil company by market value, last month said production will be lower than expected.

Skeptics

Some analysts and investors said the corrosion at BP's Prudhoe Bay field doesn't mean all equipment the same age will fail. The lifespan of a pipe, valve or storage tank can vary.

"Within any mature field there's going to be a mix of brand new and old," said Patrick Gibson, a global oil-supply analyst at consultants Wood Mackenzie in Edinburgh. "It really depends how it's been maintained."

Oil infrastructure "is certainly vulnerable because it is aging," Weeden analyst Maxwell said in a phone interview from his office in Greenwich, Connecticut. Still, he said he doesn't expect the failures seen at Prudhoe Bay to crop up elsewhere. The

situation there is probably a "one-off," he said. "I've been in this business for 40 years and we have never had a scare like this before."

Slow Repairs

Shutdowns continue to occur. Russia's Transneft, the world's biggest pipeline operator, in July closed the Druzhba-1 line connecting Russia with Lithuania because of a leak, cutting supply to the only refinery in the Baltic states. The 42-year-old pipeline was beyond its expected lifespan, Deputy Chief Executive Officer Sergei Grigoryev said in an Aug. 16 telephone interview in Moscow.

The Druzhba pipeline will be permanently closed, according to a report in the Moscow Times. Grigoryev wouldn't comment on whether the pipeline will be shut.

Transneft spends \$1.2 billion a year maintaining its network. The company replaces 600 to 1,000 kilometers of its 50,000 kilometers (31,075 miles) a year.

"Going at the same rate as we are now, the last station will have its upgrade completed 28 years from now," Semyon Mikhailovich, president of Transneft, said in an interview posted this month on the company's Web site. "It should have been yesterday."

To contact the reporters on this story: Tom Cahill in Paris at tcahill@bloomberg.net; Sonja Franklin in Calgary at sfranklin6@bloomberg.net