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ENERGY Oil's Dropped, but Price Contracts Haven't

By Steven Mufson Washington Post Staff Writer Thursday, October 30, 2008; Page D01

As oil prices were spiking in July, Southwest Airlines chief executive Gary C. Kelly told a conference that his company was "very well prepared to weather the storm" and "prepared for \$4 jet fuel." But it turned out that what Southwest wasn't ready for was \$2 jet fuel.



Gary Kelly is chief of Southwest Airlines, which made bad oil bets. (By David Zalubowski -- Associated Press)

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Famous for its ability to play the oil markets to lock in low fuel costs, Southwest made some bad bets in late spring and summer. Now, it's paying a heavy price just when it should be celebrating lower costs. A \$189 million loss on fuel contracts put the company in the red for the first time in 17 years.

Southwest isn't alone. Though plunging oil prices have been a silver lining for the ailing economy, many companies are still covering high costs they locked in months or weeks ago.

Light, sweet crude for December delivery settled at \$67.50 a barrel yesterday on the New York Mercantile Exchange. But many airlines, spooked by forecasts by analysts such as those at Goldman Sachs who were predicting \$200-a-barrel crude oil, locked in prices higher than yesterday's for large portions of their fuel needs.

A wide variety of other companies did, too. Coca-Cola Enterprises, the world's largest Coke bottler and distributor, said it had suffered \$11 million in losses on "ineffective" attempts to hedge future fuel prices. Britannia Bulk Holdings, a British dry bulk shipping firm, said it had "significant" losses on purchases made earlier in the year for bunker fuel, the type of petroleum its ships use. In a statement, it said "the company entered into a bunker fuel hedge which is currently uncompetitive because it is hedged to prices which are significantly above the current market price of bunker fuel."

Even professional traders have been burned. T. Boone Pickens, whose BP Capital fund lost 33 percent in July and 9 percent in August, lost 21 percent in September. In a recent television interview with Charlie Rose, Pickens said

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he had lost about \$2 billion.

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If savvy oil traders are losing big, how can ordinary consumers decide what to do? Yet that's what heating oil users have to decide. Heating oil dealers are offering customers three choices: a price set on day of delivery, a fixed price locked in now (at a premium over current prices), or a fluctuating price with a cap (for which consumers would pay a smaller premium).

Kevin Rooney, chief executive of the Oil Heat Institute of Long Island, estimates that half of the island's 600,000 homes using heating oil locked in prices or caps two years ago. With prices on the decline now, he estimates that only about 15

percent have locked in for this winter.

"We get dozens of calls every day asking what prices are and for projections, as though I have some kind of crystal ball," Rooney said. "If I knew, I'd be taking this call from a South Seas island villa." Rooney works in Hauppauge, N.Y.

Some companies have done relatively well at hedging fuel prices.

Royal Caribbean Cruises, for whom energy costs amount to about 10 percent of revenue, has smoothed out its energy costs by betting on prices. Though its costs might be higher now because it hedged 55 percent of the fuel needed for the quarter, for the entire year, the company is looking to spend less than it would have without hedging. It expects its full-year fuel costs to come to \$686 million this year, up less than 25 percent while expanding service. Crude oil prices so far in 2008 are averaging almost 50 percent more than in 2007.

"We have a program in place meant to remove some of the volatility from our income in the event of extreme swings in fuel prices," said Ian Bailey, head of investor relations at Royal Caribbean. "We don't try to time the market or take positions. We're not in this to try to speculate."

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