AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

S. HRG. 110–496

EXPLORING THE SKYROCKETING PRICE OF OIL

HEARING

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

MAY 21, 2008

Serial No. J–110–94

Printed for the use of the Committee on the Judiciary

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00001 Fmt 6011 Sfmt 6011 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

EXPLORING THE SKYROCKETING PRICE OF OIL

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00002 Fmt 6019 Sfmt 6019 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

S. HRG. 110–496

EXPLORING THE SKYROCKETING PRICE OF OIL

HEARING

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

MAY 21, 2008

Serial No. J–110–94

Printed for the use of the Committee on the Judiciary

U.S. GOVERNMENT PRINTING OFFICE

43–354 PDF WASHINGTON : 2008

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00003 Fmt 5011 Sfmt 5011 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

COMMITTEE ON THE JUDICIARY

PATRICK J. LEAHY, Vermont, *Chairman*

EDWARD M. KENNEDY, Massachusetts
JOSEPH R. BIDEN, JR., Delaware
HERB KOHL, Wisconsin
DIANNE FEINSTEIN, California
RUSSELL D. FEINGOLD, Wisconsin
CHARLES E. SCHUMER, New York
RICHARD J. DURBIN, Illinois
BENJAMIN L. CARDIN, Maryland
SHELDON WHITEHOUSE, Rhode Island

ARLEN SPECTER, Pennsylvania
ORRIN G. HATCH, Utah
CHARLES E. GRASSLEY, Iowa
JON KYL, Arizona
JEFF SESSIONS, Alabama
LINDSEY O. GRAHAM, South Carolina
JOHN CORNYN, Texas
SAM BROWNBACK, Kansas
TOM COBURN, Oklahoma

BRUCE A. COHEN, *Chief Counsel and Staff Director*
STEPHANIE A. MIDDLETON, *Republican Staff Director*
NICHOLAS A. ROSSI, *Republican Chief Counsel*

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00004 Fmt 5904 Sfmt 5904 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

CONTENTS

STATEMENTS OF COMMITTEE MEMBERS

	Page
Kohl, Hon. Herb, a U.S. Senator from the State of Wisconsin	3
Leahy, Hon. Patrick J., a U.S. Senator from the State of Vermont	1
prepared statement and closing statement	249
Specter, Hon. Arlen, a U.S. Senator from the State of Pennsylvania	7

WITNESSES

Hofmeister, John, President, Shell Oil Company, Houston, Texas	8
Lowe, John E., Executive Vice President, ConocoPhillips Company, Houston, Texas	12
Malone, Robert A., Chairman and President, BP America, Houston, Texas	5
Robertson, Peter J., Vice Chairman of the Board, Chevron Corporation, San Ramon, California	10
Simon, J. Stephen, Senior Vice President, Exxon Mobil Corporation, Irving, Texas	14

QUESTIONS AND ANSWERS

Responses of John Hofmeister to questions submitted by Senators Whitehouse, Durbin, Kohl, Leahy and Feinstein	57
Responses of John E. Lowe to qustions submitted by Senators Leahy, Kohl, Durbin, Whitehouse and Feinstein	97
Responses of Robert A. Malone to questions submitted by Senators Leahy, Feinstein, Durbin, Whitehouse and Kohl	150
Responses of Peter J. Robertson to questions submitted by Senators Durbin, Kohl, Leahy, Whitehouse and Feinstein	176
Responses of J. Stephen Simon to questions submitted by Senators Whitehouse, Durbin, Kohl, Leahy and Feinstein	205

SUBMISSIONS FOR THE RECORD

Hofmeister, John, President, Shell Oil Company, Houston, Texas, statement	236
Lowe, John E., Executive Vice President, ConocoPhillips Company, Houston, Texas, statement	252
Malone, Robert A., Chairman and President, BP America, Houston, Texas, statement	304
Robertson, Peter J., Vice Chairman of the Board, Chevron Corporation, San Ramon, California, statement	327
Simon, J. Stephen, Senior Vice President, Exxon Mobil Corporation, Irving, Texas, statement and attachment	340

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00005 Fmt 5904 Sfmt 5904 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

EXPLORING THE SKYROCKETING PRICE OF OIL

WEDNESDAY, MAY 21, 2008

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The Committee met, Pursuant to notice, at 10:02 a.m., in room SD–106, Dirksen Senate Office Building, Hon. Patrick J. Leahy, Chairman of the Committee, presiding.

Present: Senators Leahy, Kohl, Feinstein, Feingold, Schumer, Durbin, Cardin, Whitehouse, Specter, Hatch, Grassley, Sessions, and Cornyn.

OPENING STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM THE STATE OF VERMONT

Chairman LEAHY. As I have said before at hearings, we will not have disruptions in the Committee, whether for or against any position I may take or anybody else may. Everybody is welcome to be at the Committee. I would ask that nobody disrupt or stand or in any way block the views of others who are here as guests of the Senate.

This weekend, when I was home in Vermont, I heard more than anything else about the price of a gallon of gas. And the price of a gallon of gas at the pump today in Vermont reached a record $3.77. And that is less than in a lot of other States. Nationwide, the average price has more than doubled since the President took office.

The President once boasted that with his pals in the oil industry, he would be able to keep prices low and consumers would benefit. Instead, it appears to be his friends in the oil industry who have benefited. American consumers and the American economy have suffered immensely.

Today's witnesses represent the major, vertically integrated oil companies that, collectively, made more than $36 billion in profits in just the first quarter of this year—$36 billion in the 3 months, certainly more than the gross domestic product of some countries.

I want these witnesses to hear about Warren Hill, whose family settled in Greensboro, Vermont, more than 200 years ago. Warren runs a logging and trucking company that he dreams of passing on to his son. But the increase in fuel prices has led him to question whether his business, which has been very successful for over 30 years, can survive.

I think Mr. Hill wants to know how all of you can justify such exorbitant profits on the backs of the middle class and hard-work-

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00007 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

ing families. And I think he deserves answers. Every member of this Committee, every Member of this Congress, whatever part of the country they are from, they have constituents with similar stories and similar questions.

We hear from the oil industry that the price of gas at the pump is directly related to the price of crude oil. One of the witnesses we have here today has said that normal supply and demand indicates that the price should be somewhere around $50 to $55 a barrel. As he said, "There is a disconnect." There is. Well, as I was driving to work early this morning, they were saying that oil had reached $133 and some odd cents a barrel. I would like to know, and I am sure American families and American small businesses would like to know, why prices are so disconnected from what normal supply and demand would indicate. Why has the price of oil increased 400 percent since President Bush took office? Why has it nearly doubled in the last year alone? We have seen it go up 6 years in a row, the first time that has ever happened. The prices should not skyrocket like this in a properly functioning, competitive market.

Certainly the cost of oil to these companies has not doubled or quadrupled. Certainly our witnesses today would not contend that it is service station operators who are gouging consumers for windfall profits.

I expect that none of our witnesses would dispute that a protracted war in Iraq has caused the price of oil to rise. I expect that none of our witnesses would dispute that the Administration's economic policies, which have crippled the value of the dollar, have contributed to the rising price of oil.

But I want to hear directly from these oil companies about causes of the rising price of oil, causes on which Congress can act. This Committee unanimously approved Senator Kohl's NOPEC legislation, which would put an end to artificial limits on supply by ensuring that the U.S. Government has the authority to prosecute OPEC members for collusive behavior. Seventy members, Republicans and Democrats alike, have voted for this legislation, as have 345 Members of the House, Republicans and Democrats alike. But the President threatened to veto it.

I would like to know what these oil executives think about applying principles of competition from our antitrust laws to the commercial activity of the oil-producing states.

The members of OPEC meet regularly to agree on limits on the amount of oil they will produce. I think that is wrong, and I think it hurts Americans. If such a meeting took place in almost any other context, the participants would likely be charged and arrested for an illegal conspiracy in the restraint of trade.

So do our witnesses agree that we need to crack down on speculation and manipulation in the oil commodities market? Numerous experts have testified before this Committee and others that oil prices are moving higher as a result of speculators. Investors are betting up the price of oil, and consumers are paying the bill. Increasingly, this speculation takes place in over-the-counter trading, which avoids the oversight of the Commodity Futures Trading Commission. That is because of the Enron loophole.

That is an unjustified loophole. Senator Feinstein and I, among others, have been actively trying to close it. To keep the CFTC

blind to speculation and manipulation in the oil futures market, we can only say that is inexcusable. Last week, Congress passed the farm bill that would close the Enron loophole. And now the President has threatened to veto the legislation to close the Enron loophole. I would like to know what these oil executives think about that.

Finally, last week we were able to pass legislation calling for the Government to stop artificially inflating demand by diverting fuel to the Strategic Petroleum Reserve. The President opposed that. Filling the Strategic Reserve may have made sense when oil was $25 a barrel. At $125 a barrel, it is simply hurting consumers.

So we need some answers so Congress can act in a way the administration apparently will not—for the benefit of consumers, for American families, for small businesses. We need to get prices under control and back to competitive levels, and we need to do it now. Warren Hill and his family in Vermont, and all Americans, deserve a Government that will stand up for them. Small businesses should not be forced to close their doors because oil prices are skyrocketing out of control.

[The prepared statements of Senator Leahy appear as submissions for the record.]

Normally we would not have other opening statements, but the Chairman and the Ranking Member of the Antitrust Subcommittee, Senator Kohl and Senator Sessions, are here, and so I will recognize each of them for an opening statement. Senator Kohl?

STATEMENT OF HON. HERB KOHL, A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator KOHL. Thank you, Mr. Chairman.

As gas prices approach the previously unthinkable level of $4 per gallon, and crude oil passes $130 per barrel, we can only conclude that the oil market has failed. Driving to the doctor or to the grocery story have become unaffordable burdens on the family budget. Consumers are angry and they have every right to be, and the American economy is buckling under the weight of gas prices. And while consumers and businesses suffer from these price increases, the oil industry seems only to get richer and richer.

Last year, for example, Exxon Mobil reported all-time record profits for a U.S. corporation—an astounding $40.6 billion for all of 2007, an amount that has nearly doubled in the past 5 years. We are forced to worry that we are witnessing profiteering caused by market manipulation, price gouging, and collusion.

The oil companies defend high energy prices by claiming that there have been sharp increases in demand, and yet the record shows that demand for petroleum in the United States has hardly changed in the past 27 years. According to Government statistics, in January 1981, 571 million barrels of petroleum products were supplied to the U.S. market, and in February of 2008, 27 years later, from 571 million it got to 573 million barrels that were supplied. Hardly any change at all.

So while demand has remained flat, prices and profits are breaking records. The question remains what is going on here. Do market forces alone explain the skyrocketing price of oil and gas? Each

of the executives testifying today should not leave here without telling us something meaningful about what is causing this miserable situation and how to correct it.

Problems of failed oil markets are compounded by the effects of speculation. Unlike equities, speculators can buy oil futures with a very low margin requirement, as little as 8 cents on the dollar. These low margins drive speculation, which in turn causes sharp increases in the price of crude oil. So it is vitally important to increase margin requirements on the oil commodity markets so that millions of ordinary consumers do not pay the price at the pump for the billions made by hedge funds.

I also believe that it is long past due for us to take action on the NOPEC bill. The NOPEC bill would make nations that participate in the OPEC oil cartel accountable under U.S. antitrust law when that cartel limits supply in order to fix the price of oil. There is simply no reason that nations participating in a cartel designed to control the price of oil should be treated any differently than a private international price-fixing conspiracy harming U.S. consumers. This legislation would, for the first time, give our Government a real tool to combat OPEC.

The need for this tool was demonstrated once again just last week by Saudi Arabia's rejection of President Bush's appeal for increased oil production. Just yesterday, NOPEC passed the House with 324 votes in favor. It did pass the Senate last year by a similarly overwhelming margin, but it was stripped from last year's energy bill in conference.

When I first introduced this legislation in the year 2000, the price of crude oil on the world market was $29 a barrel—a price that has now more than quadrupled. We need to bring this measure to the Senate floor now so it can be enacted into law.

Mr. Chairman, I appreciate your calling this hearing, and I look forward to the testimony.

Chairman LEAHY. Thank you. And I was incorrect. It is Senator Hatch who serves as Ranking, and Senator Sessions has been either Chairman or Ranking on virtually every Subcommittee in this place, and I will ask him, just before I swear in the witnesses, Senator Sessions, did you want to say anything?

Senator SESSIONS. Thank you, Mr. Chairman. We know that the world market for oil is not a free market. We have got nation states who are deliberately and systematically taking steps to keep prices high. Our guests here today do not exist to produce the lowest possible price of fuel for our constituents. They exist to maximize their profits for their shareholders. I know that is what you exist for, and you are going to charge what the traffic will bear, and shortages of supplies have allowed, I think, extraordinary profits to occur. And those of us in the public sector need to think about what we can do to create a climate where such is not so—these prices are not so high. That is the No. 1 thing I hear from my constituents. It is savaging the family budget, $50, $75, $100 more a month for the same number of gallons were buying just a few years ago, reducing their ability to purchase in the marketplace, and I do not think anyone can argue that it has not affected our economy.

I am particularly concerned about diesel. Mr. Chairman, on average, 50 percent of the cars in Europe are now diesel. They get at

least 35 to 40 percent better gas mileage. Had we had 50 percent of our vehicles diesel, we would be utilizing substantially fewer gallons from our witnesses today in overall liquid fuel.

So I think there are a number of things we need to think about. Thank you for your leadership, and I do believe that we need to utilize what forces, Senator Kohl, we can to deal with the sovereign state problem and that is exacerbating the world price of fuel.

Thank you.

Chairman LEAHY. Thank you.

Gentlemen, would you please stand and raise your right hand? Do you solemnly swear that the testimony you will give in this matter will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. MALONE. I do.

Mr. HOFMEISTER. I do.

Mr. ROBERTSON. I do.

Mr. LOWE. I do.

Mr. SIMON. I do.

Chairman LEAHY. Let the record show that all five of the witnesses have been sworn in and have taken the oath.

We will go through each witness before we open it to questions. The first witness, Mr. Robert Malone, is the Chairman and President of BP America. Mr. Malone became Chairman and President of BP America on July 1, 2006. He is based on Houston, Texas. He holds a Bachelor of Science degree from the University of Texas at El Paso. He received a Master's of Science in management from the Massachusetts Institute of Technology. He has been selected for the board of trustees of the National Urban League, the Foreign Policy Association, and the National Petroleum Council. He is also currently on the executive committee of the American Petroleum Institute.

I would say to Mr. Malone and all the others, your full statements, of course, will be made part of the record. You will certainly be given a chance to look at the transcript after you have answered questions. After you have looked at your answers, if there are things you want to add to it or change, if you feel you got a number wrong or something like that and you want to change it, obviously you will be given the opportunity to do that.

Mr. Malone, go ahead.

STATEMENT OF ROBERT A. MALONE, CHAIRMAN AND PRESIDENT, BP AMERICA, HOUSTON, TEXAS

Mr. MALONE. Thank you, Mr. Chairman, Senator Sessions, members of the Committee. Good morning.

We know that high energy prices are having an adverse impact on the economy here in the United States and on workers and families across this Nation. Every week I receive letters from consumers about the impact that high energy prices are having on their everyday lives.

Unfortunately, I cannot and we cannot change the world market on which this Nation now relies for 60 percent—60 percent—of the oil it consumes every day. What we can do is work with this Congress, with the administration, with governments and consumers to

move toward greater energy security and a lower carbon energy future.

Today's high prices are linked to the failure, both here and abroad, to increase the supply of oil, gas, and renewables, and to reduce demand through conservation and energy efficiency. The oil market is tight. Geopolitical risk and concern about future supply are having a big impact on price today.

We are working very hard to expand and diversify U.S. energy supply. We are the Nation's largest producer of domestic oil and gas and one of the Nation's largest energy investors. Over the last 5 years, we have invested $31.5 billion in development of U.S. energy supply, almost dollar for dollar of our U.S. profits. We expect to spend $30 billion over the next 5 years to maintain production of natural gas in the Rocky Mountain West, to renew critical infrastructure in Alaska, and continue development of the Deepwater Gulf of Mexico, and increase gasoline production from Midwest refineries.

We are nearly doubling the capacity of our Frederick, Maryland, solar plant, and by the end of this year, we would expect to have a thousand megawatts of U.S. wind power capacity online. That should increase to 2,400 megawatts by the end of 2010.

We are already one of the largest blenders of ethanol in this Nation. However, over the next decade, we will invest more than $500 million in the search for a new generation of biofuels that contains more energy, has less impact on the environment, and which is not made from a food crop. And together with ConocoPhillips, we have recently announced the largest private sector investment ever in the U.S.—the Denali, Alaska, gas pipeline.

Our investments across the entire energy spectrum are huge, but the hard truth is that even with major improvements in energy efficiency and the rapid growth of solar, wind, and biofuels, the United States is going to need more oil, more coal, more natural gas, and more nuclear in 2030 than it does today. The United States, with 5 percent of the world's population, consumes 25 percent of daily world oil production. The U.S. has got to produce more energy, and it needs to conserve and use this energy wisely.

On the supply side, we support incentives for alternatives. But taking one form of energy to encourage production of another will reduce the ability to keep up with growing U.S. energy demand. The result is going to be less investment, less production, higher energy markets, and potentially even higher prices at the pump.

This Nation should be encouraging production of all forms of energy, especially oil and gas. But adopting measures that limit access to U.S. resources, dampen investment in infrastructure, and discourage trade with our Canadian neighbors will make our economy increasingly vulnerable to market influences outside of our borders.

BP is serious about bringing new sources of oil and gas to the U.S. market. We are also serious about building a sustainable, profitable alternative energy business that is capable of delivering the clean, affordable power that consumers need. My company is ready to work with you and others to address the energy and environmental needs of this Nation through a bipartisan and comprehensive energy policy.

Thank you.

[The prepared statement of Mr. Malone appears as a submission for the record.]

Chairman LEAHY. Thank you very much.

We have been joined by the Ranking Member of the Committee, Senator Specter, and, Senator Specter, did you want to say anything before we go to the next witness?

STATEMENT OF HON. ARLEN SPECTER, A U.S. SENATOR FROM THE STATE OF PENNSYLVANIA

Senator SPECTER. Well, thank you, Mr. Chairman. Just a word or two.

First, I commend you for holding this very important hearing. We are obviously in a crisis, national, international, with the escalating cost of oil and the intolerable prices of gasoline at the pump, and it is important that we bear all of our resources to try to figure out what to do about it. It seems to be an intractable problem, but we have to keep trying. And you have assembled a very distinguished group of witnesses here today.

For some time, this Committee has been trying to push legislation on eliminating the antitrust exemption for OPEC. They have, for some curious reason under our case law, an exemption for our antitrust laws. They get into a small room and decide what the supply will be, and that has the inevitable potential, at least, for raising prices.

Senator Kohl and I reported out of Committee, as you know, Mr. Chairman, and have on the floor ready for action—i would hope that we would get some action on that bill. It certainly could not do any harm.

I understand the complexities of the issue on the OPEC and the pricing, but at least they ought to be subject to the antitrust laws to have an impact if that would be successful.

Then we have to search further. We have talked about it a lot, and, regrettably, too little action since the historic gas lines of 1973 and 1974. In a conversation I had earlier today with Mr. Hofmeister talking about a good many of the issues, and it is extraordinarily complex. We have to work on it.

One item which caught my attention especially, which is worth mentioning, is the credit card cost. At least as Mr. Hofmeister outlined it to me, it is a few cents for companies like Shell, it is, I think, 8 cents for the dealer, and 14 cents for the credit card. Am I quoting you right, Mr. Hofmeister?

Mr. HOFMEISTER. That is an average number, yes. Thank you.

Senator SPECTER. Well, we have been studying this interchange cost for a long time as to the issue of the credit card companies and what they do, and that sounds like a pretty big bite to me. But we are all consumed with the problem, and I thank you again, Senator Leahy, for moving ahead on this.

Chairman LEAHY. Thank you very much. You mentioned Mr. Hofmeister, and he is the President of Shell Oil Company. He was named President of Shell Oil Company in March of 2005. He has a Bachelor's and Master's degree in political science from Kansas State University, serves as Chairman of the National Urban League, serves on the boards of the Foreign Policy Association, U.S.

Energy Association, National Association of Manufacturers. He is a member of the American Petroleum Institute's executive policy committee.

I understand that Shell is announcing you will retire at the end of this month. I hope that is not because you had to appear before this Committee, Mr. Hofmeister, but I assume that was something long in the works, and we appreciate your being here with us today.

STATEMENT OF JOHN HOFMEISTER, PRESIDENT, SHELL OIL COMPANY, HOUSTON, TEXAS

Mr. HOFMEISTER. Thank you, Chairman Leahy and Ranking Member Specter, members of the Committee. I am John Hofmeister, the retiring President of Shell Oil Company, and thank you for this opportunity to testify on these very important subjects.

Let me offer my best wishes to your friend Senator Kennedy. We wish him and his family well in this time of uncertainty.

Chairman LEAHY. If I may interrupt on my time, Mr. Hofmeister, I have just received word that Senator Kennedy will leave the hospital and will go back to the Kennedy compound in Hyannis where, being on the water, I know how much he will enjoy that. And I was pleased to see the strong, bipartisan expressions in the Senate. He is in our prayers, all of us, Republicans and Democrats alike, and I thank you for your comments.

Mr. HOFMEISTER. Thank you.

In addition to my formal written statement, I welcome this opportunity to offer several additional thoughts.

Much has and will be said about the rising energy demand and the actions being taken to supply this energy by major oil companies. My written testimony speaks to Shell's unique efforts in this regard.

This is an era of remarkable capital expenditures for major new projects and infrastructure, strong investments in technology, and the aggressive pursuit of energy alternatives. We are setting records in one of the most expansionary periods the industry has ever known. Yet in the face of this sustained record spending, the relentless increase in the price of the crude oil continues.

As repetitive and uninteresting as it may sound, the fundamental laws of supply and demand are at work. Oil- exporting nations, as has been said, are managing their natural resource development and production to supply their local and global markets in their own self-interest. While all oil-importing nations buy oil at global prices, some—notably, India and China—subsidize the cost of oil products to their nations' consumers, feeding the demand for more oil despite record prices. They do this to speed economic growth and to ensure competitive advantage relative to other nations.

Meanwhile, in the United States, access to our own oil and gas resources has been limited for the last 30 years, prohibiting companies such as Shell from exploring and developing resources for the benefit of the American people. Senator Sessions, I agree it is not a free market.

According to the Department of the Interior, 62 percent of all onshore Federal lands are off limits to oil and gas developments, with

restrictions applying to 92 percent of all Federal lands. We have an outer continental shelf moratorium on the Atlantic Ocean, an outer continental shelf moratorium on the Pacific Ocean, an outer continental shelf moratorium on the eastern Gulf of Mexico, congressional bans on onshore oil and gas activities in specific areas of the Rockies and Alaska, and even a congressional ban on doing an analysis of the resource potential for oil and gas in the Atlantic, Pacific, and eastern Gulf of Mexico.

The Argonne National Laboratory did a report in 2004 that identified 40 specific Federal policy areas that halt, limit, delay, or restrict natural gas projects. I urge you to review it. It is a long list. If I may, I offer it today, if you would like to include it in the record.

When many of these policies were implemented, oil was selling in the single digits, not the triple digits we see now. The cumulative effect of these policies has been to discourage U.S. investment and send U.S. companies outside the United States to produce new supplies. As a result, U.S. production has declined so much that nearly 60 percent of daily consumption comes from foreign sources.

U.S. reliance on foreign oil may drop this year for the first time since 1977, according to the EIA. But it is not clear yet whether that drop in foreign imports is sustainable given the restricted access to U.S. resources. Alternative and renewable energy sources play a role and are growing substantially. Energy efficiencies will improve as new technologies are developed and implemented. But leading experts forecast that oil and natural gas will continue to meet more than half of the world's energy needs in the year 2030. EIA says that by 2030 we are still expected to import more than half of our own oil in this country.

The problem of access can be solved in this country by the same government that has prohibited it. Congress could, if it chose, lift some or all of the current restrictions on exploration and production of oil and gas. Congress could provide national policy to reverse the persistent decline of domestically secured natural resource development. If the Nation set a goal of increasing domestic production by 2 to 3 million barrels a day by opening up new sources for exploration and production, in addition to recent laws you have passed to increase the production of renewable fuels, and to increase miles per gallon in the vehicles that we drive, we could demonstrate to the world that we are in control of our own destiny. If we did this, it would be unnecessary for our national leaders to ask the rulers of other sovereign nations to produce more oil for U.S. consumers and risk the discomfort of a nonresponsive reply. Let's establish a national policy on domestic resource development and get on with the business of helping our Nation compete by producing more affordable energy.

In addition to more access, we need additional refining capacity. As you know from my written testimony, Shell is a 50-percent participant in the $7 billion expansion of the Motiva refinery Port Arthur, Texas. This project will expand production of finished products by more than 300,000 barrels per day and, when finished, will be one of the largest refineries in the United States and in the world.

Refining capacity is particularly critical when it comes to the demand for diesel, aviation fuel, and heating oil—all products that we in the industry refer to as "the middle of the barrel." At home and around the world, demand for these middle distillates is growing faster than the demand for gasoline. Due to the sustained demand for diesel mobility and air travel, prices for these products are rising as fast or faster than for other products. There is simply no way to keep up, let alone get ahead of demand, except by producing more oil and building more refining capacity. That is because of the make-up of a barrel of crude. Only a third to a half of a barrel of crude oil can be used to make these products. we cannot use more than half of a barrel of oil to make diesel and aviation fuel. To meet this demand, we need more capacity.

So we need policies that enable both more crude supply and more refining. Higher taxes would only serve to diminish the expansion capacity of this critical capital investment. I urge you on behalf of American consumers to resist such punitive policies.

In conclusion, Mr. Chairman, when it comes to energy security and affordability in this country, there is no challenge that cannot be turned into opportunity. The United States has the natural resources, the technology, the financial capital, the human resources, and the desire to be energy self-sufficient. By addressing our challenges in the short term, the medium term, and the long term, Shell believes the U.S. can become more energy secure, and I look forward to your questions.

[The prepared statement of Mr. Hofmeister appears as a submission for the record.]

Chairman LEAHY. Thank you.

Peter Robertson is the Vice Chairman of Chevron Corporation. He has been in this position since 2002. Mr. Robertson is a native of Scotland, and he earned his Bachelor's degree in mechanical engineering from Edinburgh University, a Master's degree in business administration from the Wharton School. He is the Chairman of the U.S.-Saudi Arabian Business Council and a director of the American Petroleum Institute. He is the past Chairman of the U.S. Energy Association.

Incidentally, if I get the facts wrong on any one of you, feel free to correct it.

Mr. Robertson, go ahead.

STATEMENT OF PETER J. ROBERTSON, VICE CHAIRMAN OF THE BOARD, CHEVRON CORPORATION, SAN RAMON, CALIFORNIA

Mr. ROBERTSON. Good morning. Mr. Chairman, Ranking Member Specter, and members of the Committee, my name is Peter Robertson, and I am Vice Chairman of Chevron Corporation. I am here today proudly representing 59,000 Chevron employees around the world.

I appreciate the opportunity to discuss the energy issues that are on the minds of all Americans, and I will address three issues: rising oil prices, increasing energy supplies and improving efficiency, and urgent policy actions to achieve energy security.

Americans feel the brunt of record oil prices, and not just at the pump. Everything is more expensive. People are concerned about

rising costs, and rightly so. Global issues affecting the supply and demand of oil are driving prices up. The world is consuming oil at an ever increasing rate, and it is projected to continue. There are more than a billion people who enjoy our standard of living. There are billions more striving for the same.

The current system is straining to meet all our needs. There is dramatically reduced spare supply and no room for error. Any disruption or perceived threat of disruption sends oil prices up. And the declining value of the dollar, along with investors buying more commodities, has only worsened the situation.

In the past year, oil prices have doubled. We need to take steps to protect our economy, our consumers, and our future. Massive investment is needed around the world, some $22 trillion by 2030, and all stakeholders must do their part.

So what are we doing? Chevron produces 1.7 million barrels of oil a day. As large as that number sounds, it is less than 2 percent of world oil demand. We are aggressively spending to develop additional oil and natural gas supplies. Our capital budget this year is $23 billion for new energy projects, a record amount for our company and triple what we spent in 2004.

In the previous 6 years, we invested nearly $73 billion, an amount greater than what we earned. As the Nation's sixth largest refiner, we are spending $2.3 billion this year on our U.S. refining and marketing business, and we are developing renewables and improving energy efficiency. We are the leading producer of geothermal energy and provider of energy efficiency services.

But Congress also has an important role to play. For starters, we strongly urge you to implement the recommendations of last year's National Petroleum Council study. Its first recommendation is to reduce demand. We need to treat energy as a precious resource and become a Nation of energy savers. The study also urges us to increase energy supplies in all forms.

When it comes to energy security, we need smart policies that support our competitiveness and help us decrease our dependence on foreign oil. American energy companies operate at the frontiers of geography, geology, and technology. We are large compared with most American companies, but relatively small when you stack us up against the national oil companies against which we compete. These companies have control over most of the world's known reserves, and many enjoy the unqualified support of their national governments.

Given these realities, Americans need companies that can effectively compete for access to new resources and responsibly develop new energy frontiers. Our size and strength allows us to develop many complex and expensive projects that can take more than a decade to complete. At Chevron alone, we have more than 40 projects in development right now, each costing, our share, over a billion dollars.

Americans also need your leadership. Punitive measures that weaken us in the face of this international competition are the wrong solution at this critical point in our history. Such measures will only increase our dependence upon foreign supplies of energy while resources at home are untapped. The stunning changes during this decade taught us that easy access to cheap oil is over. Con-

sumers know this and are making hard choices to budget for their household needs.

We are making hard choices to mobilize more people and more money to increasingly remote locations in the world for more supplies. Chevron employees understand the enormous responsibility they have to deliver energy reliably, and I can personally attest to that strong commitment.

Congress has recently made some hard policy choices on renewables and energy efficiency. We hope you can also make the equally hard choices to open up more Federal lands and allow us to responsible produce more American oil and natural gas which can supply us for decades to come. We cannot expect other countries to expand their resource development to meet our increasing needs when we limit our development without good reason.

Our collective actions can demonstrate leadership on issues that are within our control and can help us weather the powerful forces that we cannot control. You can count on us to work with you on this extraordinary challenge.

Thank you very much.

[The prepared statement of Mr. Robertson appears as a submission for the record.]

Chairman LEAHY. Thank you very much, Mr. Robertson.

Our next witness is John Lowe. He is the Executive Vice President for Exploration and Production at ConocoPhillips. He has been Vice President since 1999. In 2002, he was made Executive Vice President for Planning, Strategy, and Corporate Affairs, named to his current position in charge of exploration and production in 2007. He received a Bachelor of Science degree from Pittsburg State University in Pittsburg, Kansas.

Go ahead, sir.

STATEMENT OF JOHN E. LOWE, EXECUTIVE VICE PRESIDENT, CONOCOPHILLIPS COMPANY, HOUSTON, TEXAS

Mr. LOWE. Good morning, Chairman Leahy and members of the Committee. We share the public's concern about rising energy prices and appreciate the opportunity to present our views on what is driving the increase, what our company is doing to respond, and what we believe Congress can do.

Crude oil represents over 70 percent of the current cost of gasoline, so higher crude prices are driving higher gasoline prices. So why have crude oil prices increased so dramatically? There are numerous factors, the biggest contributor being a long period of strong global economic growth, particularly in developing Asia. Limited access to resources both here and abroad also constrains the growth in supply. In addition, higher taxes, service cost inflation, little excess production capacity, and high geopolitical risk also contribute. Adding to this are the investor funds flowing into oil futures as a hedge against credit risk, inflation, and dollar devaluation.

I cannot overemphasize the access issue. Access to resources is severely restricted in the United States and abroad, and the American oil industry must compete with national oil companies who are often much larger and have the support of their governments. We can only compete directly for 7 percent of the world's available re-

serves, while about 75 percent is completely controlled by national oil companies and are not accessible.

ConocoPhillips is working to bring more energy to the market. Over the past 6 years, we have reinvested, on average, 106 percent of our income. In 2007, we earned $12 billion; but we reinvested $13 billion. And we have over $15 billion in investments planned this year. This investment includes finding added supplies of oil and gas, expanding refining capacity, and continuing to research and bring renewable and alternative fuels to the market.

Here in North America, we are drilling exploratory wells, developing the Canadian oil sands, and building infrastructure. But we want to do more, such as explore the vast areas of the U.S. that are off limits due to drilling moratoriums. These areas could more than double the Nation's oil and gas reserves. Downstream, we are increasing our refining capacity and our ability to process lower-quality crudes.

Unfortunately, our efforts here in the U.S. have been met with continuing opposition. At our Wood River, Illinois, refinery, the tenth largest in the United States, we are experiencing long permitting delays via the appeals process that are blocking our expansion plans. In California, a project to make ultra-low-sulfur diesel fuel has been threatened by permit challenge for 4 years. We are working hard to bring renewable fuels into the market by looking at ways to process them at traditional refineries and researching new technologies.

Fifty-five percent of our U.S. gasoline volumes contain ethanol. E–85 and biodiesel are being marketed at our branded facilities. We are producing renewable diesel fuel and researching next-generation biofuels like cellulosic ethanol, and we are developing better materials for the lithium ion batteries in electric vehicles.

So what can Congress do to help address energy concerns? Congress can enact a balanced national energy policy that encourages development of the conventional fuels that power our economy, clears the permitting logjam, encourages alternative sources, including all forms of biofuels, and removes the current tariff on imported ethanol, encourage higher energy efficiency, and accelerates technological innovation.

Meanwhile, we urge you not to pass measures that have public appeal but would be counterproductive, such as tax increases that diminish our investment capabilities, reduce the attractiveness of high-cost domestic production, or disadvantage U.S. oil and gas companies. This has been tried before with extremely negative results, reducing supplies, eliminating jobs, and resulting in higher prices. The Nation cannot afford to make that mistake again.

The U.S. is in a global race for energy. We are competing against national oil companies that are far larger and that enjoy preferred access and governmental cooperation. We must move beyond today's adversarial relationship and start working together to find real solutions.

U.S. oil companies should be viewed as the key to the energy solution, not as scapegoats but as assets in this global energy race. We must be allowed to compete on level ground for the benefit of our country.

Mr. Chairman, that concludes my statement. Thank you.

[The prepared statement of Mr. Lowe appears as a submission for the record.]

Chairman LEAHY. Thank you very much.

Our last witness is J. Stephen Simon, Senior Vice President of the Exxon Mobil Corporation. He is a member of its Board of Directors. He has served Exxon around the country and around the world—in Baton Rouge, Houston, New York, London, Italy. He received his Bachelor of Science degree in civil engineering from Duke University, his MBA from Northwestern. He is a member of the Board of Directors of the U.S.-China Business Council and the American Petroleum Institute.

When he finishes, we will go into questions. We will begin in the normal order first by myself and Senator Specter, and we will alternate between Senator Kohl, Senator Grassley, Senator Feinstein, Senator Sessions, Senator Durbin, Senator Cornyn, Senator Feingold, and Senator Hatch, and others as they come in.

Go ahead, Mr. Simon.

STATEMENT OF J. STEPHEN SIMON, SENIOR VICE PRESIDENT, EXXON MOBIL CORPORATION, IRVING, TEXAS

Mr. SIMON. Thank you, Chairman Leahy, Ranking Member Specter, and members of the Committee.

Energy is essential to the U.S. economy and is a topic on many Americans' minds. They are raising important questions about how our industry is helping meet their vital energy needs at competitive prices.

I welcome the opportunity to respond to these questions and to clear up some misconceptions regarding our industry. And to this end, I would like to make two points during my allotted time.

First, the prices Americans pay at the pump reflect the dynamics of an enormous, international market for energy, which means that in order for American energy companies like Exxon Mobil to successfully compete, it is vital that we have sufficient financial strength and scale.

To meet the world's growing demand for energy of all types, an estimated total investment of $22 trillion is needed between 2006 and 2030, or roughly 8 times the size of the estimated 2007 Federal budget.

Within this vital global marketplace, competition is fierce. Exxon Mobil is the largest U.S. oil and gas company, but we account for only 2 percent of global energy production, only 3 percent of global oil production, only 6 percent of global refining capacity, and only 1 percent of global petroleum reserves. With respect to petroleum reserves, we rank 14th. Government-owned national oil companies dominate the top spots.

For an American company to succeed in this competitive landscape and go head to head with huge, government-backed national oil companies, it needs financial strength and scale to execute massive, complex energy projects requiring enormous, long-term investments.

To simply maintain our current operations and make needed capital investments, Exxon Mobil spends nearly $1 billion each day.

Over the past 25 years, we have invested $355 billion in new energy projects, which is more than we earned during this same pe-

riod. Over the next 5 years, we plan to invest at least $125 billion more.

Our profitability in absolute terms is large, but it must be viewed in the context of the massive scale of our industry and our dependence on high earnings in the current up cycle to sustain the huge investments required over the longer term.

The second point I would like to make is to address the concerns your constituents and our customers have about where their gas dollars are going.

Last year, the average price in the United States of a gallon of regular unleaded gasoline was around $2.80.

On average, in 2007 approximately 58 percent of the price reflected the amount paid for crude oil.

Consumers pay for that crude oil, and so do we. Of the 2 million barrels per day Exxon Mobil refined in 2007 here in the United States, 90 percent were purchased from others. Last year we spent over $40 billion ourselves buying crude oil and feedstocks on the open market to fill our U.S. refineries.

Fifteen percent of the average price Americans paid at the pump last year reflected the amount collected in Federal, State, and local taxes.

The remaining 27 percent reflected refining, marketing, and transportation. For our refining and markets business, that 27 percent would be more than 23 percent costs and less than 4 percent earnings, which translates to earnings of only 10 cents per gallon of product sold. That is about one- quarter of the amount collected by taxes.

Since last year, the increase in gasoline prices—and more—can be attributed to the rise in the cost of crude oil. Product prices have not risen as much as crude oil, so industry margins have been reduced. In fact, our U.S. refining and marketing earnings have actually been cut by more than half compared to last year, to approximately 4 cents a gallon sold.

Our margins are tight because our industry is very competitive. The Federal Trade Commission and other Government agencies have repeatedly confirmed this fact.

When energy prices are high, the urge to point fingers at oil companies is strong.

But undercutting the ability of American companies like Exxon Mobil to compete in a huge global marketplace only makes it harder for Americans to secure the energy they need at competitive prices.

We should instead work together to strengthen U.S. competitiveness and meet the needs of the American people we all serve.

Thank you.

[The prepared statement of Mr. Simon appears as a submission for the record.]

Chairman LEAHY. Thank you. Well, Mr. Simon, I listened with interest to what you and the others had to say, and if I listen to your testimony, we should almost be embarrassed to even ask questions of you. The way you put it, you speak of this current up cycle. What a nice term. And I suppose we can tell our constituents, when they find that they cannot afford to go to work because

of the price of gas, "Don't worry. You are in a current up cycle." I think it is a little bit more serious than that.

Let's look at the—this hearing is on the upstream parts of the oil market. There is no question that with oil over $125 a barrel, the price of oil is currently the biggest factor in the price at the pump.

Now, look at this chart. This is part of a multimillion-dollar advertising campaign from your industry. It goes along with what you were testifying. To show where the money is that we spend at the pump, 72 percent for crude oil, 16 percent for refined distribution service stations, 12 percent for taxes. That adds up to 100 percent. You would think that you were a charitable organization because there is nothing on that chart about profits.

Ah, way down here, the asterisk. It says the industry in 2007 earned 8.3 cents per dollar. I assume that is after-tax profit.

Is there any reason why that is not up here in this chart, or does that kind of cut into the testimony?

Mr. SIMON. Mr. Chairman, let me address that from Exxon Mobil's perspective. When you look at our profitability in the first quarter of this year, only 4 percent of that profitability was associated with producing products for the American consumer here in the United States, our refining and marketing business.

To bring that back into terms I think people better understand, for every dollar paid at the pump, only 1.4 cents of that was attributable to our profitability.

Chairman LEAHY. Let me go into that a little bit. I understand the number is after tax, but we are still talking about tens of billions of dollars a year in profits, and I assume that among your expenses, your compensation, and all the other executives. Is that correct?

Mr. SIMON. That is correct, and I think—

Chairman LEAHY. And I know it is a matter of public record, but last year, what was your compensation, counting all the amounts that you have to list in salary, deferred compensation, and so forth.

Mr. SIMON. In total, about $12.5 million.

Chairman LEAHY. Thank you.

Mr. Lowe, what was yours?

Mr. LOWE. My compensation—

Chairman LEAHY. Press the button.

Mr. LOWE. I am sorry. I know it is a matter of public record. I do not know the exact amount.

Chairman LEAHY. Well, Mr. Lowe, I wish I made enough money that I did not even have to know how much I make.

[Laughter.]

Chairman LEAHY. Is it over, say, $100,000 a year?

Mr. LOWE. Yes, sir.

Chairman LEAHY. Is it considerably over $100,000 a year?

Mr. LOWE. Yes, sir. It would be—

Chairman LEAHY. Is it over $1 million a year?

Mr. LOWE. Yes, sir.

Chairman LEAHY. Do you suppose you might be able to find out how much you make and let us know?

Mr. LOWE. Yes, sir.

Chairman LEAHY. Thank you.

Mr. Robertson?

Mr. ROBERTSON. I am in the same boat. It is certainly well over $1 million. It is public record. I would be happy to—

Chairman LEAHY. Is it over $2 million?

Mr. ROBERTSON. Yes, it is, sir.

Chairman LEAHY. Is it over $3 million?

Mr. ROBERTSON. Yes, sir.

Chairman LEAHY. Is it over $4 million?

Mr. ROBERTSON. I don't remember. I don't know—it depends. There's a whole bunch of ways of—

Chairman LEAHY. You know, if I may—

Mr. ROBERTSON. But I will tell you that it is several million—

Chairman LEAHY. If I made over $4 million a year, I probably would not remember either, but—

Mr. ROBERTSON. It is several million dollars, and I would be happy to provide it. It is in our proxy statement and is a matter of public record.

Chairman LEAHY. We have had witnesses here before who don't remember. I hope you will recall and send it in to us.

Mr. Hofmeister, you can probably see where this is going.

Mr. HOFMEISTER. My income is not publicly reported because it is not within the top five executives of my company, but for the record, it was about $2.2 million.

Chairman LEAHY. Thank you, and thank you for your honesty.

Mr. Malone?

Mr. MALONE. Chairman, mine is not a matter of public record either, but it is in excess of $2 million.

Chairman LEAHY. Thank you very much.

We understand that the price of crude oil is set on the world market. Given its influence by speculation in the commodities market, it affects the price at the pump. We all agree on that. But the efficiencies associated with the vertical integration of your companies—and they are vertically integrated companies—should include the ability to refine the oil that you do produce in a manner that costs less then to purchase, and some of these costs are reflecting oil not based on suddenly a new discovery, but discoveries in the past. You have already expensed those costs. I am not sure how this vertical integration is working for the customers.

For example, if you refine this oil and gas from oil you produced, what price could you charge for a gallon of gas and still be profitable? Mr. Malone? And I realize that would be an approximation.

Mr. MALONE. Senator, if I understand the question, if I might, in the case of my company we produce about 600,000 barrels a day. I refine 1.2 million, and I have 1.6 million barrels a day that go into the consumer. So I am a net purchaser on the external markets. So we bring in millions of barrels—

Chairman LEAHY. But would the price be different if you were—and I am not asking if you should do this, but would the—I am just trying to understand your industry. You work in it all the time. You understand it better. But if you refine only the oil you produce, would the price still be the same at the pump?

Mr. MALONE. It would be because the oil is priced as a global commodity, so—

Chairman LEAHY. Mr. Hofmeister?

Mr. HOFMEISTER. Well, the market sets the price for the pump—the product that you buy at the pump. And what we do in terms of our production of crude, turning it into finished product and putting it then into the marketplace for sale, is a function of a whole range of activity.

Chairman LEAHY. But if the market sets the price, the market sure moves in awfully lockstep on this. I mean, to go from—a doubling almost in the last few months, are those truly market forces? For example, Senator Kohl and Senator Specter and 67 Members of the Senate, 345 Members of the House, want the Justice Department to look into anticompetitive measures. What about the NOPEC bill? You have all been briefed on that. What about the ability to bring our antitrust laws to bear? Would that make a difference in the price?

Mr. HOFMEISTER. Well, I think in my testimony I talked about the restrictions of access in this country. It seems to me that the place to start the free market is in our own country where we have practiced free market enterprise for a very long time. And the restriction of our own supplies to our producers in this country I believe is really setting the stage for OPEC to essentially do what is being done in this country, and that is, withdraw production from the free market.

Chairman LEAHY. Where do you think the price of oil should be?

Mr. HOFMEISTER. I personally believe that the price of oil is extraordinary because of the limits on production.

Chairman LEAHY. But what do you think the market should be?

Mr. HOFMEISTER. I think in a range of somewhere between $35 and $65 a barrel is what has been consistent in our ability to run a successful company.

Chairman LEAHY. Mr. Robertson?

Mr. ROBERTSON. I have got no idea what the market price of oil should be, but I do know that the prices are being driven by the—there are a lot of fundamentals in the prices today—

Chairman LEAHY. At $35 to $60, would you be able to be profitable?

Mr. ROBERTSON. I don't believe that you can produce the marginal barrels today, the kinds of complex resources that we are having to produce today, in that price range. So I—

Chairman LEAHY. Mr. Lowe? Mr. Lowe, where do you think it should be?

Mr. LOWE. Well, I believe that the incremental cost of supplies, as Mr. Robertson was just alluding to, is something above $90 a barrel in this environment.

Chairman LEAHY. Mr. Simon?

Mr. SIMON. I have no idea what the price should be today. I think the market determines that, Senator.

Chairman LEAHY. At what price could you be profitable as a company?

Mr. SIMON. Again, when you look at the marginal costs of production to meet demand today, it is significantly above the range that you gave.

Chairman LEAHY. Up to $130 a barrel? Below $130?

Mr. SIMON. I can't answer that, Senator.

Chairman LEAHY. Mr. Malone, do you want to take a stab at that?

Mr. MALONE. You know, right now on some of our projects—and, of course, the sensitivity is that this is commercially sensitive. But an oil price in the range of $60, I think in the range that you have heard today. But, that does not include the geopolitics, which are doing a lot to drive the price higher. And right now some of these heavy oil projects in Deepwater Gulf require a very high price to bring these fields online.

Chairman LEAHY. Mr. Malone and Mr. Hofmeister, I appreciate your candor.

Senator Specter?

Senator SPECTER. Thank you, Mr. Chairman.

Mr. Simon, there has been substantial publicity about the profits of Exxon Mobil. I have taken a look at the trend, and in 2002, Exxon Mobil made $11 billion; in 2003, $21 billion; in 2004, $25 billion; in 2005, $36 billion; in 2006, $39 billion; in 2007, $40.6 billion. Very, very steep escalation in profits. And that raises a question in the minds of many people, including Arlen Specter, about the scope of those profits, and a lot of talk about taxing excess profits, a lot of talk about oil's benefits.

We are mindful at the same time about the costs of exploration and very mindful about the problems of tampering with the free market. We want to be very careful we do not cause damage with what looks like a good idea.

But when you take a look from $11.5 billion in 2002 to $40.6 billion in 2007, with the consumers suffering so drastically not only at the pump but big issues on heating oil for the elderly, especially in a State like mine—Pennsylvania—don't you think that gives some cause for wonderment and questioning as to why profits have gone up so high when the consumer is suffering so much?

Mr. SIMON. Absolutely, Senator, and I understand people's concerns about that. When you look at our profitability, however, I do think it helps, as you point out, to break that down on what makes that up.

When you look at our profitability last year and you look again at the profitability associated with manufacturing the products that we are talking about here, 10 percent of that profitability was associated with our refining and marketing business here in the United States. To put that into perspective, that is 4 cents on the dollar. To put that 4 cents into perspective, that compares to 7.8 cents from the Dow Jones Industrials, or about half.

The point is it is not our profitability in this business that is driving the higher price that consumers pay. It is the raw materials that we have to purchase on the open market to produce those products for our customers. That is what is driving the higher price.

Senator SPECTER. Mr. Simon, that is a good logical agreement, but is there any merit to those who contend that given that explanation, that when Exxon Mobil's profits are so high, that there might be some give which would have an impact on the cost of heating oil and the cost of gasoline at the pump, looking at it on an overall picture?

Mr. SIMON. Well, again, when you think about that, Senator—which I understand people saying—again, when the profitability that we have is 4 cents on the dollar, the market is working today. The market is working. I understand consumers are feeling the pain, but we are seeing a reduction in demand in this country as a result, and we are bringing on more supplies.

When you look at what the industry has projected to bring onstream—and this is the DOE that has made this projection—five additional refineries will come onstream between now and the year 2012 by incrementally expanding existing capacity. To put that into perspective, that is three more refineries than is needed to meet the projected demand growth.

The point is that the market is working. If we leave the market alone, if we do not additionally tax the industry, if we do not put in place additional mandates, the market will work to the benefit of the American consumer.

Senator SPECTER. Let me shift gears to the issue of OPEC, Mr. Robertson, and direct this question to you. The 13 OPEC countries produce 40 percent of the world's oil supply. Saudi Arabia made an announcement that they were going to increase production by 300,000 barrels by June. At the same time, the other OPEC countries announced that they were going to decrease production by about 390,000 barrels.

A lot of analysis here about the supply, talk about other exploration. Why shouldn't the OPEC countries be under our antitrust laws so that a group of companies cannot sit down in a room, 13 companies, decide to lower production, less supply? At least under the traditional laws of supply and demand, that raises prices. Why should we give them preferential status in our economy?

Mr. ROBERTSON. Well, Senator, I don't support the NOPEC proposal. I don't think that suing foreign governments in our courts will do anything to raise the supply in the world. I think that engagement in partnerships and talking to these people and spending time with them I think is the most important thing—

Senator SPECTER. Well, the talk has not done a whole lot of good—

Mr. ROBERTSON. I think the issue—

Senator SPECTER. Vice President Cheney is practically on a commuter line.

Mr. ROBERTSON. I think the issue—

Senator SPECTER. And the President was just there—

Mr. ROBERTSON. I know that.

Senator SPECTER.—tank was empty.

Mr. ROBERTSON. Yes, sir, I know that. But I think that the real issue here is more investment in the world. There are many countries that are not making investments. There are many countries that are. There are many—

Senator SPECTER. But we—

Mr. ROBERTSON. We are one of the ones that should be making more investment.

Senator SPECTER. I have got less than a minute left, but we cannot control—we cannot control—

Mr. ROBERTSON. I don't think we can control OPEC. I don't think it is our place to control OPEC. But I do think that there are sig-

nificant investments needed in many of the OPEC countries, significant additional investments, because this is all about investment. There is not much spare capacity in the world. OPEC does not have much spare capacity to change the world's supply right now. So many of the OPEC countries are making investments, many are not. But we need across this business, across the world, more investment to increase the supply, and it is not just the OPEC countries.

Senator SPECTER. Well, I am not sure we can't—OK, we can't control OPEC, but we might have some impact. But I think right now OPEC may be doing a pretty good job of controlling us.

Mr. ROBERTSON. Senator, I think—

Senator SPECTER. My red light—

Mr. ROBERTSON.—a negative impact.

Senator SPECTER. Excuse me. Excuse me.

Mr. ROBERTSON. Excuse me.

Senator SPECTER. My red light is not yet on, Mr. Hofmeister, so I want to come back to an issue we talked about privately in the little time I have remaining about the cost of gasoline at the pump. As you described it to me, how much is attributable to the credit card costs?

Mr. HOFMEISTER. Well, I think the credit card rates are set through a particular process by the credit card companies, and they are set at a percentage of the retail price. And so if you just take that percentage times the retail price, it comes out somewhere in the range of 12 to 15 cents a gallon.

Senator SPECTER. And how much is the profit of the gasoline operator at the pump?

Mr. HOFMEISTER. Well, for the retail operator, it depends on their cost structure, obviously, and that various from State to State, from station to station. But, you know, I think our retailers generally are somewhere in the range of, at the low side, 2 to 3 cents a gallon; at the high side, depending upon the wholesale margins that they are having to pay for, could be in the range of 8 to 10 cents a gallon, averaging somewhere around 6 to 8 cents.

Senator SPECTER. And how about Shell? What is Shell's profit margin?

Mr. HOFMEISTER. The wholesale margins are much thinner than that. In some cases, they are just barely profitable margins, sometimes as low as a cent a gallon.

Senator SPECTER. Well, we have been looking at the issue of exchange rates with Visa and MasterCard. It is a pretty bleak picture if you say the credit cards are 12 to 15 cents and the dealer at the pump is about 6 cents and the oil companies are about 1 cent. That is a very significant factor that we will have to look at further.

Thank you, gentlemen, for coming in. We really appreciate your being here, and we know it is not easy, but we really want to try to find some answer to this, if we can.

Thank you, Mr. Chairman.

Chairman LEAHY. Thank you very much, Senator Specter.

Senator Kohl?

Senator KOHL. Thank you, Mr. Chairman.

Just proceeding to try and get some clarity here, as I said in my opening statement, back in 1981 the total petroleum product sup-

plied to our market here in the United States was 571 million barrels in January 1981; and 27 years later, in February of 2008, the total number of barrels in petroleum products supplied was 573 million barrels. So it was the same. Twenty-seven years later, we were supplying our market with the same amount by way of raw material. And you might say, well, the worldwide situation needs to be considered because that is—and certainly you have your point, and it is true. But worldwide petroleum consumption increased from 2004 to 2006 just 2.8 percent.

So that does not explain why prices are up 40 percent, 60 percent over last year. You cannot say it is because demand has gone through the roof. So what is the answer? Yes, sir?

Mr. ROBERTSON. I think there are several things that have happened. First of all, the market did work in the 1980's, and as a result of very severe price increases in oil, people changed their behaviors, and people did buy smaller cars and people did get a lot more efficient because prices were high, and that in the United States dropped demand dramatically over a period of time. And, in fact, it took pretty close to 15 to 20 years to recover from that, so—to recover, I mean for the demand to grow and for the economy to grow so that we are back to where we were in terms of the use of oil.

So we did get much more efficient in the United States, and that was a good thing. And some of us believe that with higher prices here this time, we will again become more efficient, and we will again use our technology, and we will again use our, you know, behavior patterns in the United States to reduce demand. So the market, higher prices did have an impact in the past and will have an impact this time.

Senator KOHL. Well, that is true but—

Mr. ROBERTSON. The other thing—can I make another point?

Senator KOHL. Go ahead.

Mr. ROBERTSON. The other thing I would say is that the other thing that we haven't talked about yet is underlying decline rates. Oil production declines, and we have in the world about a 4-percent decline on all the existing fields, or something like that. So there are massive investments needed every year just to stay even. So when we talk about the world growing at 2 or 3 percent, or whatever it is, it is really 2 or 3 percent plus the decline of 5 or 6 percent, which is an enormous investment that is required.

So, I mean, the growth is bigger, I think, in the world in terms of the investment that is needed than perhaps the relatively small growth rates would suggest.

Senator KOHL. People listening just do not get it. When demand is not going crazy, why are prices going crazy? They do not get it. You say, well, we need more investment and so on. But demand is not going crazy. Why are prices at the pump going crazy when demand is not going crazy?

Mr. ROBERTSON. Well, I think the combination of supply and demand are going crazy. There is a significant demand increase in the world, and there is a significant continuing reduction in supply unless we continue to invest. So it is the combination of those two things. I think as you say, it is not going crazy, but this is an enormous gap that exists.

Senator KOHL. But they are not going crazy like prices are going crazy.

Now I want to talk about OPEC because you said given that OPEC is really not something we should be tampering with, you know, we need to get more supply here in the United States. But it is true that as long as the OPEC cartel decides on supply, therefore, prices are going to follow—we know that. Unless we deal with OPEC in the foreseeable future, we are not going to be able to deal with the price at the pump. If they are allowed to get together and decide what supply is going to be, and then decide what the prices are going to be, we are helpless. There is nothing we can do. And if you say, well, we need to invest more, we need to drill more, that might take 5 or 10 years to come onstream.

So you are saying that we should not tamper with the OPEC cartel. You are, therefore, saying that we are helpless to do anything about what we are paying at the pump for the foreseeable future. You are saying that.

Mr. ROBERTSON. No, I am not saying that.

Senator KOHL. But if we do not deal with the OPEC cartel, how are we in the foreseeable future going to deal with the price at the pump?

Mr. ROBERTSON. I just maintain that the surplus that exists, even in the OPEC countries or in other countries, is minimal at this point. So what is going to be required, whether it is within OPEC or whether it is within Russia or whether it is within the United States, what is going to be required is not—OPEC is not the issue here. The issue is we have to as a world invest more. OPEC is certainly some of the places where there is some investment to be made, but it is not just OPEC. So I don't believe—

Senator KOHL. But that comes back, again, to demand. Demand is not going crazy, but prices are going crazy.

Mr. ROBERTSON. Well, in this kind of world, a several-percent increase is a huge amount, particularly with the underlying decline rate going—

Senator KOHL. And then I just want to hit on this next point and listen to all of you, if you would. Generally, when raw materials go up in a company and the raw materials just skyrocket in price, it is pretty hard to continue making even the margin of profit that you were making. And yet as you have said, your raw material cost is just beyond your ability almost to deal with it. And, nevertheless, your profits are going up hugely. Again, that is something we—we find it hard to understand that.

Mr. Simon, you were talking about that—just in almost every industry that I know of, including some of the businesses I have been in, when raw materials jump like crazy, we cannot make the profit that we used to. With you, it is just the opposite. You are making more money than ever. In effect, your industry has no problem in doubling your profits, tripling your profits. Even when prices at the pump go crazy, you have no problem in keeping up with your increasing profit.

It does not seem fair, guys. It just does not seem fair.

Mr. SIMON. Senator?

Senator KOHL. Yes, sir.

Mr. SIMON. Again, when you look at our profit, again, on the manufacture of products here in the United States, it has not kept the same. The price of crude oil, our raw material, has gone up 78 percent, May of this year compared to May of last year. The price of diesel fuel has gone up 52 percent. The price of motor gasoline has gone up 16 percent. Profit margins have been squeezed. As I said before, our profitability last year was 10 cents a gallon. That is now down around 4 cents a gallon. We are seeing the impact because 90 percent of the raw materials that we use to make our products, we buy on the open market. It is not our own production. We buy it on the open market, and we are not able to pass that through.

Senator KOHL. Well, you are retiring, Mr. Hofmeister, so you can really be candid with us today.

[Laughter.]

Senator KOHL. How about it?

Mr. HOFMEISTER. I think, Senator, from my point of view on all of this, the profitability that we are reporting is very large in absolute numbers. But we are—you have to look at the different segments of our business to understand where the profit comes from.

In the upstream of our business, at $125 a barrel, when we are producing oil that we have been producing from oil fields that are much lower cost oil fields because of their historic age and the write-down of the costs, the profits coming from those oil fields where the marginal cost of producing the oil might be, you know, low double digits given the history and the sales price is $125 in the global trading market, there is a lot of profit coming from that. But it is earned profit. It is earned because the market sets the price, our costs are very low. But as we look at new fields, new fields that are costing—and I would indicate that my 35 to 65 range that I said earlier was on a "should be" basis, which includes the value of the dollar restoring itself to some measure as it used to be. The costs of new fields are extraordinarily much higher.

And I agree with colleagues here who have said that the marginal costs of production are in the $70-plus range for many of these new fields. So we are not making as much money on new oil as we are making on old oil. When it comes to refining, we are making considerably less this year on refining than we were last year because there is much less demand.

So when you add all of that together—the old oil profit, the new oil much lower profit, the much lower refining margins—Shell's result in the first quarter was 6.9 percent return on sales. They sound like big numbers at $7.8 billion profit on $114 billion in revenue. But if I was reporting $7.8 million on $114 million in revenue, we would not be here today. Just change the word "million" to "billion." It is the same percentage, 6.9 percent, which I think is a rather average number. In fact, we spent more money on capital investment in the first quarter than we did on—than we returned in profit.

Senator KOHL. Thank you, Mr. Hofmeister.

Thank you, Mr. Chairman.

Chairman LEAHY. Thank you.

We have been joined by Senator Grassley. Senator Grassley, you are next.

Senator GRASSLEY. Most of my questions will be to any one or all of you on the panel, and I don't necessarily demand that you all answer them from the standpoint of being repetitive. There is no point in doing that.

According to the Center for Agricultural and Rural Development at Iowa State University, ethanol use has lowered retail gasoline prices by 30 to 40 cents per gallon. A Merrill Lynch strategist estimates that oil and gas prices would be about 15 percent higher if biofuels were unavailable. Some have estimated that gas today would be $1.40 more if you removed the 4.5 billion gallons that would be removed by a bill introduced by Senator Hutchison from the alternative fuels market.

What would happen to retail prices if that 3 to 7 percent that is biofuel were removed from the fuel supply? Any one of you? But hurry, because we have only got 7 minutes.

Mr. SIMON. Senator, I would make just one comment, and that is, when you look at producing motor gasoline out of crude versus ethanol out of corn, at today's prices, even with the extraordinary high price of crude, it is still more costly to produce an equivalent gallon of gasoline out of corn or ethanol than it is out of crude.

Senator GRASSLEY. OK. But my question is we have got x percentage of supply coming from biofuels. If that were taken off the market, would that increase the price at the pump for the consumer?

Mr. ROBERTSON. Well, there is no doubt in my mind that it would.

Senator GRASSLEY. OK.

Mr. ROBERTSON. Because I think it is an important component of the supply today.

Senator GRASSLEY. Is there anybody that disagrees with him? OK. Let's move on.

Currently, refineries are blending ethanol and 60 percent of the Nation's gasoline. Many of your companies, including BP, Shell, and Chevron, are pursuing biofuel projects. From your opening statements, I assume each of you support the use of ethanol. If you don't, say so. And I also assume that if there is more supply of ethanol, you are going to continue to increase that, use of ethanol. If that is not so, I would like to have you clear that up because I do not want to ask a series of questions if the assumption is going to be that you like ethanol, you are going to continue to use ethanol, et cetera, et cetera.

Mr. SIMON. I think mandating use of ethanol is not the right approach. I think ethanol ought to stand on its own. We ought not to mandate and subsidize it. Let's let the free market work, and we will make that determination.

Senator GRASSLEY. OK. But in the meantime, you are going to continue—beyond, you know, right now, the mandate is 7.5 billion gallons, going up to 15 billion. We have just about reached that 7.5, 9 billion next I guess it is. Probably if there is—are you saying that if there is ethanol available above the mandate, you might not use above the mandate?

Mr. SIMON. We wouldn't even be using as much as we are today were it not for the mandate.

Senator GRASSLEY. So then if gasoline with ethanol in it is 13 cents a gallon cheaper in Iowa, then otherwise you want the consumer to pay more?

Mr. SIMON. No. We would be using where it was economic to be using it, but there are areas where it is not.

Senator GRASSLEY. OK. We have your general support for ethanol with or without mandates, I think. You have also agreed that without renewable fuel, gas prices would be higher. I think you have said that. Yet we have Charles Drevna, President of the National Petrochemical and Refiners Association, recently stating that biofuel policies "have significant detrimental effect to our country and its consumers," and that biofuels "fail the economy, fail the environment, fail energy security, and fail the American consumers."

Now, I assume your companies are prominent members of the National Petrochemical and Refiners Association. If it is not, correct me. But if I am correct, does Mr. Drevna speak for you when he makes these statements? For those of you doing active research on biofuels, do you agree with Mr. Drevna's outrageous comments that denigrate our efforts to promote renewable fuels? OK, go ahead.

Mr. HOFMEISTER. Well, I think from the Shell standpoint, we see biofuel as a new and growing industry, not only in this country but elsewhere around the world. The research and development that we are pursuing happens to be non-food based ethanol, which is second-generation or cellulosic ethanol, where in the last year we have announced a number of major projects, a number of future fuel streams which we think will be necessary as a way of delivering energy security to this country, the reason for that being the convenient, easy oil that we—when I talked about earlier sort of the old oil, it is scarcer and scarcer. And we cannot predicate our future business on the probability of access being more free in this country. And, therefore, we think it is necessary to have an alternative. We think cellulosic ethanol is the way to go.

Senator GRASSLEY. I take what you are saying then is when Mr. Drevna says it "fails the economy, fails the environment, fails energy security, and fails the American consumers," he does not speak for you?

Mr. HOFMEISTER. I don't approve what he says.

Senator GRASSLEY. OK—you don't approve of it, or you don't—

Mr. HOFMEISTER. I don't get to approve it before it is said.

Senator GRASSLEY. OK. And so you obviously disagree with it.

Mr. HOFMEISTER. That is correct.

Senator GRASSLEY. In remarks before the House Committee, Mr. Drevna made accusations that increased biofuel production is driving up the cost of food. However, numerous economists, including Iowa State University, including Texas A&M, U.S. Department of Energy, U.S. Department of Agriculture, and the White House Council of Economic Advisers, have all concluded that biofuel policies have had a very minor, if any, impact on food prices. Unless Mr. Drevna is an expert in agricultural policy or food economics, do any of you know why we should believe the claims of the head of this trade association over the Chief Economist of the U.S. Department of Agriculture and the Chairman of the President's Council of Economic Advisers?

Mr. ROBERTSON. No. All I can say is that we need all forms of energy today, and I think biofuels are an important part of that energy mix. I do think that there are some implications for food that I do not personally understand well, but I think there are tradeoffs in everything we do. So I think there is a limit to how much corn-based ethanol we should be using, and the mandate calls for about 10 percent of our U.S. gasoline capacity.

I agree with Mr. Hofmeister that moving to some other form of ethanol—cellulose-based ethanol or something else—is the right track, and Chevron and many of the other companies are on that. But I do think that it is an important part of the fuel supply today, not only in the United States but in the world.

Senator GRASSLEY. Well, you know—

Mr. ROBERTSON. And if we did not have that, we would be feeling more pressure on the other system of oil and gas.

Senator GRASSLEY. Yes. Well, you know, it is our policy right now in law that not more than 15 billion gallons of ethanol is going to be made from grain.

Thank you, Mr. Chairman.

Chairman LEAHY. I thank you, Senator Grassley.

Senator Feinstein?

Senator FEINSTEIN. Thank you very much, Mr. Chairman.

Gentlemen, it is good to see you. Mr. Robertson, good to see you again.

I must tell you up front, as I listened to your opening comments, to me it was just a litany of complaints, that you are all just hapless victims of a system. You blame one thing or another, which most people would say is just simply the cost of doing business. And yet you rack up record profits—record profits for any corporation in the United States of America—quarter after quarter after quarter, and apparently have no ethical compass about the price of gasoline. You are just victims.

I do not think you are, really, and I want to read something to you. The Chief Economist of Commodity Futures Trading Commission and the Director of Market Surveillance of that Commission said before Congress—and it is in a written paper—a few days ago, "Our studies consistently find that when new information comes to the market and prices respond, it is the commercial traders, such as oil companies, utilities, airlines, who react first by adjusting their futures positions. When these commercial traders adjust their futures positions, it is speculators who are most often on the other side of the trade. Price changes that prompt hedgers to alter their futures positions attract speculators, who change their positions in response. Simply stated, there is no evidence that position changes by speculators precede price changes for crude oil futures contracts."

In other words, the CFTC is saying oil companies are driving up the price of oil in this way, and other market participants are simply responding to your constant increases.

I would like to know your response to that. Mr. Simon?

Mr. SIMON. Senator, we do no speculation.

Senator FEINSTEIN. I did not say you did.

Mr. SIMON. Well, you are saying that what we are doing in terms of taking positions influences the market, and we do not do that as a corporation.

Senator FEINSTEIN. That is exactly what the CFTC's experts are saying. I am not saying that. That is what they are—

Mr. SIMON. Well, I am just saying that we as a corporation do not take positions. We do not speculate.

Senator FEINSTEIN. OK—well, all right. Any other comments on that? Mr. Robertson?

Mr. ROBERTSON. Well, I would just like to say, first of all, I am sorry for sounding like a victim because I do not feel like a victim at all.

Senator FEINSTEIN. I don't think you are.

Mr. ROBERTSON. I feel very proud of what we do. We have changed our future by increasing our investment patterns dramatically. I feel very proud of the fact that, you know, we are investing all of our earnings. That is why we earn money, is to invest. We are an investing machine, and we invest in future supplies for the people of the world. So I am very proud of that.

With regard to the speculation, we sell about 2 million barrels a day of oil into the market which we produce, and we buy about 2 million barrels a day, round numbers, for our refineries. We trade in the market to basically—on a physical basis and to sort of optimize our position. We are not a speculating company at all. We support all transparency and support the bill that you have put forward. So that is not an issue for us, and I don't feel threatened by it at all. And I don't feel like a victim.

Senator FEINSTEIN. I don't think you are a victim. It is just when I heard it is one complaint after the other, it is American policy, it is permitting, you can go on and on and on. But let me go back.

Mr. Simon, last month you testified before the House Select Committee on Energy, and you agreed that speculation is part of the problem. You said, "When you look at the fundamentals, the price should be $50 to $55 a barrel of oil." Today, in response to the question, you said you did not know. Why is that?

Mr. SIMON. Yes, thank you very much, Senator, for giving me the opportunity to clarify that. What I did comment was that when you looked at historical fundamentals, it would predict a crude price about $50 to $55 a barrel. And then I outlined three factors that have caused a disconnect since 2005, the first of 2005: one is the weaker dollar; the other is geopolitical uncertainty in combination with a very low level of spare capacity in the world; and the third is speculation. But what I did not say was that if you eliminated or reduced that, that that would necessarily change the price today, because those are true factors in today's market, and the price that you see in the market today is reflective of what is required to balance supply and demand.

Senator FEINSTEIN. Well, let me ask you this question. When you said that last month, did you mean that the marginal cost to produce an additional barrel of oil is $55?

Mr. SIMON. No, that is not what I indicated at all.

Senator FEINSTEIN. What exactly did you mean by fundamentals?

Mr. SIMON. If you look at the historical relationship between usable commercial days of inventory around the world in terms of

crude oil inventories, there has been a reasonable correlation between that and crude price. That correlation broke down beginning 2005, and the three factors that have been identified as contributing to that disconnect are the three that I just indicated.

Senator FEINSTEIN. I guess I am really not understanding. I think it is—based on what everybody said, it is probably correct that the price should be somewhere between $40 and $60. I remember when royalty relief was anything over $35 a barrel of oil, and we are now at $130 a barrel of oil today. And it seems to me that those same basic fundamentals that enabled somebody to produce oil much more inexpensively are still there. And all these extra features that you are adding in, I am having a very hard time understanding.

Mr. SIMON. But I think they are reflective of the world's perception of the supply demand balance. When you have got such a very low level of spare capacity, it does not take much of a disruption in supplies to cause that. And what you are seeing today is the market's perception of the price that is required to balance supply and demand given that very low level of spare capacity.

Senator FEINSTEIN. So what you are talking about is the futures trading of the market—

Mr. SIMON. I think it is—

Senator FEINSTEIN.—increasing the cost of oil.

Mr. SIMON. That is one factor because, again, when they look at that amount of spare capacity, there is a risk premium in the market today.

Senator FEINSTEIN. How much per barrel do you believe is speculation of this type?

Mr. SIMON. What I indicated before is, roughly speaking, maybe a third, a third, a third. But I will frankly admit, Senator, I have no way of really knowing that because there is such a lot of interrelationship between those three factors that I just indicated.

Senator FEINSTEIN. Well, let me ask others. I am absolutely convinced that futures speculation is a big part of it. I am also convinced that the falling dollar is part of it when you can buy much better with the euro than you can with the dollar, clearly. But does anybody else have a view on futures speculation and its influence on the price of gasoline? How much would that be?

Mr. ROBERTSON. Senator, I want to raise—

Senator FEINSTEIN. Mr. Robertson?

Mr. ROBERTSON. It is a slightly different point, but the cost of everything has gone up. Oil as a commodity clearly has gone up. But the cost of all other commodities has gone up, too, and so the cost—you were talking about the incremental or the marginal cost of producing a barrel of oil. The marginal cost of producing a barrel of oil has been impacted by the cost of steel, by the cost of cement, by the cost of all of these other commodities in the world that you see. So actually, as the price of oil has gone up, the cost of producing those barrels of oil has gone up because all commodities have gone up and because the complexity of the projects that we are having to go to today has gone up dramatically, and I would give you one example. We are just completing a project in Kazakhstan, a $6 billion project. It is 250,000 barrels a day, which is less than 1 percent—less than half of 1 percent of global oil de-

mand, and the amount of man-hours that went into producing that, creating that project, is more than building the Panama Canal.

So these are enormously complex projects, getting more complex by the day, the kinds of resources that we are getting access to, as opposed to the places where we can't get access to, are getting more and more difficult. So not only prices have gone up, costs have gone up dramatically, too, and that has been a big part of the run-up, and it has changed the fundamentals from the time that you are talking about, I believe.

Senator FEINSTEIN. Thank you. My time is up.

Chairman LEAHY. Thank you.

Senator Sessions?

Senator SESSIONS. Thank you, Mr. Chairman.

The oil man Boone Pickens recently said that our $500- billion-a-year transfer of wealth to buy foreign oil is the greatest wealth transfer in the history of the world. I guess, Mr. Simon, would you agree that 50 percent of our balance-of-payments deficit is one reason the dollar is declining in the world market?

Mr. SIMON. I think that is one factor, but, Senator, I would be the first to admit I am not expert in that area.

Senator SESSIONS. Well, that is what they tell me, too, that trade deficits tend to weaken the dollar, and this huge—and that is—what?—15 percent of the price of oil now in the last 3 or 4 years is a decline—15 percent of the increase is related to the decline in the dollar? Is that 10, 15 percent? Is that what—

Mr. SIMON. The U.S. dollar has weakened about 20 percent since 2004 relative to the euro.

Senator SESSIONS. Well, I don't know how much it is, but it is a factor, and it strikes me that, therefore, our fundamental policy needs to be more conservation and more clean American production. Those two things will help make us less dependent, help reduce our balance-of-trade deficit, and keep wealth at home, hiring Americans, paying them decent wages with decent retirement benefits.

Mr. Hofmeister, let me just clear one thing up. When I say sometimes we need to produce more oil in the United States, in Alaska, offshore—which I have been a strong advocate of and believe it is unthinkable that we have not done that, and it is absolutely a factor in increasing the price of oil, and it is a factor in our wealth transfer, which we could have kept at home no matter what the price of oil was.

Senator SESSIONS. But explain—and people say, well, you are just talking—you are shilling for the oil companies. That is what the oil companies say.

Explain to us briefly how it is in America's interest and that you would have to compete for those resources and have to produce them and sell them at a competitive price on the marketplace. But to me, it is America's interest in producing more oil and gas at home, not to benefit you in any way.

Mr. HOFMEISTER. I think the first benefit is to the American consumer. If, in fact, futures speculation is based on scarcity, if there is a sense in the market that there will be an abundance of oil because of the extra exploration and production which the United States is now committing itself to, the futures market is turned up-

side down, because we look at a future of surplus because of new American oil heretofore off limits, now being brought into the marketplace. The immediate beneficiary would be the American consumer because futures speculation would take that into account.

Second, the job creation content of new oil exploration and production would be enormous. I just point to the example of Motiva's Port Arthur, Texas, refinery of which Shell has a 50-percent share. We are going to have 6,000 construction workers at the peak of construction in adding on to that refinery. Now, much of the crude oil is going to come from foreign oil sources, but if, in fact, over some longer period of time there was more production coming from the Gulf of Mexico, more production from the east or the west coast or the eastern Gulf of Mexico, this would have a dramatic impact not just on that refinery but other refineries in the United States getting oil that is now coming from oil produced by American workers.

Senator SESSIONS. And I am exceedingly disappointed that the Democrat leadership slipped in the two bills, changed the law in the last year to, in effect, stop oil shale production. Mr. Hofmeister, I believe your company is investing in oil shale. Do you believe that if you are allowed to produce that that you can produce huge amounts of oil in the United States, American oil, at less than this $130 world price of oil?

Mr. HOFMEISTER. Well, I think it would depend upon what all the other costs are at the time that our research and development project is completed. We do see that, you know, as we have talked earlier, the marginal cost of a barrel is increasing. That is because steel is more expensive, labor is more expensive, the house pumps, everything is more expensive. So we do not know what the future cost structure might look like of oil shale, but let's be clear. When there is a natural deposit of more than a trillion potentially recoverable barrels of oil in a particular geography within the continental United States, not to develop that is really, in my opinion, a disservice to the American consumer.

Senator SESSIONS. Well, and a trillion barrels, we spend about 5 billion—we utilize about 5 billion a year, so that is a couple of hundred years' worth of oil right there. We would not have to—your engineer in the Energy Committee either this week or last week testified that you could bring it out for less, far less than the world price. And then the coal to liquid also can be brought forth at less than this world price right now. And with good technology, we may even get better. But both of those were blocked, I would note.

So a majority in the Congress, I just have to say, have blocked Alaska, they have blocked the Pacific Coast, they have blocked the Atlantic Coast, they have blocked off Florida and made it far more difficult to produce on certain Federal lands, leaving us more dependent on foreign oil.

Now, I am not pleased with some things that I think are occurring. I cannot fathom why the United States is producing so little diesel, and Europe has half of its automobiles diesel automobiles. Diesel is cheaper in Europe than in the United States, cheaper relative to gasoline. It gets, I have always understood, about 38 percent better gas mileage than a gasoline engine. We have recently seen a Popular Mechanics article that compared them and said it

gets 38 percent better than a hybrid vehicle that we have been committing so much to and I have supported.

Why aren't we doing more diesel? What is the policy that has us at 3 percent diesel automobiles whereas Europe has 50 percent diesel automobiles? And if we were using diesel, we would be utilizing about 35 percent fewer gallons of that fuel we put in our cars and it would hurt your business? I am asking Mr. Robertson.

Mr. ROBERTSON. Mr. Sessions, you are exactly right. Diesel is fundamentally a better product, so there is fundamentally more energy in a barrel of diesel than there is in a barrel of gasoline. And so you would expect that the price, if everything else were equal—which it is not—the price would be higher.

Europe has traditionally tax-advantaged diesel through policy, and so the European system is fundamentally—the European refining system is fundamentally built to produce diesel. The American refining system is fundamentally built to produce gasoline, so the—

Senator SESSIONS. Why? Why?

Mr. ROBERTSON.—facilities are different. It used to be that diesel was a product that people did not like, they did not like the kind of cars, they did not like the noise, they did not like the smell. And, of course, technology has changed all that. But our refining system is fundamentally focused on gasoline as a primary product.

Senator SESSIONS. Well, I am going to be pursuing that in more depth, but I would note that new diesel engines are cleaner, emit fewer CO2, and our diesel—low-sulfur diesel fuel is the cleanest fuel in the world. The whole ideas about dirty diesel are not correct. It actually is environmentally friendly.

Mr. ROBERTSON. I was agreeing with you. But the problem is that we have built our system for something else, so there is—

Senator SESSIONS. I know. I want to find out how we made that mistake.

Chairman LEAHY. Maybe this could wait for another round.

Senator Durbin?

Senator DURBIN. Thank you, Mr. Chairman. Thank you to the witnesses who are here today.

The Chairman's earlier questions about CEO compensation left me a little puzzled when I heard your responses. I asked the Congressional Research Service to give me updated information on the CEO salaries of the oil industry, and these salaries relate to 2005. That is the only information they had readily available. They are dramatically larger than the amounts which we have been told—for instance, Mr. Tillerson, CEO of Exxon Mobil in 2005, $21.7 million in salary, $69.7 million in stock options. It turned out the average salaries, bonuses, deferred compensation, stock options of the 15 United States oil CEOs in 2005 averaged $32.7 million. In comparison, the average compensation for the largest corporation CEOs in America was $11.6 million, about a third.

So I would like to ask, Mr. Chairman, as a followup to your question, for the record if you all will be kind enough to update these figures for each of your companies, the amount that is being paid to CEOs in salary, bonus, deferred compensation, and other stock options so that the record is complete. I thank you for asking that question.

Mr. Chairman, I am glad we had this hearing, and I am sure it is not the first or last time that these gentlemen or people like them will be called before Congress, as they should be. But the honest answer is it takes us a long time to respond to a national crisis like the one we face. And it is tough. The idea of a windfall profits tax, which I support—and I assume the entire panel opposes—is not likely to pass in this Congress because these gentlemen and their companies have very powerful people in Washington that make it difficult to bring those measures before us. I understand that.

It strikes me that this is the right situation for a President to step in, for a President of the United States to step in. I can understand when the President of the United States goes to Saudi Arabia and begs the sheikhs, please, release more oil, you are killing the American economy, they told him to take a hike. They sent him home empty-handed.

I think the President should be calling you all before his little meeting place in the White House and talking about what you are doing to the American economy. You have to sense what you are doing to us. We are on the precipice here and about to fall into a recession. Working families across this country have been falling behind for 7 straight years in the cost of living. And if I ask any family in Illinois—which, incidentally, has the dubious distinction of having the Nation's top gas prices as of Tuesday of this week. If I asked any family in Illinois, "What is the biggest pain you face?" they are going to point at you and what it costs to fill a tank of gas. It cost me 61 bucks to fill up my Ford pick-up truck at the Shell station in Springfield, Illinois, Friday. That is the most I have ever paid in my life. I am afraid it is going to go higher.

I come down to this basic question. You do not all work for American companies, but you all, I think understandably feel a certain pride in this country and an obligation to this country. Does it trouble any of you when you see what you are doing to us, the profits that you are taking, the costs that you are imposing on working families, small businesses, truckers, farmers? Does it trouble you when you say, you know, if we take that extra billion dollars here, it is right out of America, it is right out of our economy? Is there anybody here that has any concerns about what you are doing to this country with the prices that you are charging and the profits you are taking?

Mr. SIMON. Senator, we have—and I can certainly speak for our corporation. We have a lot of concern about that, and we are doing all that we can to produce as much product as we can to put downward pressure on prices.

When you look at what we have done, for example, in refining, we have expanded our refining capacity at a rate 40 percent higher than the rest of industry.

Senator DURBIN. If I could just interrupt you for a second, do you know what the current utilization of refining capacity is for the oil companies in America? Do you know what the percentage is?

Mr. SIMON. I know what ours is, and it is about 93 percent.

Senator DURBIN. OK. Nationwide, industry-wide, it is 85 percent. They are begging us for more refineries. They are begging us for more exploration. And they are utilizing current refining capacity

at 85 percent, which is the lowest since 1992. You are shorting the market a product when we desperately need more of it.

I do not understand that. Why is that the case?

Mr. SIMON. Let me address that, at least from our corporation, and I think others can do the same. We are using every bit of available capacity that we have, Senator. We have a number of units that we have to take down on overhaul. Those have been running for 5 to 7 years between overhauls. We do not plan those; we started planning those 20 to 30 months ago. We have to take them down. We take them down during the slack period, right after the heating oil season but before the mogas season.

Now, again, when you look at our utilization as a corporation, it has been higher than the industry average. I understand—

Senator DURBIN. Well, let's listen to some of the others. I would like some of the others to have a chance to respond to this, about this 85-percent refinery capacity. Why are you not operating at higher levels of capacity? Is it all what Mr. Simon has said, the situation where you have to take some offline at a given period of time for transition?

Mr. ROBERTSON. Well, everybody has that situation, but I would just like to start by saying that, I am a regular person, I have got lots of friends who are regular people, and we do not like this situation. We have to explain to our families and friends what is going on with—

Senator DURBIN. How do you explain your profits?

Mr. ROBERTSON. Well, I explain my profits by saying we reinvest it all. So what we are doing—

Senator DURBIN. Oh, really?

Mr. ROBERTSON. Yes. We reinvest all our—

Senator DURBIN. Do you know how much cash on hand your companies have?

Mr. ROBERTSON. I know how much cash in—

Senator DURBIN. Compared to capital investment? In the past several years, there has been almost a 300-percent increase in your cash on hand while your industry has been an 81-percent increase in capital investment.

Mr. ROBERTSON. We are investing at the capability of our company to invest, and that has been equal to our earnings over the last 5 to 6 years.

Senator DURBIN. But for you to take—

Mr. ROBERTSON. So we are—

Senator DURBIN.—profits and hold it in cash while the price of gasoline is breaking the back of the American economy is unconscionable.

Mr. ROBERTSON. We—

Senator DURBIN. Where is the corporate conscience here?

Mr. ROBERTSON. Right now, we are investing all we can, first of all. The things that we can do is we can invest to produce more supply. We are investing all that we can, given the limitations of access around the world, given the limitations of our own human capacity, given the limitations of the contractor community and the drilling rigs and all these things that are available in the world. We are investing at our capacity.

In terms of the refining situation, the markets that we supply are well supplied. Inventories of gasoline are as high as they have been in all time. So the issue is not refining capacity right now. The issue is the price of crude oil. That is the largest single—

Senator DURBIN. Do you have adequate refining capacity? You are not—

Mr. ROBERTSON. We have adequate refining capacity, and we have got the inventories at an all-time level, and our markets are all well supplied—

Senator DURBIN. My time has run out, Mr. Chairman, but I would just close by saying because of the high price of a barrel of oil, many companies are looking at sources they had never considered before—Senator Sessions alluded to oil shale—and one of these is Canadian tar sands. I know BP, Conoco, and maybe all of you, you will readily concede this is one of the dirtiest sources of oil that we could be refining, and it has environmental concerns which we all should share. When you talk to us about drilling in every direction in every place and expanding refinery capacity for some of the dirtiest crude sources in the world, excuse me, but we also have an environmental and public health responsibility that we have to take into consideration. This should not come down to an equation of your money or your life. And if you are telling us we have to sacrifice the public health of America to bring gasoline prices down, I am telling you we ought to take a closer look at your industry and who is making the decisions.

Thank you.

Chairman LEAHY. Thank you.

Mr. ROBERTSON. Well, I certainly did not say that, Senator.

Chairman LEAHY. Thank you. I—

Senator DURBIN. And I did not suggest you did, Mr. Robertson. I am sorry if that was your conclusion.

Chairman LEAHY. I am going to yield just a moment to Senator Hatch, who has been waiting here patiently, as the Ranking Member of the Subcommittee. I am going to have to step out after that, and Senator Whitehouse has agreed to stay and chair. But I was struck, if I might, by something that Senator Durbin said. He talked about Saudi Arabia and their response. The President has flown twice to Saudi Arabia this year to plead with the Saudis to increase oil production in order to lower gas prices.

Here we have this photograph of him. He has failed in his efforts, although he touted himself as a friend of the Saudis, could work with them and jawbone them into action.

Do you agree or disagree with the Saudi Oil Minister's statement that supply and demand are in balance today and with the Bush administration's statement that Saudi Arabia does not have customers who are making requests for oil that they are not able to satisfy? Mr. Malone, do you agree with those two statements? Yes or on.

Mr. MALONE. No.

Chairman LEAHY. Mr. Hofmeister?

Mr. HOFMEISTER. No, I don't. I think the underlying demand requires more supply.

Chairman LEAHY. Mr. Robertson?

Mr. ROBERTSON. I think the real issue is the shortage of supply and capacity available in the system that just is not very much. So I think the market is pretty well supplied today.

Chairman LEAHY. Thank you. Mr. Lowe?

Mr. LOWE. As Mr. Robertson said, while the market is currently supplied, there is very little, if any, excess capacity.

Chairman LEAHY. Mr. Simon?

Mr. SIMON. The market is well supplied. We have 35 refineries around the world, and not a single one of them are having any trouble finding the crude and feedstocks to run at high utilization.

Chairman LEAHY. And so you agree that Saudi Arabia does not have customers making requests for oil that they are not able to satisfy?

Mr. SIMON. This is not a supply issue.

Chairman LEAHY. Thank you. Thank you and I thank Senator Hatch for, as always, his courtesy.

Senator HATCH. Well, thank you, Mr. Chairman. I appreciate your courtesy.

Mr. Hofmeister, just to set the record straight, as you know, the Democrat leadership in the Congress has passed legislation that would ban our Government from purchasing oil from the oil sands up in Canada. And Canada has moved to a million barrels a day, and they are moving up to 3 million barrels a day.

Now, do you see this as a problem for oil supply in this country?

Mr. HOFMEISTER. I absolutely do, Senator, and I do believe that there are environmental remediations both underway and future technology will deliver more so that the world can benefit and the U.S. in particular can benefit from not just oil sands production coming from Alberta, but also oil shale production that could come from Utah, Wyoming—

Senator HATCH. I am going to get into that. In other words, we are talking about Utah, Colorado, and Wyoming. It is fair to say that they are not considered part of America's $22 billion of proven reserves.

Mr. HOFMEISTER. Not at all.

Senator HATCH. Now, but experts agree that there is between 800 billion to almost 2 trillion barrels of oil that could be recoverable there, and that is good oil, isn't it?

Mr. HOFMEISTER. That is correct.

Senator HATCH. It could be recovered at somewhere between 30 and 40 bucks a barrel?

Mr. HOFMEISTER. I think those costs are probably a bit dated now based upon what we have seen—

Senator HATCH. Somewhere in that area.

Mr. HOFMEISTER. I don't know what the exact costs would be, but, you know, if there is more supply, I think inflation in the oil industry would be cracked. And we are facing severe inflation because of the limited amount of supply against the demand.

Senator HATCH. I guess what I am saying, though, is that if we started to develop the oil shale in those three States, we could do it within this framework of over $100 a barrel and make a profit.

Mr. HOFMEISTER. I believe we could.

Senator HATCH. And we could help our country alleviate its oil pressures.

Mr. HOFMEISTER. Yes.

Senator HATCH. But they are stopping us from doing that right here as we sit here. We just had a hearing last week where Democrats have stopped the ability to do that in at least Colorado.

Mr. HOFMEISTER. Well, as I said in my opening statement, I think the public policy constraints on the supply side in this country are a disservice to the American consumer.

Senator HATCH. Well, if the Government gave you free access to the oil that could be recovered, would that make a difference to you in Shell?

Mr. HOFMEISTER. Yes, it would, over time.

Senator HATCH. Well, how would it make a difference?

Mr. HOFMEISTER. We would be steering investments toward—on a global capital allocation basis, we would steer investments toward the best opportunities for the most prolific supply. We are a supply side company. That is what we do. And anytime we can move into a new source of supply and it is economic, we would proceed to invest capital to produce more product.

Senator HATCH. You are already moving into that new source of supply, if you could, in Colorado especially.

Mr. HOFMEISTER. Correct. We have been there 20 years doing a research and development project for a technology that does not require mining, that does not require opening up the surface, other than by drilling, which we have done for a hundred years.

Senator HATCH. Well, who is stopping you from doing that?

Mr. HOFMEISTER. Well, currently it is—we are still not at a point of making a commercial decision because of the research work that is necessary to know that we can do this in an environmentally safe manner and that we can use the—we can find an energy source for our heating technology which is also environmentally sound, and that we would have the water plan, the land use plans, et cetera.

So we are not ready to make a commercial decision yet, but we would be unable to make a commercial decision unless the Minerals Management Service creates the necessary regulatory framework, including a royalty structure, that would enable us to know what we will be able to produce.

Senator HATCH. And leasing structure.

Mr. HOFMEISTER. And leasing structure, yes.

Senator HATCH. Mr. Simon, isn't it true that we are spending about $600 billion a year for offshore oil?

Mr. SIMON. I am not sure what the number is, Senator.

Senator HATCH. Anybody know the number? That is what I have been told. It is around $600 billion a year that we are sending overseas to Venezuela, Russia, the Middle East.

Mr. SIMON. I know that we are dependent upon imports for about 60 percent of our petroleum use.

Senator HATCH. Let me ask you this: How much of a barrel of crude does the Government take in taxes?

Mr. SIMON. Well, when you look—the numbers I gave before is when you look at a gallon of gasoline, it is about 15 percent.

Senator HATCH. About 15 percent. Now, your profits range between, what, 4 and 8 percent?

Mr. SIMON. When you look at our profitability for refining and marketing in the U.S. during the first quarter of this year, it is about 4 cents.

Senator HATCH. Anybody over 8 percent down there? Anybody? You are all shaking your heads no. So the Government is taking 15 percent—

Mr. SIMON. Fifteen cents on the—

Senator HATCH. Well, that is 15 percent.

Mr. SIMON. Well, the—

Senator HATCH. Am I missing something here?

Mr. SIMON. The gallon is currently about $3.80, I think.

Senator HATCH. Oh, OK. So it is 15 cents on a gallon.

Mr. SIMON. It is 15 percent on a gallon. Our profitability this year is 4 cents.

Senator HATCH. OK. Now, if all of you—you hear all these comments on Capitol Hill all the time about "big oil." I think they are referring to you. If you put all the so- called big oil companies together, what percentage would they be of producers in the world oil stage?

Mr. ROBERTSON. We are about 2 percent.

Senator HATCH. But total, all lumped together.

Mr. ROBERTSON. My guess would be about 10 percent, probably.

Senator HATCH. I have been told 6 percent.

Mr. SIMON. When you look at worldwide crude reserves, Senator, you are right. It is about 6 percent versus 80 percent for the national oil companies.

Senator HATCH. OK. That is what I have been—that is my understanding.

Now, I am the author of the CLEAR ACT to develop alternative fuels, alternative fuel resources, alternative fuel vehicles, alternative fuel infrastructure. I also was one of the people who put the tax credits for alternative energy into the 1995—both of these are in the 1995 energy bill. So I take second place to nobody with regard to trying to develop alternative fuels and other renewable fuels. But let me just ask you, if we do everything we can in solar, wind, geothermal—I will leave nuclear off here right now—solar, thermal, which my friend Bernard Koestler is doing out there. He is going to have 200 megawatts of power by 2010. If we do everything we can, what percentage of energy would that provide for our country to run our trucks, our cars, our trains, our planes? Can anybody tell me that? Mr. Hofmeister?

Mr. HOFMEISTER. The estimate that I have seen is that by 2030 it could be about 20 percent.

Senator HATCH. Twenty percent would be the maximum?

Mr. HOFMEISTER. Based on what I have been—

Senator HATCH. Well, where would we get the other 80 percent to keep our country going, run our cars, our trucks, our—

Mr. HOFMEISTER. All of the estimates say that traditional hydrocarbons must be part of our long-term energy security, meaning gas, oil, coal.

Senator HATCH. But that is dirty. I mean, why would we subject ourselves to being hostage to 80 percent of this type of production?

Mr. HOFMEISTER. I think there are some brilliant technologies that are coming down the pike that will enable us to manage CO2

and continue to use hydrocarbons. And I for one and Shell is a fan of a cap-and-trade bill for this country on a national basis, using these new technologies to both produce hydrocarbons to keep the economy strong while developing alternative forms of energy.

Senator HATCH. Would it be fair to say that with that 80 percent, if we do not have that, we could not run our country?

Mr. SIMON. I would agree with that, Senator. Eighty percent of the outlook is fossil fuel, 60 percent for oil and gas alone. And let me correct myself, you are absolutely right with what you said before. In 2007 it was 15 percent on taxes, and our profitability was 4 percent. I apologize if I—

Senator HATCH. I am glad to have that apology. Do the rest of you agree with what he just said? Do you agree with the 80 percent?

Mr. ROBERTSON. Yes, sir.

Senator HATCH. We cannot run our country. We cannot run our cars, our trucks, our trains, and our planes—at least over the next 20, 25, 30 years—if we do everything we can with regard to alternative fuels, renewable fuels. We cannot do it without oil and gas. Is that right?

Mr. ROBERTSON. That is exactly right, but we can do it—

Senator HATCH. And anybody who does not understand that just does not understand what it takes to run America.

Mr. ROBERTSON. What we can do, we can do it with more North American oil and gas.

Senator HATCH. We could become somewhat independent of—

Mr. ROBERTSON. So my take on your question was we are importing 10 million barrels a day of oil today. We can make a significant dent in that by doing more here.

Senator HATCH. If you were not hampered by Congress, right, or Government?

Mr. ROBERTSON. If we weren't hampered by a lot of barriers to investment, yes. The thing I would also add is that we can do a lot more—

Senator HATCH. You are so much more diplomatic than I.

Mr. ROBERTSON. Well, I am an engineer. The one thing I would say is, don't forget Canada either. And I know you mentioned Canada. We talk about importing 10 million barrels a day of oil; 1.3 million barrels a day of that comes from Canada. And so the resource that exists in Canada—we have talked a little bit about it—is a really important resource, just like the shale oil and just like the offshore and just like the coal, and just like all of these fossil fuel resources that we have in North America. So we have the capacity in North America to significantly reduce our imports of foreign oil, and, frankly, that is a good thing not only for America, but it is a good thing for the world because it will reduce our load on the world and, frankly, free up more for other people.

So I think it does drive prices down, and it is good for America, and it is possible.

Senator HATCH. Thank you, Mr. Chairman. I appreciate it.

Senator WHITEHOUSE. [Presiding.] Senator—

[Audience outburst.]

Senator WHITEHOUSE. This room will come to order.

We will suspend for a moment while the proceedings are brought to order. My apologies.

[Pause.]

Senator WHITEHOUSE. I hope there will not be further disruptions like that, and I call on the guests who are here to conform themselves to the behavior that the Senate Committee expects.

Senator Feingold?

Senator FEINGOLD. I thank the Chair and the Ranking Member for holding this hearing to investigate the skyrocketing price of oil. Americans may have a hard time believing this, as they fill up their cars, but the United States is the third top oil-producing country in the world, exceeded only by Saudi Arabia and Russia. We produce 4 times more oil than Iraq, 3 times more oil than Venezuela, and over double the production in Canada, Mexico, China, and Iran. And yet we have never been able to meet our needs domestically because the U.S. consumes more oil than any other country in the world. Our annual consumption of 20.7 million gallons of oil a day is threefold the consumption level of the next highest consuming country. In short, we have an insatiable appetite—an appetite that cannot be met even by adding an amount equivalent to all the oil in the top oil-producing country of Saudi Arabia. Even President Bush famously declared that the United States is addicted to oil.

The problem is clear. Now we need solutions. We do not need economists in the room to explain the basic principles of supply and demand. Given ever increasing global demand and predictions of continued skyrocketing oil prices, we need to start the long-term transition to renewable energy and alternative fuels immediately.

Mr. Hofmeister, the President of Shell Oil, stated in an NBC interview last year that he, too, agrees that we must and can get over our addiction to oil over decades and that Shell Oil will be there when it comes to renewables and alternative fuels. However, his colleague, Mr. Simon, the President of Exxon Mobil, declared at a House hearing last month that oil and gas will represent 80 percent of our energy portfolio in 2050, over four decades from now. So how many decades from now are we talking before your companies will seriously invest in alternative fuels and renewable energy?

Three years ago, the same oil companies testified before the Senate's Energy and Commerce Committees and had similar discussions, and yet based on April 2008 data published in the Oil and Gas Journal and distributed by the American Petroleum Institute, over this time period your companies invested more in marketing than renewable energy.

Mr. Chairman, I ask that this data be submitted for the record.

Senator WHITEHOUSE. Without objection.

Senator FEINGOLD. Thank you, Mr. Chairman.

Obviously, you are private companies looking to make a profit. And succeeding—we have all read the headlines regarding your companies' record-setting profits, $123 billion for 2007. Meanwhile, my constituents are facing financially challenging times. I have never seen anything really like it in my 26 years in public life. From our farm fields to our grocery stores and gas pumps, Ameri-

cans really are feeling quite an effect of record oil prices, and they are looking to us for help.

There are some things we can do to provide some short- term relief, such as no longer filling the Strategic Petroleum Reserve and preventing market manipulation. We have recently made some progress in both of these areas. We also need to promote policies that encourage renewable energy, alternative fuels, as well as energy efficiency and conservation, and last year's energy bill moves in that direction.

But more is needed, and I hope that oil companies will step up and be a part of the solution finally, and I would like to ask a bit about what you can still do given your own resources.

Could you tell me, how many oil and gas leases on Federal lands do you currently have that are not in development? Surely some of you know.

Mr. HOFMEISTER. Senator, frankly, I would have to go check. We have thousands of leases that are out there that we have won over a number of years, and I do not have a current inventory at my disposal. I would have to go research that number.

Senator FEINGOLD. My guess is some of you have a general sense of this issue. Currently, your companies hold leases on 42 million acres of Federal land, and yet you are only producing on 12 million acres. This means you are not producing on 30 million acres. Can you talk to me about why this is?

Mr. ROBERTSON. Well, Senator, I am in the same position. We have got thousands of leases, and I could not tell you how many, but I can tell you that we pay rent on those, and so we do not lease them unless we are going to do something with them. As we look at those and do seismic work a lot of them will, frankly, prove to have nothing to drill on, and we will relinquish those. So, I mean, all of them we are either keeping because we are doing work on them, or we are going to relinquish them.

Senator FEINGOLD. Do you have the manpower and infrastructure to put your current leases on a lot of these acres in production?

Mr. ROBERTSON. Well, a lot of them will never come on production because they do not have—at the end of the day you look at them, and they don't have the prospectivity. So we are working on—

Senator FEINGOLD. But you have adequate manpower and infrastructure to do the work on those that you do think will be productive?

Mr. ROBERTSON. Yes, sir.

Senator FEINGOLD. All right. Well, I would appreciate some followup in writing from you on this so I can get a better sense of that question.

I would like to know a little more about how your companies are going to assist in the significant transition we need to make. Ideally, of course, we do this gradually, but I am concerned it is happening too slowly.

Mr. Lowe, following a 2006 Judiciary Committee hearing, James Mulva, the Chairman and Chief Executive Officer of ConocoPhillips, responded to one of my questions regarding the company's investment in alternatives by stating, "ConocoPhillips is

an oil and gas company and, as such, we are in the business of finding new sources of fossil fuels to meet consumer demands. Eventually, there will be an evolution to the next generation of fuels, but this evolution will not occur for some time," he said.

Is this still ConocoPhillips' position that alternatives are years off? Have you increased your annual investments in renewable energy and alternative fuels?

Mr. LOWE. Yes, Senator. We have significantly increased our efforts. We are combining with universities such as Iowa State to try and develop cellulosic ethanol. We are working with companies such as Tyson and ADM to try and develop alternative sources, renewable sources of fuel. And we are also working on projects such as carbon capture and storage to make a positive impact and what we think is necessary for the development of the Canadian oil sands—

Senator FEINGOLD. So has the company's position changed? Are the alternatives more immediately available or is this something, as your previous spokesman said, that is still years off?

Mr. LOWE. I think that in the short term, we are really limited to corn-based, sugar-based ethanol as far as alternative fuels, as far as ethanol. But longer term, we can have an impact through these other sources, and ConocoPhillips is advancing those.

Senator FEINGOLD. Mr. Hofmeister, I would like to give you a chance to respond to this question, since, as I mentioned in my opening remarks, you seem to be saying the right things. Is Shell backing up what you said about being part of the energy revolution and investing in alternative energy?

Mr. HOFMEISTER. Senator, I would like to call attention to a document that I made part of my written record, which is a Shell report on all of the areas on which we are working, which includes hydrocarbon, includes new technology in hydrocarbons, for example, coal gassification, liquefied natural gas, also includes biofuel, wind, solar, and hydrogen fuel cell work that we are doing with automotive makers.

In addition to that, we do put significant emphasis on efficiency. Without better use of the molecule of hydrocarbon, I think we cannot in any way keep up with the future demand for product, and there is so much opportunity for efficiency that we ought to consider that as a whole new form—in a sense, new form of energy.

Senator FEINGOLD. OK. And, Mr. Simon, could you just answer that question also, please?

Mr. SIMON. I appreciate, Senator, the opportunity to clarify our position on alternative fuels. I think we have been painted with a brush that we are against alternatives, and that is not the case at all. Our scientists have looked at every form of alternative fuels and current technology, current generation, and frankly, we have not found any in terms of producing an appreciable amount of energy when you look at the energy balance or that have mitigated greenhouse gas emissions in any appreciable way.

So what we are doing is to try to look at the next- generation new technologies which can produce energy with scale and also dramatically reduce greenhouse gas emissions. And we are working with a number of research institutions in that area.

Senator FEINGOLD. Thank you very much, Mr. Chairman.

Senator WHITEHOUSE. Senator Schumer?

Senator SCHUMER. Thank you, Mr. Chairman.

Just to followup, Mr. Simon, give me a number. How much do you invest in research and development of alternative fuels?

Mr. SIMON. Senator, it would be hard for me to answer that because I do not know the answer. We have—

Senator SCHUMER. OK. When your Chairman was here, he told us $15 million. Has it changed appreciably from that?

Mr. SIMON. I think it is higher than that, but we have—

Senator SCHUMER. How much?

Mr. SIMON.—a number of efforts underway, and I haven't added them all—

Senator SCHUMER. Sir, is it over $100 million?

Mr. SIMON. It is over $100 million, but I don't know how—

Senator SCHUMER. It is over $200 million?

Mr. SIMON. I do not know how high it is.

Senator SCHUMER. OK. Could you get to me an answer in writing exactly how much you invest in alternative fuels and in which ones.

Mr. SIMON. I could, but—

Senator SCHUMER. Thank you.

Mr. SIMON.—the other comment I would make, Senator, is that we don't measure progress based on how much we spend. We measure it based on results.

Senator SCHUMER. Right. That is what your annual reports always say, what your progress is, not on how much money you make or what your price per shareholder is. Please. How much you spend will be a pretty good indication of how much you believe in alternative fuels. Your Chairman told us you do not believe in alternative fuels and invested about $15 million in some institute. I would like to know if that has dramatically changed. That will clarify your answer.

Mr. SIMON. I would be happy to provide that, Senator.

Senator SCHUMER. Thank you.

Next, also for you, Mr. Simon, new data has been released this week saying that Iraq could exceed Saudi Arabia as the largest oil producer in the world. The Iraqi Government does not have a national oil law or a revenue-sharing agreement for either its competing factions or how much the United States gets back. I know you would like to be players in Iraqi oil, but I would like to ask you, Mr. Simon, do you think it would be appropriate for your company to sign a contract with Iraq before an Iraqi national oil law or revenue-sharing agreement is in place? And do you think it is appropriate for you to sign one before that?

Mr. SIMON. We are looking at a technical agreement right now, and we will take into account all factors, and—

Senator SCHUMER. So you do think it is appropriate? I would ask you right now, would you say here that Exxon will not sign such an agreement until there is a revenue-sharing agreement or national oil law in place? Would you commit to that?

Mr. SIMON. I am not going to make any commitment at this time.

Senator SCHUMER. Don't you think such a contract could exacerbate the strife in Iraq that our troops are struggling to quell every day?

Mr. SIMON. I think we ought to be looking at every form around the world of additional supplies, and that is one of them that we as a country should be looking at.

Senator SCHUMER. OK. Well, let me tell you, I think it is outrageous for Exxon Mobil to go ahead and again pursue its own policies that will exacerbate the very problems that our soldiers, General Petraeus, and others are trying to undo.

The next question is for, I guess—let me ask any of you. If Saudi Arabia increased its production tomorrow of a million barrels of oil a day—let's just assume they do. We know they can because it is lower by about several hundred thousand barrels a day than it was in 2005, and they have added production. How much would the price of oil go down in the next few months? Just if you can give me an approximate guess. Does anyone want to hazard a guess? Does anyone think it would not go down? Raise your hand if you think it would not go down. OK. Do you want to say something on this, Mr. Robertson?

Mr. ROBERTSON. I think it would go down. I think the real—what really is important to the market is what is going to happen in the future. Maybe they could produce a million barrels a day for some—

Senator SCHUMER. Well, what if they committed for 2 years?

Mr. ROBERTSON. I think it would make a difference, and I think we all—any of us that showed that we were going to increase production by some significant amount over a significant period of time would make a difference.

Senator SCHUMER. And the estimates I have seen, not done by me but by experts, say it could go down—if they did a million barrels of oil a day, increased from today, it would go down about—in transition to gasoline, it would be about 50 cents a gallon, maybe 62. Does anyone think that is out of line, seriously out of line?

Mr. SIMON. I would have no way of estimating that, Senator.

Senator SCHUMER. Right. How about—OK. Would it go down significantly? Does anyone disagree that it would go down significantly, a million barrels a day?

Mr. SIMON. One point I would like to make, Senator, is when you look at the market today, it is well supplied. And so if you take a well-supplied market and then you throw another million barrels a day in it, yes, it will go down.

Senator SCHUMER. Right. And if you all are preaching to us that you need new exploration so you can find more oil, which is something I do not always disagree with—I support it. I was in the handful of Democrats to support more drilling in the east gulf so we could do just that—then, clearly, a million barrels a day production now would have a significant effect because you cannot—it is a contradiction, isn't it, that you finding new supplies and producing them will keep the price in line, but Saudis just pumping a million barrels wouldn't keep the price in line, right? Mr. Robertson, you are shaking your head.

Mr. ROBERTSON. No. I am nodding my head.

Senator SCHUMER. Shaking your head yes.

Mr. ROBERTSON. I think that the really critical things here are signals to the world that there is a determination to increase production for the foreseeable future.

Senator SCHUMER. Correct.

Mr. ROBERTSON. We could do that in our country, I believe. It wouldn't—

Senator SCHUMER. The Saudis could do it tomorrow, couldn't they?

Mr. ROBERTSON. Well, the Saudis are making significant investments to increase capacity. They could, by—

Senator SCHUMER. No, but right now—

Mr. ROBERTSON. Anybody in the world that made a—you are talking about short term. Anybody in the world that made a commitment for the long term to increase production—

Senator SCHUMER. Right.

Mr. ROBERTSON.—by a significant amount would have an effect on our—

Senator SCHUMER. But here, Senator Kohl was asking you about OPEC and how OPEC restrains supply and that keeps the price high, and you all go along with OPEC.

Now, the bottom line is if there weren't an OPEC and if Saudi—or within OPEC Saudi decided to do what they could do tomorrow, from what I understand they have 2 million barrels more of capacity, the price would go down significantly. And I think there is agreement from all of you about that—not that you can force them to do it. No one is saying that. I see that everyone is nodding. Anyone disagree with that?

Mr. SIMON. Again, when you look at the market today, though, Senator, it is well supplied.

Senator SCHUMER. I did not ask you that.

Mr. SIMON. OK.

Senator SCHUMER. I asked you—"well supplied" is a very flexible definition. OK? I asked you—I want to now then ask you, yes or no: If Saudi Arabia tomorrow said for the rest of their—for the next 3 years they are increasing supply by a million barrels a day and it will not stop, would the price go down significantly?

Mr. SIMON. It would go down today because then you would—

Senator SCHUMER. Yes.

Mr. SIMON.—be flooding the market with an extra million barrels a day to a well-supplied market.

Senator SCHUMER. OK. Next, Burma. I would like to ask you, Mr. Robertson, about Burma, where we now have a brutal dictatorship. There are people who feel that you should leave Burma. There are people who feel you should not be dealing with such a harsh dictatorship. So my question is: What is Chevron's future plans in Burma in the wake of the massive popular opposition to the military junta and its initial refusal to accept disaster aid? Have you weighed in with the Burmese Government about accepting disaster aid? And, more generally, does your presence in Burma not bolster the military junta?

Mr. ROBERTSON. Well, thank you. We have, just in the last few days, committed $2 million to aid in Burma. The agencies that we are working with, some of them have matched it, so it is $3 million. I have some photographs in my file here of aid being delivered to

people in Burma, so I know it is happening. Our people on the ground are seeing it. So we are delivering aid. Even though a lot of others cannot, we are. So that is an advantage, I think—

Senator SCHUMER. Do you think they could use a lot more than $2 million?

Mr. ROBERTSON. Of course, they could. But I am saying what Chevron can do we are doing, and we are doing a significant amount, and that goes a long way in Burma.

Our plan is to stay in Burma. I have been there and have seen the people that live in the area where we operate along our pipeline system. I know for a fact that they are better off by us being there than by anybody else being there. So I know we are doing the right thing in Burma.

Senator SCHUMER. Are you—

Mr. ROBERTSON. The Burmese Government is benefiting from the fact that natural gas is being produced in Burma, but the fact is that if we were there or anybody else was there, that gas would still be being produced. It has been developed, and so the only thing we can do by leaving is enhancing the value to the Burmese Government. They would get our interest. If we sell our interest, we would pay a large capital gains tax to them. Any way of extracting us would be a benefit, a windfall benefit to the Burmese Government. And I know the people there are better by us being there.

Senator SCHUMER. Are you trying to pressure the military government to let in more aid right now in addition to the $2 million you are giving?

Mr. ROBERTSON. No. We—

Senator SCHUMER. Do you think that would be helpful?

Mr. ROBERTSON. I don't think we could have much effect on that. I can tell you that I am working with the United Nations Ambassador, who is Mr. Gambari, Ambassador Gambari, who is working with the Burmese. We are working with the EU Ambassador that is working with the Burmese. So we are doing everything that we think we can, but I can assure you, I don't think that Chevron as a non-operating partner in an operation in Burma could have much personal effect on the Burmese Government.

Senator SCHUMER. Would I have time for one more question, Mr. Chairman?

Senator WHITEHOUSE. Take your time, Senator.

Senator SCHUMER. Thank you, Mr. Chairman.

This relates to refinery capacity. Again, we all talked about the difficulty of building new refineries, and that is sort of obvious that if you—you know, that you need to build more new refineries if you are going to increase production someplace or other in the world. But right now, refinery capacity is at 81 percent compared to 90 percent last year. Eighty-one percent would strike most people at a time when the price of gasoline and other petroleum products is so high as not very good and not very adequate. This is not about building new refineries. This is the same existing refineries and the capacity they had.

Could any of you comment on why refinery, present—I do not want a discussion of building new refineries. I am talking about present refinery capacity. Why is it so much lower, 10 percent

lower than it was last year, even though the price is through the roof? Mr. Malone?

Mr. MALONE. I can't speak to the entire industry. I can speak to my company, which is our utilization rate is higher this year than it was last year.

Senator SCHUMER. What is it?

Mr. MALONE. We are up—probably the average across all of them is in the area of 88, 89 percent of available capacity.

Senator SCHUMER. OK.

Mr. MALONE. Remember, we have our huge Texas City refinery still going through rebuild so that knocks our numbers down.

Senator SCHUMER. Right. Mr. Hofmeister?

Mr. HOFMEISTER. Shell year to date has been running about 92-percent refining capacity. We had two shutdowns which were unexpected in two refineries. It would have been higher were it not for those two unplanned shutdowns.

Senator SCHUMER. Is the amount of money you are putting in to keep maintaining the refineries higher or lower than it was last year?

Mr. HOFMEISTER. It is on average less for existing refineries, but more overall because of a major refinery expansion in Port Arthur, Texas, which will more than double the size of that refinery.

Senator SCHUMER. Any of your refineries' capacity lower than, say, 85 percent? Mr. Lowe is shaking his head no.

Mr. LOWE. ConocoPhillips has consistently outperformed the industry in utilization rates over the last 4 years. We had some operating upsets in the first quarter, but still ran at a refinery utilization rate of about 90 percent.

Senator SCHUMER. Mr. Robertson?

Mr. ROBERTSON. I would just make a comment. The industry has continued to expand its refinery capacity, so even though we have not built any new refineries, we continue to expand it, and refining throughputs this year in the first 19 weeks of this year are at all-time highs.

Senator SCHUMER. But why is the—

Mr. ROBERTSON. Gasoline—

Senator SCHUMER.—capacity so low, 81 percent?

Mr. ROBERTSON. Because the market, you know, basically the market has not needed it. I mean, inventories are high. Look, we are producing gasoline at an all-time-high capacity, and the market—the demand has shrunk by 2 percent. So, I mean, people are seeing higher prices, using less; we are producing more gasoline than—

Senator SCHUMER. Well, if demand has shrunk, isn't—

Mr. ROBERTSON. Demand has shrunk.

Senator SCHUMER. Isn't it logical for the price to go down as opposed to the supply to decrease?

Mr. ROBERTSON. The fundamental, though, the real thing that is happening here is the cost of oil on the world market. That is what is being paid. I mean, over time, reduced demand will drop prices, and that is what has happened in the past. But it will take a lot of time, and it will take more than just the United States gasoline market.

Senator SCHUMER. I would just say—and I have gone way over my time, and I thank the Chairman's indulgence, and Senator Cardin has walked in. But I would say, to me at least, 81 percent refinery capacity in the industry as a whole—this is not new refineries but existing—asks a whole lot of questions at a time when the price is high. And one wonders if the pattern of oil companies here, big ones and small ones, is to decrease supply and increase price rather than increase demand and decrease price. And it may well be your shareholders do better with the first than the latter, but the American consumer does better with the second.

Thank you, Mr. Chairman.

Senator WHITEHOUSE. Senator Cardin?

Senator CARDIN. Well, thank you, Mr. Chairman. I thank Senator Whitehouse for his courtesy in allowing me to question at this time.

Let me just preface my comments by reflecting that I have followed Senator Sarbanes. I have his seat in the U.S. Senate, and I am sure all of you know Senator Sarbanes, but you also know Sarbanes-Oxley. And Sarbanes-Oxley I think was a moment in the history of America where we said, you know, there is a responsibility of corporate America that it does not go just to the private sector. There is a public responsibility.

We have a national problem. We are dependent upon foreign oil, and that dependency upon foreign oil has caused us security problems in regards to our international concerns. It has caused us environmental problems with global climate change. And we are now seeing how it is causing us economic problems. The people in Maryland and around this Nation are hurting today because of the cost of gasoline at the pump. It is affecting our lives in a very dramatic way. I have small businesses that will probably go out of business because they cannot afford the cost of gasoline.

So this is having a dramatic impact, and I would like to see a greater urgency from our leaders in our energy field than I have seen.

Mr. Robertson, let me just—I think you were the one who said you are investing $6 billion in Kazakhstan, I believe. Pardon?

Mr. ROBERTSON. I said we had one project that—

Senator CARDIN. One project, $6 billion in Kazakhstan. I guess my disappointment is—were you here seeking changes in law in the United States so that $6 billion could have been invested in America—

Mr. ROBERTSON. Absolutely.

Senator CARDIN. One moment. I haven't finished my question.—in alternative and renewable energy sources so that we could become energy independent and wean ourselves off of oil?

Mr. ROBERTSON. We have supported all—

Senator CARDIN. I know you have supported—but have you been here to really fight for the types of policies—the more you invest in foreign oil, you have got to get your return. It creates a dilemma for you, for your shareholders. You have got to get that $6 billion back.

Now, if that money would have been invested in America, we would be more secure today.

Mr. ROBERTSON. Well, maybe I should have talked about some of the investments we are making in America, because that was one example that I used of a project, the typical project around the world. We are just finishing up a $4.7 billion project in the U.S. Gulf of Mexico, in the Deepwater, to produce 125,000 barrels a day for the United States of America, which is—

Senator CARDIN. I am more interested in alternative fuels.

Mr. ROBERTSON. OK. I understand. We are making a lot of investment in the United States.

Senator CARDIN. Do we need—

Mr. ROBERTSON. Over the next couple of years, we are going to invest $2.5 billion in renewable fuels and energy efficiency services for outsiders. So $2.5 billion. We are spending—with the largest geothermal energy company in the world, we are investing in that. We are investing in cellulose-based ethanol. We have got a joint venture—

Senator CARDIN. Do you believe we need stronger economic incentives in this country so that we can have an energy policy that is in the best interest of our country?

Mr. ROBERTSON. I don't think that we need new incentives. The prices that exist today are pulling huge amounts of money, including Chevron money, into alternative fuels. I think $150 billion last year was being spent on renewable energy. So the problem is—

Senator CARDIN. So based upon our—

Mr. ROBERTSON.—a time problem.

Senator CARDIN. OK. Based upon our current incentives, then, you believe that we will solve our energy problem and become energy independent?

Mr. ROBERTSON. I believe that there is a lot we can do and are doing in this country, not to mention—you know, we have talked about shale and—

Senator CARDIN. And how many years will it take us to be energy independent under our current policies where we do not have to import foreign energy?

Mr. ROBERTSON. I don't think that we will be energy independent.

Senator CARDIN. And you don't think that is a worthy goal?

Mr. ROBERTSON. I think reducing our dependence on the rest of the world is a hugely worthy goal, yes.

Senator CARDIN. But you are satisfied with current policies?

Mr. ROBERTSON. No, I am not satisfied with current policies. I think there are a lot of policies that need to be made to enhance the ability to produce natural gas in this country, which is a clean fuel. I think there are a lot of policies that need to help us invest more in the oil business in this country. I think there are a lot of policies that need to be done to invest in the coal business in this country, and I think in renewable.

Senator CARDIN. Well, I—

Mr. ROBERTSON. We need the removal of barriers to investment, not incentives to invest.

Senator CARDIN. I hear your verbal support for these types of programs. I don't see the energy by the leadership that is at the table today in helping us develop an energy policy for our country that is in the best interest of our national security, environment,

and economy, and may very well adjust the way that your company does business in the future and may very well affect your company's future. But I do not see that leadership as Americans do what is right for our country. That is my take on it, and I would be more than happy to have your response.

But let me ask a question. We have S. 2991 and it deals with some of the oil speculation, oil market speculation. I know you are not experts in that field because that is not what you participate in. You have had a chance to review that legislation. Do you support sensible regulation on oil market speculation? Any one of you.

Mr. ROBERTSON. I think I have already mentioned it. As I know the bills that are around, we support completely transparency and we have not seen any bill that we object to.

Mr. MALONE. Senator, we support the market provisions in that bill, and anything that, again, allows for transparency and liquidity, it is so important that we bring in 60 percent of oil and gas, we need markets that are properly regulated and allow for those variables.

Senator CARDIN. Do you believe that there is price gouging in our markets in the United States, either at the retail level or elsewhere? Is that a problem?

Mr. ROBERTSON. I don't believe so.

Mr. HOFMEISTER. I do not either.

Senator CARDIN. So you have checked every gas station in the country and—

Mr. SIMON. No, I haven't, but the FTC has done many investigations in that area and have not found any inappropriate, non-competitive behavior as a result of those.

Mr. ROBERTSON. And we do monitor our stations, so if any of them get way out of line, then we do go and followup with them. So we do monitor.

Senator CARDIN. So the variation in cost that I see in Maryland at a particular brand station is just the normal fluctuations in a region in Maryland?

Mr. SIMON. You know, when you look at the 166,000 individual retail outlets, in our case about a half a percent of those are those that we own, operate, and, therefore, set the price in. Most of those are set by independent men and women business people, and they look at their sphere of competition, and that is what they set their prices based upon. And, yes, it can differ from one zone to the next, depending upon competition.

Senator CARDIN. I understand that, so it can vary from one neighborhood to another, as I have seen in Maryland.

I would just make an observation. It would be good to have some independent verification here. I appreciate the fact that you are doing that, but I can tell you that what is happening in pricing of gasoline is a crisis in this country. And we need more help from you in dealing with this. I don't think—and everybody sort of says, well, this is the market, it is going to work itself out. It has gone beyond that.

I appreciate your support for the oil market speculation issues. I would like to see a greater urgency for our national energy needs and not just the bottom line of your company. I think in a way that was the message of Senator Sarbanes when he held this seat, and

he was effective in bringing about a major change. Unfortunately, it happened after many people were injured.

We have got to get a sensible policy for this country that deals with the current pricing of gasoline at the pump and deals with the long-term security of this country and environmental needs.

Thank you, Mr. Chairman.

Chairman LEAHY. [Presiding.] Senator Whitehouse, thank you again for covering for me. I understand you had yielded time, so you have not asked questions yet.

Senator WHITEHOUSE. That is correct.

Chairman LEAHY. The floor is yours.

Senator WHITEHOUSE. Thank you very much.

Gentlemen, my question is: Where does this end? I went home this weekend in Rhode Island. Regular was $3.89, medium was $4.04, super was $4.12. A gentleman from Bristol, Rhode Island, who is in the home heating oil business, came in and said that just in the last few weeks his supply costs had gone up 60 cents. Since George Bush was sworn in as President, the cost increases amount to $2,000 per family in Rhode Island, and for a lot of families who are working in Rhode Island in an economy where wage growth has been completely stagnant, flat, and families are working harder than ever to keep up with increased costs, they don't have that $2,000 lying around. And they are looking at family budgets, and they are comparing what they can afford for gas to what they can afford for food to whether they are going to be able to buy new clothes for their kids when the go to school in September. They are making very, very hard choices, and I think they are entitled to look ahead and try to get a sense of what they have got coming.

What is your view on where the price of gasoline is going to be a month from now, 6 months from now, a year from now? What are American families looking at?

Mr. SIMON. Senator, I would like to be able to answer that question, and answer that question for our customers as well. But the practical fact of the matter is there is no way that we can make that prediction. Seventy-five percent of the costs that people are paying at the pump today is a result of the raw materials that we must buy in order to make those products—crude oil. There are so many factors that go into establishing that price: supply and demand, weakness of the dollar, geopolitical situation, the amount of speculation coming into the market, the amount of spare capacity. It is absolutely impossible to take all of those factors and make any kind of intelligent prediction. The market will make that determination, and I am not smart enough to do so.

Senator WHITEHOUSE. Anyone else? Mr. Robertson.

Mr. ROBERTSON. Well, can I respond to a comment that was made a couple of minutes ago about leadership? There have been some recommendations made to the U.S. Government from our industry and a lot broader range than just our industry through the National Petroleum Council, and that was a very extensive document that was just put together and made some very specific recommendations for Government action and for policy in the United States. The No. 1 recommendation was reduce the demand, get more efficient. That is something that we can do in America today.

The only things we can do to change prices are to either reduce demand or increase supply, or hopefully both.

One thing we can do in reducing demand, we have a company that sells energy efficiency services. They go to many, many installations around the country. They put in solar panels. They put in fuel cells. They put in insulation. Their average savings has been 30 percent over 800 projects. A 30- percent reduction in energy use in big Government installations and private installations around this country would have a dramatic impact, almost more than anything else we can do.

The best thing we can do as leaders for the people that are suffering under these huge price increases is to get more efficient as a Nation, to provide leadership in terms of getting more efficient as a Nation, and to make it the right thing to do, because it can really make a difference. That is the best thing we can do in the short term.

Senator WHITEHOUSE. Well, let me ask you this: You are all international—you are here representing international oil companies whose purpose is to sell oil and gas and make money by doing so. We are an America that has complex energy needs, which include, as you have mentioned, Mr. Robertson, conservation, alternative fuels, solar, wind. There are also very significant national interests at stake in our continued use of oil and gas. There are very significant economic problems that we have all alluded. There are very significant environmental risks that could be the most damaging thing ever to happen to the human species. There are very significant national security risks. We are at war in Iraq right now in large part because of our dependence on foreign oil.

So the cost of this can be extremely high, and it is not really the cost of your product. It is the cost to our country of not engaging in other ways. And my question to you is: Do you see yourselves as energy companies, or do you see yourselves as oil companies? And where the international interest seems very, very strongly to be steering us away from oil and gas, and that is your primary product, what assurances can you give us that as people who are making decisions for the American people, we can trust you to be making the right decisions for this country where they seem very apparently to be diverging from the corporate interests of the companies you represent? I see those two paths as on a very, very different trajectory, and I don't know how to bring them together.

Mr. HOFMEISTER. If I could speak for my own company, we see ourselves, Senator, really as both. I don't want to hide and say we are not doing oil and gas, because we are doing oil and gas. But in respect of the economic value creation for this country, the jobs that we create, the contracting and procurement that we do which provides thousands of more jobs in the oil and gas sector, in the last 7 months, 8 months, just in the United States Shell has committed some $10 billion to economic value creation, which translates into jobs. That is all part of what our industry does.

If you visit new hydrogen stations, for example, in California and New York and Washington, this is part of a whole new economy—

Senator WHITEHOUSE. Mr. Hofmeister, I am not suggesting that you are incapable of doing things that are beneficial to the United States. I am suggesting that when we are making policy, it may

be that there is a significant conflict of interest between your corporate interests and our national security, environmental, and economic interests as a country. And what are the ways that we can do to try to reconcile those two more?

Mr. HOFMEISTER. Well, I think across the whole range of social issues that move from the climate and the environment, the stewardship that we demonstrate, our activism, our advocacy of cap-and trade—Shell is a member of the United States Climate Action Partnership, as are several other companies here—we are trying to promote means by which we can reduce carbon emissions in the atmosphere, taking very active stands. In my 3-year tenure as President of Shell Oil Company, I average some 30 visits to Capitol Hill a year to advocate for—or to educate, I should say, on various policy initiatives ranging from hydrocarbons to hydrogen. And I think—that is, hydrocarbon-free hydrogen. And I think that, you know, personally I believe that America can improve its competitiveness by solving our energy issues in a comprehensive, holistic way.

Senator WHITEHOUSE. My time has expired, and I am now operating under the Chairman's indulgence, so let me just ask all of you one other request. It is not so much a question for the hearing as it is a request. We are facing a potentially existential threat to the human species. We can warm the planet as much as we please with global warming and the planet will be fine. The question is: Will the species be fine? And it is a very, very significant risk. It is one we absolutely have to do something about, in my view.

Also in my view, the science has become extremely clear on this. I am married to a marine biologist. I understand a little bit of the science. I have read into this a great deal. There is an astonishing level of scientific agreement about this considering that science is by its nature an area of debate and exploration and experimentation. But the degree of agreement about it is phenomenal.

And yet there remain fringe views, many of them endorsed, espoused, promulgated by organizations that either are now or have been in the past funded by your companies, with, in my view, the intention of misleading the people of the country about the actual state of the science.

And I would ask that each of you, when you go back from this hearing, talk to the folks in your companies and take a look to see if this is still going on. Our regulatory proceedings in this country are riddled with phony science, with propped-up, phony organizations that are fronts for industrial interests. It is a real disservice to the people of this country that that is going on, and I think when people at your level support that kind of behavior, it is a terrible mistake. And I would ask you to review it and try to put an end to that practice, if it still exists in your companies.

Thank you, Mr. Chairman.

Mr. ROBERTSON. It does not exist in our company.

Senator WHITEHOUSE. I am very glad to hear that. Thank you, Mr. Robertson.

Mr. SIMON. And I would take exception with your comments as well, Senator.

Senator WHITEHOUSE. You take exception with them?

Mr. SIMON. I do.

Senator WHITEHOUSE. In what sense?

Mr. SIMON. In other words, that we are supporting junk science and trying to make people think that this is not an issue. I think all of us recognize it is an issue. It is how we deal with it—and I think we are dealing with it, and we are doing so in a responsible fashion.

Senator WHITEHOUSE. Well, allow me to disagree, and I am happy to continue the discussion. Thank you.

Chairman LEAHY. Thank you.

Senator Sessions, you wanted a couple minutes more for a followup?

Senator SESSIONS. I did. This is a free country, and if you want to invest your money in expressing a view on science, you have every right to do so. And I think you have an individual responsibility to make sure it is done with integrity, because you are major corporations and you have great responsibilities.

I understand fundamentally that a responsible large corporation exists to make a profit and that—but you have a responsibility also to do so in a way that is consistent with high ethical standards.

One thing I would want to disagree with you about is a sense that nothing can be done about the OPEC situation. As I understand it, it costs less than $10 a barrel to produce a barrel of oil in Saudi Arabia, and probably in some of these other countries. And so it is now selling for $130 on the world market. You are not allowed, may I ask, you are not allowed to go in and produce more of that oil any time you want to. Is that correct, Mr. Hofmeister?

Mr. HOFMEISTER. I think Saudi Aramco is the—

Senator SESSIONS. They control it, they say how much can go on the world market, and by producing below their capacity, they are creating shortages that are allowing companies, you and others and other national oil companies, to maximize profits. We need policies here in our country to end that. We need to fight back, and I believe the President has certain leverage—I don't know what that is—but I believe a sophisticated, sustained effort.

Now Senator Kohl, I really liked the intent behind his effort to confront OPEC and create an antitrust lawsuit. However, I think it is true that historically, and legally, we have not been able to say to a nation, a sovereign nation, they have got to sell an asset they have on the world market. That is apparently a component of sovereignty, to be able to decide how much of your resources you want to put on the world market. But there are other pressures that we need to bring forth, and I hope that you guys will see that it will be helpful to us in the future to get away from this power that is being established there.

I think most of you have drilled offshore. I was very pleased that in the aftermath of the devastating Hurricane Katrina, where many rigs actually were damaged, and severely, there was almost no spills of any oil. I think if we can sustain that kind of hurricane, as massive as it is, I think that gives us confidence that the technology that you are using is good.

I would point out that we expanded some areas in the gulf for drilling, 100 miles or more offshore, but Florida blocked even further offshore than that, to my great disappointment. They like the situation, I think, where a pipeline from Mobile, Alabama, to

Tampa, Florida, takes our natural gas that we produce so they can burn it and have their aid conditioning and drink their mint juleps while the sun sets. You know, that is happy to them. But nobody can drill within 200 miles of their shore.

We have got to get beyond that, and I would just note, as a former Department of Justice employee, States do not own the offshore outside their own waters; 50, 100 miles is controlled by the Federal Government.

So I guess I want to ask you, do you believe—let's say in the Gulf of Mexico the Destin Dome, which is still not open, some of those areas contain very large amounts of oil and gas and it can be produced safely?

Mr. SIMON. Senator, when you look at the estimates, it has been estimated that there are 30 billion barrels of oil that have been placed off limits by the Federal Government, 125 trillion cubic feet of natural gas. To put that into perspective, that is enough oil to back out imports for a period of over 8 years, enough natural gas to heat 15 million U.S. homes for over 100 years.

This is the only Government in the world that denies its citizens access to known, recoverable oil and gas. We can develop that in an environmentally responsible fashion, as we are doing everywhere else in the world in environments much more severe and much more challenging than we would confront here in this country.

Senator SESSIONS. The North Sea is a much tougher environment, would you say, than the—

Mr. SIMON. The North Sea, Sakhalin Island off Russia.

Senator SESSIONS. But we don't mind buying it from them, but we won't buy it from our own Americans, and the money that comes to the U.S. Government, billions of dollars from that oil produced off our shores in the Gulf of Mexico and, for example, 50 percent of that goes to the general treasury, 12.5 percent goes to fully fund the Land and Water Conservation Fund, a key conservation program; 37 percent goes to the States who participate in that—my State has received millions of dollars and will receive hundreds of millions of dollars—instead of having that money go to Venezuela, Saudi Arabia, and places like that. It is just unthinkable to me that we are not examining this more carefully.

Is it possible, Mr. Simon, that there could be even larger reserves than you have suggested just in the gulf?

Mr. SIMON. There have been a number of estimates which would be higher. We really need to get out there and do some more work to really understand what is there, and that I think we are all a strong proponent of.

Senator SESSIONS. Well, and, of course, Alaska could be itself about 10 percent—reduce by 10 percent our imported oil if we had that online, and we know we can do that, and I am sorry it has not happened.

Thank you, Mr. Chairman. This is an important hearing. The American people care about this. These companies, I think it is healthy for you to have to answer to the American people.

Chairman LEAHY. Thank you.

I want to thank the witnesses for being here today, and some of you, to your credit, were more forthcoming than others in answering the questions from both sides of the aisle.

Of course, the bottom line is very simple: People we represent are hurting. Your companies and the foreign oil interests, are profiting. And we need to get this somehow into balance.

I think the price of oil has to reflect market fundamentals. If oil returns to $35 to $65 a barrel, as some of you have said, then we could bring gas prices back to competitive levels. We look at the past profits of oil companies and what they are making on previously discovered oil; oil that was very profitable for them at $55 to $65 a barrel is obviously making them windfall profits at $130 a barrel.

And I think for any of the oil companies to come here, and, as your ads suggest and others in some of the testimony today, to play the victim is extraordinary. The American people are the victims.

Billions of dollars are paid by Americans to oil companies every year to put gasoline in their cars, to heat their homes, to run their businesses. And skyrocketing oil prices hurt these consumers, but it is also hurting our Nation's economy and, thus, its security.

And despite your opposition, the administration should support the NOPEC bill, as the majority of Republicans and Democrats in the Congress have.

When OPEC countries commercially set the limit of output of oil, this Government, on behalf of all Americans, ought to be able to go after them as it could any other cartel. The President vetoed the bill to close the Enron loophole. I will ask CFTC to come in here. I hope that the veto will be overridden.

The $36 billion that your companies reported in the first 3 months of this year were drawn directly from the exorbitant amounts of money Americans are paying at the pump. It is wrong. As we heard from Senators here today, it just doesn't seem fair.

I thank Senator Durbin. For some of you who were not able to remember how much you make, I am glad that Senator Durbin reminded some of you.

But I thank you for your testimony. You have been here on Capitol Hill a lot. It is probably not the thing you enjoy the most. I thank you for being here.

We stand in recess.

[Whereupon, at 1 p.m., the Committee was adjourned.]

[Questions and answers and submissions for the record follow.]

QUESTIONS AND ANSWERS

Senate Judiciary Committee Hearing: Whitehouse

1. Has your company, any subsidiary, or any entity acting under common ownership or control, financially contributed to any organizations that study global warming or climate change? If so, which are those organizations and how much in total has your company given to each one?

   This is an answer for questions 1–11.

   Shell was one of the first energy companies to acknowledge the threat of climate change; to call for action by governments, our industry and energy users; and to take action ourselves. We are playing a leading role in demonstrating ways to manage CO2 responsibly.

   For Shell, the debate on climate change is over. It's time to work on the solutions for climate change and greenhouse gas emissions, not to debate whether climate change is a factor. Let's get on with the solutions. But the challenge cannot be met by one company or by the energy industry alone. To make CO2 mitigation viable and to deploy it on the scale that will be needed, Governments will need to take significant action.

   Several US states are working on a greenhouse gas emission policy to regulate what industry can do and what consumers can do. It will be very challenging for a company like ours to operate differently in all 50 states to meet the regulatory requirements of each state. Instead, a national solution-a national approach to greenhouse gas management-is something we consider important to the future.

2. Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the American Legislative Exchange Council? If so, how much has it contributed? Does your company agree with the American Legislative Exchange Council's opinion that increasing levels of carbon dioxide are not causing glaciers to retreat?

   See answer to question 1.

3. Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Cato Institute? If so, how much has it contributed? Either way, does your company agree with Cato Institute commentary that "science no longer provides justification for any rush to pass drastic global warming legislation."?

   See answer to question 1.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00063 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.001

4. Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Committee for a Constructive Tomorrow? If so, how much has it contributed? Does your company agree with the Committee for a Constructive Tomorrow that "recent glacial retreats, sea-level rise and migrations of temperature sensitive species are all within the bounds of known natural variability."?

   See answer to question 1.

5. Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Annapolis Center for Science-Based Public Policy? If so, how much has it contributed? Does your company agree with an Annapolis Center for Science-Based Public Policy report that states "climate models may never be able to make greenhouse-warming predictions with certainty?"

   See answer to question 1.

6. Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Acton Institute for the Study of Religion and Liberty? If so, how much has it contributed? Does your company agree with Acton Institute for the Study of Religion and Liberty commentary that it is a "myth that [global warming] is an emergency that demands a drastic cutback in CO-2 emissions" and that "making a case against CO-2 without making a case against nature is like making an omelet without breaking the proverbial egg. It is impossible."?

   See answer to question 1.

7. Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Center for the Study of Carbon Dioxide and Global Change? If so, how much has it contributed? Does your company agree with the Center for the Study of Carbon Dioxide and Global Change that "there is no compelling reason to believe that the rise in temperature was caused by the rise in CO-2."?

   See answer to question 1.

8. Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Frontiers of Freedom Institute? If so, how much has it contributed? Does your company agree with the Frontiers of Freedom Institute that S.2191, America's Climate Security Act, is "a hyped-up rallying cry against a 'problem' that scientists can't even agree exists in the first place."?

   See answer to question 1.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00064 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.002

9. Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the George C. Marshall Institute? If so, how much has it contributed? Does your company agree with the George C. Marshall Institute that there is a "shattered consensus" on the state of global warming?

See answer to question 1.

10. Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Heartland Institute? If so, how much has it contributed? Does your company agree with the Heartland Institute that "there is no consensus about the causes, effects, or future rate of global warming," and that "most climate scientists doubt the reliability of computer models and the accuracy of land-based temperature records," and that "reports by the IPCC are unreliable due to political editing and rewriting of the reports' conclusions," and that "some of the key evidence cited in past IPCC reports has been shown to be fraudulent."?

See answer to question 1.

11. Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Institute for Energy Research? If so, how much has it contributed? Does your company agree with the Institute for Energy Research that global climate change is a "craze...fueled by alarmist rhetoric and trumped up scientific claims."?

See answer to question 1.

12. At a time when gasoline prices were near record highs, your five companies earned record-breaking profits last year: $116 billion. ExxonMobil made $40.6 billion last year, which is more than the all federal highway spending and about as much as the entire credit card industry earned that year. Since 2002, your five companies have consistently broken profit records. If you continue to profit this year at the pace you did in the first quarter, you are once again poised to smash profit records, not just for your industry, but for all industries. Please explain why what, in raw numbers, may be the most profitable industry in history needs the multi-billion dollar Section 199 domestic manufacturing tax breaks enacted in 2004. Why aren't those profits adequate to provide access to capital without those tax incentives?

The oil and gas industry is very capital intensive and with expectations for robust global demand, the International Energy Agency estimates that trillions in investment will be required by 2030 for the industry to develop the oil and gas that we need. For example, one deep water Gulf of Mexico platform costs over $1 billion. Globally, Shell has committed to spending well over

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00065 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.003

$20 billion worldwide this year to develop a broad portfolio of energies, more than any other investor owned international oil company (IOC) in the world. Continued and sustained capital expenditures are required each year to find and develop energy resources, despite the cyclical nature of business and risks involved. Given the industry's long-term capital allocation models in a global and free marketplace, it is important to have stable and consistent tax policy in order to meet all of the challenges ahead. Energy industry profits must be understood in the context of historical cycles, the global marketplace and supply/demand economics, the scale of the business (including the annual billions needed in risky environments) and overall rate of return on investment. The reality is that the industry's rate of return on investment has been very much in line with other industries. Energy companies invest significant amounts in new technologies, new production, refining and product distribution infrastructure and environmental improvements, and make such investments considering long-term commitments...The §199 deduction applies to most industries, and was passed in the American Jobs Creation Act of 2004 to support US manufacturing and production and the jobs related thereto. The repeal of the §199 deduction for only large oil and gas companies will result in a multi-billion dollar tax increase on the domestic oil and gas industry, and will operate as an indirect windfall profits tax (WPT) on domestic oil and gas production. History has shown that windfall profits type taxes do not work, and result in less capital for investment in domestic energy reserves, production and infrastructure; higher prices at the pump; and fewer jobs in the industry.

In addition, repeal of the Section 199 deduction will leave the industry with less capital to make the investments necessary to meet America's growing energy needs. This proposal would also damage Shell's ability to compete internationally with foreign oil companies. It is vital to America's energy security that we remain competitive in a world where 90 percent of the proven oil reserves are in the hands of oil companies controlled by foreign governments. Finally this tax proposal could impact our development of renewable energies. Some members of Congress propose increasing taxes on the very oil and gas companies that produce the renewable energies the public wants more of. At Shell, profits from our fossil fuel business fund our renewable energy endeavors.

13. The petroleum industry operates in an unusual fashion. Your five corporations are integrated oil giants that control all stages of production and distribution. From the exploration and mining to the refinement and transportation to the moment the customer swipes her Exxon or Shell charge card at the pump, you control everything. Are you aware of any other industries that operate in this fashion? How would you respond to the suggestion that it may be time to examine whether the vertically integrated ownership structure facilitates price gouging and harms consumers? Would you support a Congressionally-directed study to examine the effects of your ownership structure?

It is true that the energy industry is one of the world's largest and most complex industries requiring very large investments over long periods of time

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00066 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.004

to be able to continue to supply the world's energy needs. In Shell's case, however, we do not have control of prices at the vast majority of our branded stations. Ninety-five percent (95%) of Shell-branded sites in the U.S. are independently owned and operated by local business people who make their own operating decisions and who have the right to set gasoline prices as they believe appropriate. Moreover, the FTC has been quite rigorous in its review of industry mergers, acquisitions and transactions. The FTC has required a number of divestitures that were designed to prevent declines in the numbers of competitors or increases in concentration. From Shell's perspective, competition in the energy industry remains highly robust and efficient and does not require further government regulations.

14. The attached graph illustrates that the growth in profits of your five companies over the past six years has outpaced even the sharp increase in the price of gasoline. Why is your profit margin rising at a rate that is so much higher than the price of your product?

Oil and natural gas industry profits are in line with other industries. While global revenues are high, so are the global costs of providing consumers with the energy they need. Strong earnings among all of the major oil companies will enable investment in both upstream and downstream parts of their businesses. Shell is committed to helping provide a secure energy supply to meet future energy demand in the United States. This year, Shell will spend well over $20 billion—the largest capital expenditure program in the oil and gas industry.

Prices are determined by supply and demand and are influenced by such factors as OPEC supply restrictions, free market competition, the fluctuating price of crude, supply availability, growing global demand, seasonal blend requirements, boutique fuels, the current transition to ethanol-blended gasoline and the changing regulatory landscape.

We recognize customers are concerned and affected by the price of fuel. In every country where we operate, we strive to provide customers with a consistent supply of high quality fuel at competitive prices. Prices are determined by the local market place based on several factors, some of which include: free market competition, the fluctuating price of crude, supply availability, growing global demand, seasonal blend requirements, boutique fuels, the current transition to ethanol-blended gasoline, taxes and the changing regulatory landscape. According to the Department of Energy, crude oil represents 73% of the price, refining 10% of the price, distribution and marketing 6% and the remaining 11% is comprised of taxes.

15. How much has your company invested in research and development of coal to liquids technology for use as transportation fuel in each of the past five years? How much has your company invested in research and development of hydrogen technology for use as transportation fuel in each of the past five years? How much has your company invested in research and development of non-fossil fuel renewable energy sources for use as

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00067 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.005

transportation fuel, excluding hydrogen technology, in each of the last five years?

Shell's investments in the area of Coal to Liquids (CTL) are covered in part by our coal gasification research & development (R&D) program, and in part by the GTL R&D program (these two processes are the two primary constituents of the CTL process). Over the last few years Shell's overall R&D budget has increased year-on-year and in 2007 it amounted to $1.2 billion. While we do not disclose year-on-year spend for individual R&D programs, since the start of our coal gasification and GTL programs in the early 1970s, we have spent a total of nearly $1.2 billion on R&D in these two fields.

Shell is a leader in the development of advanced biofuels and hydrogen technologies. Like most energy companies, we are engaged in the race to develop these technologies and fuels and make them commercially viable. In recent years, Shell has quadrupled its investments in cellulosic ethanol research and development. In the last six months, we have announced three new or expanded partnerships in cellulosic/advanced fuels research and development projects in the United States, including fuel from algae and a promising new technology that could convert sugars directly to gasoline, rather than ethanol. This technology could potentially eliminate the need for special infrastructure and the low blend rates now required for standard vehicles.

16. How much has your company invested in research and development of wind, solar, and geothermal energy in each of the last five years? Compare the answer to each of the three above questions with the aggregate compensation of your top 10 executives and, separately, your budget for travel, entertainment, and other fringe benefits.

The investment for R&D is not broken out by business, but our total investment in our renewables business and technologies is well over a billion dollars in the past five years. Shell is not actively involved in research and development of geothermal technology at this time.
The earnings of the top five executives are listed in the Royal Dutch Shell annual report. A summary of the Directors' Remuneration Report can be found through the following link:
www.annualreview.shell.com/2007/summarydirectorsremunerationreport.php

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00068 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.006

Senate Judiciary Committee Hearing: Durbin

Questions for all witnesses

1. Please provide a table displaying, for each year since 2000:

- the names of the top five most highly compensated individuals in your company for that year (with compensation defined to include salary, bonuses, benefits, stock options, in-kind gifts, deferred compensation, and other remuneration); and

- the amount of compensation received by each of those individuals, broken down by amount and type of compensation.

We provide below the compensation and remuneration data disclosed in annual report filings. For years 2001, 2002, 2003 and 2004, the Royal Dutch/Shell Group of Companies filed separate reports for Royal Dutch Petroleum Company and The Shell Transport and Trading Company plc. Therefore, for these years, data from the two reports is provided. Following the unification, a single report was filed by Royal Dutch Shell plc.

2007 Royal Dutch Shell plc

2007 Annual Report.doc

2006 Royal Dutch Shell plc

2006 Annual Report.doc

2005 Royal Dutch Shell plc ---- *NOTE unlike the pages for 2007 and 2006, this does not include stock options and pensions*

2005 Annual Report.doc

2004 Royal Dutch Petroleum Company ---- *NOTE does not include stock options and pensions*

2004 Annual Report--RDS.doc

2004 Shell Transport & Trading

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00069 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.007

2004 Annual Report--STT.doc

2003 Royal Dutch Petroleum Company ----- *NOTE this includes info on options, long term incentives, deferred bonus, and pension information.*

2003 Annual Report--RDP.doc

2003 Shell Transport and Trading --- *NOTE this includes options and long term incentives. Not deferred bonus or pension.*

2003 Annual Report--STT.doc

2002 Royal Dutch Petroleum Company, includes 2001 data

2002 Annual Report--RDP.doc

2002 Shell Transport & Trading, includes 2001 data

2002 Annual Report--STT.doc

2. Please provide a table displaying the following information for your company for each year since 2000:

- revenue
- net income
- return on equity
- total capital investment
- oil development investment
- refinery investment
- alternative energy research and development
- cash holdings
- marketing expenses

The information provided here is also found in annual reports filed by the company. The following explanatory notes will be helpful.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00070 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.008

Oil development investment Provided here are total Capital Expenditure for Exploration and Production and total Capital Expenditure for Oil Sands
Refinery investment Refinery investment figures are not collected or reported Provided here is total Capital Expenditure by Oil Products
Alternative energy research and development Data on this is not collected or reported
Marketing expense This data is not collected or reported

$$ Millions

	2007	2006	2005	2004	2003	2002	2001
Rev	$355 782	$318 845	$306 731	$266 386	$195 236	$160 797	$1__ 453
I m	$31 331	$ 5 442	$25 311	$18 540	$12 3_2	$9 671	$10 3 1
Ret m Equity	26 %	23 9 %	26 7%	%	16 3%	14 2%	1 4%
Tot I C pital I vestn t	$ 7 072	$ 4 896	$17 436	$15 75	$14 294	$23 359	$10 483
E&P C p tal E pe diture	$1 723	$1 773	$10 584	$8 59	$8 059	$13 064	$6 847
G&P C p tal E p diture	$2 951	$ 009	$1 573	$1 370	$1 053	$471	$313
O I S d Cap t I Exp ditu	$1 931	$865	$274	$140	$70		
O I P od ts Cap tal Expe d ture	$3 671	$3 363	$2 810	$ 761	$2 367	$7 653	$1 46
R&D	$1 01	$885	$588	$553	$584	$472	$387
C sh H ld gs & Cash Equ ty	$9 656	$9 00	$11 730	$9 201	$2 117	$1 709	$7 254
M keting Expe							

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00071 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.009

3. Several weeks ago, the Wall Street Journal's *Market Watch* quoted an industry analyst as estimating that about $25 to $30 of the price per barrel of crude oil may be attributed solely to speculation.

a) Does your internal research support that analysis?

Shell does not make public comments as to the price of crude oil, and notes that there are differing views being expressed regarding what influence, if any, oil futures investments have on prices. What is clear, however, is that markets are signaling a need to produce more oil.

b) What in your view is the price per barrel that can be justified purely by the supply and demand in the market?

Shell does not make public comments as to the price of crude oil, and notes that there are differing views being expressed regarding what influence, if any, oil futures investments have on prices. What is clear, however, is that markets are signaling a need to produce more oil.

c) What steps do you think should be taken to protect consumers from the effects of excessive speculation in the trading markets for oil?

We urge Congress to open up access to more energy resources. Such measures could have positive effects in the oil trading markets and thereby benefit consumers.

4. In your testimony, you claim that consolidation in the oil industry has been necessary to enable your company to compete globally. However, a 2004 GAO study found that consolidation and mergers in the oil refinery industry, "generally led to higher wholesale gasoline prices in the United States." As a result of all the mergers, the largest five oil companies now control 55% of the refining market, and the largest 10 dominate 81%.

a) In your view, how has market concentration in the refinery industry affected the price of gasoline?

The refining industry is not highly concentrated. According to a 2006 FTC investigation no U.S. refiner holds a substantial capacity share either nationally or regionally. Likewise, a 2004 FTC study found that, "[d]espite increases in concentration at some production levels over [the last two decades], particularly since the mid-1990s, most sectors of the petroleum industry at the national, regional, or state level generally remain unconcentrated or moderately concentrated.".

b) Do you see a link between market concentration and reduced refinery production?

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00072 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.010

Domestic refining capacity has expanded significantly in recent years, and the evidence indicates that U.S. refineries generally operate at or near capacity. Foreign refining capacity has also expanded, as have U.S. imports of gasoline and other refined petroleum products. These developments have significantly increased competition in petroleum wholesale distribution markets.

c) How much would increased refinery production lower gasoline and diesel prices?

Gasoline and diesel prices are ultimately determined by the marketplace as influenced by a variety of complex factors, including the costs of raw materials such as crude oil, and cannot be predicted based solely on refinery production. That said, Shell has invested over the years to increase our refining capacity. We also recently announced that our joint venture, Motiva, is spending around $7 billion to double the capacity of its refinery in Port Arthur, Texas. This project, when finished in 2010, will be one of the largest refineries in the United States and in the world. By adding 325,000 barrels-per-day capacity, the expansion is equivalent to building a new refinery.

5. In the last couple of weeks, we have seen the release of a handful of reports that claim that our use of ethanol has displaced a certain amount of gasoline from the nation's pool of transportation fuels, and that the displacement of more expensive gasoline with less expensive ethanol has resulted in lower consumer prices at the gas pump. These experts say that the savings have been between 15-20%, which would translate into about $400-$600 of savings per family or about $50 billion to $75 billion saved nationwide.

a) What is the effect on retail gasoline prices of cheaper ethanol being blended into gasoline?

At present, it is economical to blend ethanol into gasoline. Thus, under current market conditions, the addition of ethanol to gasoline can lower the cost of producing finished gasoline for retail use. Ultimately, however, the price of gasoline, including blends with ethanol, is determined by supply, demand and local market conditions.

b) If the renewable fuels mandate were waived this year and nine billion gallons of ethanol were removed from the market, additional petroleum would need to be "found" to replace this fuel. Some economists say that prices would increase by as much as 50 cents to 80 cents per gallon based on standard calculations. Based on your historical observations, would you expect to see that large of an increase?

If a waiver were issued, ethanol use would not cease. Even if a waiver were issued, the 2009 mandate would presumably remain in place and

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00073 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.011

the use of ethanol in 2008 would count towards the 2009 obligation Given the sharp and immediate increases in the size of the renewable fuel mandate in 2008 and 2009 (relative to compliance obligations under the 2005 energy bill) a waiver of the 2008 mandate would not likely reduce the amount of ethanol actually used in 2008 A waiver would however make the legal obligations that Congress imposed more achievable particularly in these early years of the renewable fuel program These mandates present considerable challenges for the industry due to the dramatic increase in the volumes required and the lack of adequate lead time to build new ethanol transportation and blending infrastructure

c) One of the challenges to making production and the mandate sync up is associated with the infrastructure needed to develop the biofuels industry What is your position regarding higher blend levels of ethanol and the deployment of pumps capable of dispensing E 85?

In the near term (i e 2008 2010) the primary infrastructure challenge is the transportation of ethanol from production facilities to blending terminals and the installation of equipment at these terminals to blend ethanol into gasoline These factors present significant challenges to compliance with the mandated renewable fuel volumes due to the dramatic increase in the volumes and the lack of adequate lead time to build the new infrastructure needed

Longer term the inability to blend greater than 10 percent ethanol into main grade gasoline is a significant issue that needs to be resolved We believe that it would be preferable to increase the amount of ethanol used in main grade fuels rather than expanding the use of E 85 Lower ethanol blends are more compatible with our existing vehicles and infrastructure and would not require the dedicated or specially adapted vehicles and distribution infrastructure that E85 would require E85 currently presents a number of consumer acceptability infrastructure and regulatory issues The fuel economy (miles/gallon) of a Flexible Fuel Vehicle (FFV) is substantially reduced when operated on E85 Analysis of the gasoline and E85 city/highway fuel economy ratings for FFVs produced in model years 2004 through 2007 and listed in the DOE/EPA Fuel Economy Guide indicates that the fuel economy penalty for E85 averages about 26% With an E85 fuel economy penalty of 26% an FFV operator would have to refuel about 4 times with E85 for every 3 times that that it would fill up with gasoline As with automobile fuel system components there are potential compatibility issues with using fuel storage tanks and pumps that have not been designed to withstand the corrosive (and hygroscopic) properties associated with ethanol Increasing the amount of ethanol used in main grade fuels above ten percent by volume requires EPA s approval and it is our understanding that EPA has begun evaluating this issue Congress should urge EPA to move forward expeditiously with the evaluation

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00074 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.012

Senate Judiciary Committee Hearing: Kohl

For John Hofmeister

1. We all recognize that the anti-competitive actions of the OPEC cartel have an important role to play in higher gas prices. In your estimation what would a gallon of gas cost if there was no supply limits imposed by the OPEC cartel?

   The cost of a gallon of gasoline cannot be predicted based solely on production outputs by participants in OPEC. These prices are ultimately determined by the marketplace as influenced by a variety of factors. What is clear, however, is that increased access to energy resources in the United States would likely put downward pressure on crude oil commodity prices and thereby help to lower gasoline prices.

2. The FTC has testified to the Antitrust Subcommittee that 85 % of the variability in the cost of gasoline is caused by changes in the price of crude oil. Do you agree?

   Gasoline prices are ultimately determined by the marketplace as influenced by a variety of complex factors, including the costs of raw materials such as crude oil.

3. In your opinion, how much of the price of crude oil is due to the speculation by oil traders?

   While the number of speculative trading participants, including commercials users, such as Shell, and non-commercial users, such as pension funds, endowment funds and hedge funds, has increased, it is unclear what effect this activity has had on prices, if any. The CFTC recently stated that there was an absence of evidence that speculation had driven up oil prices.

   As you know, there are multiple factors affecting prices, not the least of which is growing world demand, accessibility restrictions to new resources and diminishing supplies at existing sources. It has been Shell's policy to not engage in public comments regarding energy price forecasts. What is clear, however, is that the combined oil commodities trading community is telling us that we need to produce more oil.

4. Many experts believe that one important reason for excessive speculation in oil is low margin requirements in oil commodity trading. Unlike with respect to many other commodities and the stock market, a trader can speculate in this market with very small amounts of money, as margin requirements are as low as 8 percent. Do you agree with these experts that margin requirements should be increased in oil trading markets in order to reduce speculation?

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00075 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.013

Shell believes that competition should be fair and open; it's part of our "Code of Conduct," which is the foundation of Shell's General Business Principals. Increasing the margin requirements would require additional cash reserves to meet margin calls. These additional cash reserves could eliminate some smaller companies from the market, possibly resulting in less liquidity in the marketplace.

5. Much of the crude oil the U.S. oil companies refine into gasoline and other petroleum products comes from their own oil fields. Your annual report shows that Shell produced 375,000 barrels of oil in the United States, more than 35% of your domestic refining capacity. Overall, the U.S. produces about 40% of the crude oil it consumes. The cost to produce this oil domestically should not be affected in any way by the rising worldwide price of crude oil, a price largely determined by the OPEC oil nations. Indeed, we've heard estimates that it costs only about $ 12 to produce each barrel of oil from a U.S. oil field, a far cry from the more than $ 130 per barrel price of crude oil on the world market. So why should the rising price of crude oil on the international markets lead to higher prices with respect to petroleum products refined from your own domestically produced oil? Are the oil companies just profiteering with respect to the oil that comes from the oil fields they own?

Oil is a global commodity. By segmenting a global market into a free-priced market and a controlled-price market, current and future investment would flow to the free-priced market and domestic production would rapidly suffer. This phenomenon has occurred in countries like Korea, Cuba, and Albania where governments attempted to enact rigid price controls.

6. In the last 15 years there has been a tremendous amount of consolidation in the oil industry – in its 2004 report, the GAO counted 2600 mergers and acquisitions in this industry since the 1990s alone. Indeed, almost all the companies represented here today are a product of these mergers. During this time, the FTC has approved most of the oil industry mergers it has reviewed, including the gigantic ones like Exxon/Mobil, Chevron/Texaco, and Conoco/Phillips. While each one of these mergers may not have seemed problematic when reviewed, taken as a whole these mergers have greatly increased concentration in the industry. And the GAO concluded that these mergers have raised gasoline prices. The GAO is currently updating its 2004 study at the request of me and some of my colleagues.

What is your view of the effects of these mergers on competition in your industry and the price of petroleum products? And please predict whether we are likely to see even more consolidation in the years ahead.

Despite the apparent size of the major investor-owned energy companies, this remains a highly competitive industry. Consider the structure of our retail gasoline business, where the Shell brand has an 11.3 percent market share

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00076 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.014

nationwide Roughly 95 percent of Shell branded stations are owned by independent retailers and jobbers We are seeing healthy new retail competition emerging with brands such as WaWa Sheetz and Turkey Hill

From the perspective of the transactions experience at Shell in markets of concern to both federal and state antitrust law enforcement agencies mandatory divestitures were designed to prevent declines in the number of competitors or increases in concentration And we have fully complied with such divestitures

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00077 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.015

Senate Judiciary Committee Hearing: Leahy

Questions for Entire Panel:

1. Mr. Hofmeister testified last week that the price of crude oil should be in the range of $35 to $65 a barrel. If the price of crude oil on the world market returned to that competitive level, what could your company charge for a gallon of gas and remain profitable?

   The referenced testimony was not intended to forecast, determine, or otherwise define commercial values for crude oil commodity prices. Shell does not make public comments as to the price of crude oil.

2. Each of your companies is vertically integrated from oil exploration and production through refining and retail gasoline sales. I understand that the price of crude oil is set on the world market, and that your companies, for the most part, sell the crude oil they produce on the market and then buy back the crude oil that they refine. I further understand that each of your companies refines more oil than it produces.

   The efficiencies that come from vertical integration, however, should include the ability to refine the oil that you produce in a manner that is less expensive than if purchased in the commodities market.

   (a) What is your company doing to make vertical integration work for consumers?

   In today's global marketplace, 100 percent vertical integration is not practical because a company's crude oil production is not necessarily technically or geographically well-matched with its refining capabilities. It is therefore more efficient and cost-effective for companies to process and refine crude oil that is produced by a variety of suppliers.

   (b) If your company refined only the oil that it actually produced, rather than buying and selling on the world market, what price could it charge for a gallon of gas today and remain profitable?

   This question does not reflect how the market structure works. If we could only refine what we produce, overall costs would be higher. Gasoline prices would still be set by supply and demand and global markets.

3. How much has each of your companies spent, directly or indirectly, on studies and reports on climate change? Please specify the studies and reports produced with your companies direct or indirect support.

   "Shell was one of the first energy companies to acknowledge the threat of climate change; to call for action by governments, our industry and energy

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00078 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.016

users; and to take action ourselves. We are playing a leading role in demonstrating ways to manage CO2 responsibly.

For Shell, the debate on climate change is over. It's time to work on the solutions for climate change and greenhouse gas emissions, not to debate whether climate change is a factor. Let's get on with the solutions. But the challenge cannot be met by one company or by the energy industry alone. To make CO2 mitigation viable and to deploy it on the scale that will be needed, Governments will need to take significant action.

Several US states are working on a greenhouse gas emission policy to regulate what industry can do and what consumers can do. It will be very challenging for a company like ours to operate differently in all 50 states to meet the regulatory requirements of each state. Instead, a national solution-a national approach to greenhouse gas management-is something we consider important to the future."

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00079 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.017

Senate Judiciary Committee Hearing: Feinstein

Questions for all witnesses:

1. According to the May 15th Congressional testimony of the CFTC's Chief Economist and the CFTC's Director of Market Surveillance, oil companies are driving up the price of oil. These experts stated: "Our studies consistently find that when new information comes to the market and prices respond, it is the commercial traders (such as oil companies, utilities, airlines) who react first by adjusting their futures positions. When these commercial traders adjust their futures positions, it is speculators who are most often on the other side of the trade. Price changes that prompt hedgers to alter their futures positions attract speculators who change their positions in response. Simply stated, there is no evidence that position changes by speculators precede price changes for crude oil futures contracts." CFTC believes that oil companies are driving up prices in futures markets, not speculators. Yet, during the Judiciary Committee hearing on May 21, Mr. Stephen Smith of Exxon Mobil asserted that his firm "does not speculate." Does your firm buy or sell positions in crude oil futures markets? If your firm participates in futures markets, can you refute CFTC's assertion that your firms are driving up oil prices?

   The recent run-up in crude oil prices is a result of both short-term and long-term circumstances, including rapid increase in global demand; geopolitical issues; global economic issues; shortage of capacity in energy services and materials; escalating costs for materials, labor and engineering services; access to oil and gas resources is becoming more difficult around the world; and oil and gas resources available for development are increasingly challenging to access (often in remote or even hostile locations), require more infrastructure, carry a greater technical risk, and are far more costly to develop than in the past. Shell utilizes the futures market to manage and mitigate price risk associated with its core business of locating, extracting, processing, refining and supplying various hydrocarbon products to its customers.

2. Your firms vehemently oppose legislation – such as the 2007 energy bill tax amendment and Senator Reid's recent legislation to tax windfall oil company profits – that would increase the tax burden on oil and gas companies, arguing that increased taxation will lead to higher gas prices for consumers. However, you argued before the Judiciary Committee that your companies are unable to lower the price of oil. You say that you simply take the price in this global marketplace, instead of offering oil for sale at a set price and set mark-up. These two positions seem inconsistent. Do the economics of your firms influence oil prices, and will oil prices go up if your taxes go up? Or do the economics of your firms stand independent of oil prices, and will oil prices be set by demand regardless of the enormous size of your profits? It can't possibly be both.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00080 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.018

At any given time, oil prices are set by a complex combination of factors including supply and demand conditions, inventory levels, infrastructure availability, geopolitical risk and uncertainty. International, investor-owned oil companies have relatively little control over most of these factors.

Over the long term, the international, investor-owned companies have a role in developing new sources of oil and gas supply, and increasing recovery rates from existing basins. All being equal, higher levels of supply should have a moderating effect on prices, again over the long -term, unless offset by reductions from other suppliers such as the OPEC countries. Projects which can add significant new oil and gas supplies are increasingly technically challenging and higher cost, as well as needing 5-10 years to develop, a period in which enormous sums of capital are committed years before any financial return is achieved. To undertake such huge investment commitments the industry needs some degree of confidence in the stability of its fiscal regime, as well as a fiscal structure, which does not unduly penalize the economic attractiveness of many new project investments.

Shell opposes increased taxation mainly because the dollars removed from the industry in this way diminish its capacity for investment in new supply. Over the long-term, lower supply will support oil prices at a higher level than they would otherwise have been, which is probably not the intention of those proposing such measures. Additionally, since factors affecting the supply and demand of crude oil and gasoline take a long time to play out, it is unlikely that any such measure could have any impact on the current consumer price of gasoline or other refined oil products.

This impact was explained recently in the Congressional Research Service Report to Congress entitled "Energy Tax Policy: History and Current Issues." May 22, 2008

"In the long run, however, all taxes distort resource allocation, and even a corporate profit tax (either of the pure type or the surtax on the existing rates) would reduce the rate of return and reduce the flow of capital into the industry. In the long run, eliminating the deduction for the domestic oil and gas industry will raise average production costs, adversely affecting the economics of domestic oil and gas projects as compared to domestic non-oil and gas projects. Generally, rates of return to investments in oil and gas would decline, causing a decline in capital flows to this industry, and an increase in capital flowing to other industries, including foreign industries. This would tend to adversely affect domestic production and increase imports: Domestic oil and gas output would be lower, and imports would be higher than they otherwise would be without the tax increase. However, because of the structure of the world oil market, market oil prices are exogenous to U.S. producers (and gas prices tend to follow market oil prices), even these longer term effects are not likely to affect oil and gas prices. Also, the retail price of refined petroleum products, such as gasoline, to consumers is determined by a complex interplay of world supply and demand market variables rather than a domestic corporate tax increase."

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00081 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.019

3. The expense and technical challenge of developing new oil resources in harsh environments such as the Arctic is a frequently heard rationale for large oil industry mergers. Are these projects working out as planned? Can we expect to see large new petroleum resources coming on line in the next few years as a result of mergers?

   Shell cannot comment on the reasons for business decisions made by other companies. Shell does agree that the expense and technical challenge of developing new oil resources is growing. Supplies of conventional oil and natural gas will not be able to match the pace of growth in energy demand that we are seeing around the globe. New oil and gas will likely be found in challenging environments, such as ultradeep water and the arctic, or in difficult unconventional formations, such as shale and oil sands. These additional supplies of oil and gas will be needed, as will all other forms of energy including conservation and energy efficiency, in order to meet demand.

4. To what extent are your refineries able to defer planned maintenance if and when refined product markets are tight? Has your company ever deferred refinery maintenance to meet a tight marketplace? If so, how frequently has your firm deferred maintenance? At what refineries and on what dates?

   Domestic refining capacity has expanded significantly in recent years, and the evidence indicates that U.S. refineries generally operate at or near capacity. Foreign refining capacity has also expanded, as have U.S. imports of gasoline and other refined petroleum products. These developments have significantly increased competition in petroleum wholesale distribution markets.

5. With constraints on the expansion of refinery capacity in California, how do you foresee meeting demand for gasoline and diesel in the future?

   See Answer to Q6.

6. According to initial research by the Government Accountability Office conducted at my request, the San Francisco Bay area has a significant degree of refinery market concentration. San Francisco also consistently has some of the highest gasoline prices in the United States – higher than other regions of California that must use the same reformulated gasoline. Do you believe that the high degree of market concentration among refineries in the San Francisco Bay Area is causing higher gasoline prices in this area?

   California is a unique market in that gasoline prices in California are impacted by state taxes and special fuel blend requirements and gasoline taxes in California are the third highest in the country. Unlike most states, California charges a sales tax on gasoline that ranges from 7.25% to 8.75% of the sales

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00082 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.020

prices. So, for example, a purchase of $3.29 per gallon would include an additional 24 cents per gallon of sales tax paid by the consumer at the pump. California's special clean-burning fuel blend regulations create added burdens and costs for manufacturing the product and for supplying the region with this unique gasoline.

Shell's supply plans in California are centered on meeting the product needs of its approximately 1200 branded gasoline retail stores located throughout the state. To achieve our high level of reliability, the majority of supply comes from Shell owned refineries with the remainder being sourced from third-party refineries, spot market purchases and imports as needed.

Shell's refinery position in California is strong and we are continually looking at ways to optimize and improve our refining portfolio. Shell maintains our supply balance with its California refinery at Martinez. The Martinez refinery, in service since 1915, operates at high capacity levels converting approximately 165,000 barrels of crude oil per day into fuels, lubricants and asphalts with 85% of its production going toward automotive gasoline, jet fuel and diesel. Our Martinez production, in combination with our third party supply relationships, is adequate to meet the demand needs of our customers. Looking forward, we fully expect that supplies will remain sufficient to meet Shell's customer demand requirements.

We note that the oil and gas industry is cyclical and that refinery economics fluctuate widely from season to season. Many factors influence these economics, including but not limited to, crude oil prices as traded on the world market and set by global competitive conditions; regional spot prices; seasonal product requirements as established by boutique fuel regulations, environmental quality standards and seasonal blends; local retail prices as set by competitive marketplace dynamics; plant facility and equipment operations, maintenance, safety and governmental compliance upgrades; etc. We also note that despite the apparent size of the major investor-owned energy companies, this remains a highly competitive industry. Consider the structure of our retail gasoline business, where the Shell brand has an 11.3 percent market share nationwide. Roughly 95 percent of Shell branded stations are owned by independent retailers and "jobbers." We are seeing healthy new retail competition emerging with brands such as WaWa, Sheetz and Turkey Hill.

7. How do pipeline and port constraints affect your ability to provide adequate supplies of fuel to consumers?

Port constraints affect the ability to adequately supply fuel to consumers in a variety of ways, including:

- Many U.S. ports have draft restrictions, causing many ships to enter ports without being fully laden;
- Many U.S. ports are thus congested with high berth occupancy becoming an issue;

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00083 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.021

- Ports in environmentally sensitive areas are often difficult to expand and many have outgrown the facility;
- Double-hull Jones Act vessels are in limited supply and often spot-market vessels are difficult to secure;
- Jones Act ship owners are struggling to recruit U.S. seafarers to man the ships, especially the brown-water tugs and barges; and
- Much of the nation's intercoastal waterways (such as the Mississippi River Gulf Outlet (MRGO)) are hampered by aging infrastructure (i.e., the 85 year-old lock system in the Inner Harbor Navigation Canal in New Orleans); eventual repair/replacement will require an extended shutdown period requiring alternate routes, which would most likely reduce efficiency and increase costs.

Shell is aggressively working to mitigate many of these issues and has committed to a long-term time charter agreement with AHL Shipping, which in turn has lead to the construction of three new shallow-draft ships to be utilized in Shell's Jones Act chartered fleet. The 49,000 DWT shallow-draft tankers are wider so they can be fully-laden and still enter ports with restricted water depths. When these tankers are all in service, Shell will have the youngest Jones Act charter fleet in the industry with an average vessel age of approximately four years.

8. Given the importance of free market competition to the energy sector, what is your view of the current 54-cent a gallon tariff on ethanol imports into the United States? Do you believe Congress should reduce the tariff, at least to the $0.45 per gallon level that blenders receive for using ethanol in the United States? Would you endorse legislation to do this?

In 2007, Shell companies paid $1.9mm in US import duties on ethanol, but recovered virtually all of the duties paid via the duty drawback program. For 2008—and the foreseeable future, our business contacts tell us that Shell will only be importing ethanol from trade preference countries which result in low/zero duties paid. So for example, as of May 2008, Shell had paid zero US import duties on ethanol.

Shell believes cellulosic ethanol holds particular promise. Shell also has partnerships to work on fuel from algae and sugars to gasoline.

From: A National Dialogue on Energy Security: The Shell Final Report:
Point 5 (of 12 point "Solutions") "Move biofuels beyond corn. We need to pursue alternatives such as cellulosic ethanol.... (Pg. 14)
Finally, from "Shell's Policy on Tax Incentives (2006)":
"Shell supports reasonable incentives in certain contexts, and will take into account the following factors in making this determination:
---New markets or new technology. Incentives may be warranted where there are new markets or new technology (e.g. SURE, IOGEN). However, such incentives must consider: Prices (in a high price environment, incentives should be phased out as a general rule); and Time (incentives should have a limited time, and should be reflective of normalization in the marketplace.

43354.022

Query: Could a continuing import duty on ethanol be viewed as a way to foster growth in cellulosic ethanol programs by keeping ethanol prices at a certain level?

9. It would appear that Russia is currently working to lay claim to the North Pole and its natural resources. How would you like to see the situation resolved? What role should the U.S. government play?

The issue of territoriality must be determined collectively by governments with claims to the Artic. International oil companies like Shell are unable to participate in the exploration and development of any potential resources in disputed territories. Therefore, the USG, with claims in this area, should work with the Government of Russia and other claimants to resolve any disputes.

10. Over half, and in some cases, roughly 75% of the proven reserves of a number of American oil companies are located abroad. Looking at, say, Venezuela as an example, it seems possible that we are beginning to see a new wave of energy resource nationalizations. How is your company working to protect shareholders from the adverse consequences of such actions?

Shell is in more than 110 countries and territories around the world and has established working relationships with many of the governments in countries where we conduct business. We have developed a balanced global portfolio, which addresses risks (both disclosed and non-disclosed) in doing business in countries around the world.

We continue to invest in areas/places that will achieve acceptable returns for our shareholders. We do not control the policy of governments and the actions they could/may take, but we will continue to invest in places where we can achieve long-term value for our shareholders.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00085 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.023

Summary Directors' Remuneration Report

This is a summary of the full Directors' Remuneration Report which can be found in the Annual Report and Form 20-F for the year ended December 31, 2007 and on the Shell website www.shell.com/annualreport.

EXECUTIVE DIRECTORS' REMUNERATION

The Remuneration Committee (REMCO) is committed to the principles of pay for performance, competitiveness, shareholding, consistency and compliance. It bases remuneration policies and decisions for Executive Directors on these principles.

The Executive Directors' compensation package is made up of base salary, annual bonus, long-term incentives, pension and other benefits.

ACTUAL TOTAL COMPENSATION OF EXECUTIVE DIRECTORS IN OFFICE DURING 2007

	Jeroen van der Veer	Malcolm Brinded	Linda Cook	Rob Routs	Peter Voser
Earnings	4,692,909	2,766,517	2,601,749	2,488,780	2,298,793
Release of LTP awards	0	0	0	0	0
Release of Deferred Bonus Plan awards	0	0	0	0	0
Share option gains	389,564	300,352	–	–	–
Pension benefits	1,421,000	68,678	1,060,792	420,000	451,818
Total compensation in euro	6,503,473	3,135,547	3,665,541	2,908,780	2,850,611
in US dollar	8,963,722	4,321,722	5,052,313	4,009,170	3,928,995
in sterling	4,473,292	2,156,723	2,521,269	2,000,746	1,960,735

EXECUTIVE DIRECTORS' 2007 EARNINGS

Base salary levels are set with reference to appropriate market levels as benchmarked against a comparator group comprising companies of comparable size, complexity and scope.

The current grouping consists of the oil majors (BP, Chevron, ExxonMobil and Total) and a selection of top European-based companies, including a selection from the FTSE and AEX. In 2007, REMCO endorsed Executive Directors' base salary increases as follows: Jeroen van der Veer 8.8%, Malcolm Brinded 4.2%, Linda Cook 5.4%, Rob Routs 4.7% and Peter Voser 5.4%. These increases sustain competitive market positions, recognizing normal market movements.

The annual bonus is designed to reward Executive Directors for achieving results that further Shell's objectives and is determined in accordance with stretching but realistic financial, operational and sustainable development targets in the Shell Scorecard. At the end of the financial year, results are translated into an overall score between a minimum of zero and a maximum of two. Bonus awards are based on this score multiplied by the target bonus level. REMCO uses its judgement to make a final determination.

SHELL SCORECARD COMPONENTS

- 25% Total Shareholder Return (TSR) against major integrated oil companies
- 25% Operational cash flow
- 30% Operational excellence in work of the businesses
- 20% Sustainable development[A]

(A) Primarily based on a number of reported rates of work-related injury, but also including other Sustainable Development measures, details of which can be found in the Shell Sustainability Report.

EARNINGS OF EXECUTIVE DIRECTORS IN OFFICE DURING 2007 (Not yet to be audited)

	Jeroen van der Veer 2007	2006	Malcolm Brinded 2007	2006	Linda Cook 2007	2006	Rob Routs 2007	2006	Peter Voser 2007	2006
Salary	1,775,000	1,625,000	1,097,500	1,052,500	960,000	825,112[A]	977,500	940,000	900,000	892,500
Bonus[B]	2,886,000	2,040,000	1,601,550	1,290,000	1,408,550	1,122,000	1,430,000	1,140,000	1,408,550	1,122,000
Cash benefits[C]	15,000	15,840	7,500	9,240	164,674	173,014	42,700	42,903	22,219	16,426
Total cash	4,676,000	3,680,840	2,706,600	2,350,840	2,533,224	2,120,936	2,450,000	2,128,903	2,290,769	2,030,926
Car benefit	–	–	24,443	22,049	20,929	24,066	21,506	35,108	–	–
Other benefits[D]	16,909	13,371	28,474	28,457	37,596	56,202	6,675	5,157	6,024	17,513
Total in euro	4,692,909	3,694,211	2,766,517	2,431,246	2,601,749	2,261,224	2,488,781	2,169,168	2,298,793	2,048,441
Total in US dollar	6,458,223	4,672,719	3,817,088	3,050,066	3,585,989	2,860,192	3,450,284	2,742,740	3,308,254	2,591,035
Total in sterling	3,227,972	2,518,173	1,902,592	1,642,703	1,789,561	1,541,276	1,711,857	1,478,621	1,649,961	1,396,327

(A) The 2006 salary was calculated from euro to US dollar allocations. The equivalent value would have been $1,042,500.
(B) The annual bonus figures are shown in the table in their related performance year and not in the following year in which they are paid.
(C) Includes representation allowances, employee contributions to health insurance plan, school fees, cost allowances and tax compensation.
(D) Corporate social security premiums paid by the employer as well as provisions for company-provided transport for home to office commuting, and occupational use of the corporate aircraft.

The aggregate amount of emoluments paid to or receivable by Executive Directors of Royal Dutch Shell and other Shell companies for services in all capacities during the fiscal year ended December 31, 2007 was €14,944,749 (2006: €11,584,406).

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00086 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.024

Summary Directors' Remuneration Report

This is a summary of the full Directors' Remuneration Report which can be found in the Annual Report and Form 20-F for the year ended December 31, 2006 and on the Shell website www.shell.com/annualreport.

EXECUTIVE DIRECTORS' REMUNERATION

The Remuneration Committee (REMCO) is committed to the principles of pay for performance, competitiveness, shareholding, consistency and compliance. It bases remuneration policies and decisions for Executive Directors on these principles.

The Executive Directors' compensation package is made up of base pay, annual bonus, long-term incentives, pension and other benefits.

	Jeroen van der Veer	Malcolm Brinded	Linda Cook	Rob Routs	Peter Voser
Total emoluments	3,694,211	2,411,346	2,261,234	2,169,168	2,048,441
Share option gains	286,943	–	584,257	287,643	–
Pension benefits[A]	1,459,000	56,162	1,087,034[B]	275,000	498,498
Total compensation in €	5,430,054	2,467,508	3,932,525	2,732,811	2,546,939
Total compensation in $	6,870,757	3,121,104	4,974,176	3,456,681	3,221,576
Total compensation in £	3,707,551	1,681,985	2,680,620	1,862,830	1,736,130

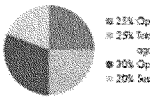
(A) The value of the retirement benefit is based on notional values.
(B) For Linda Cook, employer contributions to defined contribution plans of $238,430 made during 2006, are included.

EXECUTIVE DIRECTORS' 2006 EARNINGS

Base pay is set at a competitive level, relevant to the scope and complexity of the roles of Chief Executive and Executive Director, and reflects the reporting structure in the Executive Committee. Base pay levels are set in euro and benchmarked against the oil majors (BP, Chevron, ExxonMobil and Total) and a single grouping of top European-based companies, including a selection of FTSE and AEX companies. REMCO endorsed Executive Directors' base pay increases in 2006 as follows: Jeroen van der Veer 9.7%, Malcolm Brinded 2.4%, Linda Cook 10.0%, Rob Routs 3.2% and Peter Voser 10.0%. These increases were made in order to sustain the current market position of these levels, recognising normal market movements.

The annual bonus is designed to reward Executive Directors for achieving results that further Shell's objectives and is determined in accordance with the stretching but realistic financial, operational and sustainable development targets in the Shell Group Scorecard. At the end of the financial year, results are translated into an overall score between a minimum of zero and a maximum of two. Bonus awards are based on this score multiplied by the target bonus level. REMCO uses its judgement to make a final determination.

SHELL GROUP SCORECARD COMPONENTS



(A) Primarily based on number of recorded cases of workplace injury, but also including other Sustainable Development measures, details of which can be found in the Shell Sustainability Report.

	Jeroen van der Veer		Malcolm Brinded		Linda Cook		Rob Routs		Peter Voser	
	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005
Salaries	1,625,000	1,525,000	1,062,500	1,041,454	885,112	834,204	940,000	912,500	892,500	822,000
Bonus[A]	2,040,000[B]	1,937,500	1,290,000[B]	1,312,500	1,122,000[B]	1,062,500	1,146,000[B]	1,156,250	1,122,000[B]	1,062,500
Cash benefit	15,840[C]	16,632	8,340[D]	19,674	173,814[E]	290,040[F]	42,903[G]	69,010	16,426[H]	117,285
Total cash	3,680,840	3,479,132	2,360,840	2,373,628	2,180,926	2,186,643	2,128,903	2,138,669	2,030,928	2,001,884
Car benefit[I]	–	–	22,040	21,906	24,006	23,591	33,108	34,454	–	–
Other benefits[J]	13,371[K]	5,114	28,457	2,301	56,302[L]	49,691	5,157	5,114	17,513	5,856
Total emoluments in euro	3,694,211	3,484,246	2,411,346	2,397,835	2,261,234	2,254,065	2,169,168	2,178,237	2,048,441	2,005,740
Total emoluments in US dollar	4,672,739	4,331,484	3,050,066	2,986,152	2,860,192	2,802,170	2,743,740	2,707,902	2,591,035	2,470,632
Total emoluments in sterling	2,518,173	2,383,129	1,643,703	1,637,486	1,541,378	1,541,719	1,478,621	1,489,555	1,396,327	1,368,947

Data in all tables is converted from the currency in which it is set to euro, sterling and US dollar as appropriate.

The aggregate amount of emoluments paid to or receivable by Executive Directors of Royal Dutch Shell and other Shell Group companies for services in all capacities during the fiscal year ended December 31, 2006, was €12,584,400 (2005: €12,120,123).

(A) The annual bonus figures are shown in the notes in their related performance year and not in the following year in which they are paid.
(B) Of which 50% will be deferred under the Deferred Bonus Plan.
(C) Of which 40% will be deferred under the Deferred Bonus Plan.
(D) Includes a representation allowance, the employer's contribution to a health insurance plan and a car allowance.
(E) Includes a representation allowance and the employer's contribution to a health insurance plan.
(F) Includes a representation allowance, school fees, the employer's contribution to a health insurance plan, and tax compensation and reimbursement.
(G) The tax compensation amounts reported in 2005 have been revised downwards to reflect actual amounts payable.
(H) Includes a representation allowance, the employer's contribution to a health insurance plan and school fees.
(I) Includes a representation allowance, the employer's contribution to a health insurance plan, a car allowance and the balance of a selling-in allowance.
(J) The car benefit is stated at the value employed by the Fiscal Authorities in the Netherlands for company-provided vehicles and based on the original purchase price.
(K) Comprises social security premiums paid by the employer, as well as a provision for company-provided transport by home to office commuting.
(L) During their tenure with Shell Oil Company in the US, Jeroen van der Veer and Linda Cook received a onetime company-owned life insurance benefit, the incremental value of which is included.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00087 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.025

2005 Annual Report

SUMMARY DIRECTORS' REMUNERATION REPORT

This is a summary of the full Directors' Remuneration Report which can be found in the Annual Report and Form 20-F for the year ended December 31, 2005 and on the Shell website www.shell.com/investor.

Executive Directors' Remuneration

REMCO is committed to the principles of pay for performance, competitiveness, shareholding, consistency and compliance. It bases remuneration policies and decisions for Executive Directors on these principles.

The Executive Directors' compensation package is made up of a number of different elements.

Base pay is set at a competitive level appropriate to the scope and complexity of the roles of Chief Executive and Executive Director and reflects the reporting structure in the Executive Committee. Base pay levels are set in euros and benchmarked against the major integrated oil companies, the FTSE 20, the AEX 10 and the top 20 companies in the FTSE Eurotop 100, based on market capitalisation.

REMCO endorsed Executive Directors' base pay increases in 2005 as follows: Jeroen van der Veer 3.3%, Malcolm Brinded 2.4%, Linda Cook 4.9%, Rob Routs 2.8%, and Peter Voser 7.6%. These increases were made in order to sustain the current market position of these levels, recognising normal market movements.

The **Annual bonus** is designed to reward Executive Directors for achieving results that further Shell's objectives and is determined in accordance with the stretching but realistic financial, operational and sustainable development targets in the Shell Group scorecard. At the end of the financial year, results are translated into an overall score between a minimum of zero and a maximum of two. Bonus awards are based on this score multiplied by the target bonus level. REMCO uses its judgment in making its final determinations.

Shell Group scorecard components

* Partially based on number of reported cases (health and safety).

The target level of the 2005 bonus was 100% of base pay for Executive Directors. The overall score resulting from the 2005 Shell Group scorecard process was 1.25 and REMCO confirmed this outcome. REMCO decided that the annual bonuses payable to Executive Directors for 2005 would be 125% of base pay. The target level for Executive Directors for 2006 will be 100% of base pay.

Earnings of Executive Directors in office during 2005

The information in this table has been audited.

	Jeroen van der Veer		Malcolm Brinded		Linda Cook		Rob Routs		Peter Voser	
	2005	2004[a]	2005	2004[a]	2005	2004[a]	2005	2004[a]	2005	2004[a]
Salaries and fees	1,525,000[b]	1,281,774	1,041,454	1,015,711	834,294	338,902	912,900	884,516	822,099	197,507
Bonus[c]	1,937,500[d]	1,350,000[e]	1,312,500[f]	925,027[i]	1,062,500	442,000	1,156,250	810,000	1,062,500[k]	–
Cash benefits	16,632[g]	15,505	19,674[h]	40,488	530,401[j]	160,091	69,919[l]	69,985	117,285[m]	960,761
Total cash	3,479,132	2,647,279	2,373,628	1,001,226	2,427,195	541,993	2,138,669	1,764,501	2,001,884	1,158,358
Car benefit	–	–	21,906	22,040	23,531	10,003	34,454	35,108	–	–
Other benefits[n]	5,114	2,538	2,301	2,366	43,691	18,629	5,114	34,757[o]	3,856	4,251
Total emoluments in euro	3,484,246	2,649,817	2,397,835	2,015,641	2,494,417	970,515	2,178,237	1,834,366	2,005,740	1,162,609
Total emoluments in dollar[a]	4,331,484	3,290,881	2,986,152	2,501,612	3,100,966	1,205,300	2,707,908	2,278,150	2,479,652	1,444,590
Total emoluments in sterling[a]	2,383,129	1,798,130	1,637,486	1,366,068	1,706,114	658,582	1,489,855	1,244,782	1,368,847	788,925

The aggregate amount of emoluments paid to or receivable by Executive Directors of Royal Dutch Shell from Royal Dutch Shell, Royal Dutch, Shell Transport and other Shell Group companies (both prior to and following the Unification Transaction) for services in all capacities during the fiscal year ended December 31, 2005, was €12,360,475.

a. Dollar and sterling converted to euro and euro converted to dollar and euro converted to sterling at the applicable quarterly average rate of exchange.

b. The amounts disclosed in the 2004 Annual Report and Accounts and in the Annual Report on Form 20-F/A (Amendment No. 1) 2004 of Royal Dutch and Shell Transport have been restated to reflect the classification of various cash and benefit items to ensure consistent presentation with the 2005 amounts. Malcolm Brinded resigned from the Board of Royal Dutch and was appointed to the Board of Shell Transport on March 1, 2004. Malcolm Brinded's 2004 amounts as shown in this table include the total amounts received from Royal Dutch, Shell Transport and Shell Group companies.

c. Peter Voser was appointed an Executive Director with effect from October 4, 2004. Therefore, where appropriate, the 2004 emoluments are pro rated. His cash benefits include a overall transition payment of €938,400 / $1,260,998 / £643,000 paid in joining the Group. He was not eligible for a 2004 bonus.

d. Jeroen van der Veer's salary increase with effect from 1 November 1, 2004 did not come into payment until 2005. His 2005 salary figure as stated here excludes a payment of €32,500 relating to his November and December 2004 salary.

e. The annual bonus figures are shown in the table in their related performance year and not in the following year in which they are paid.

f. Of which 50% for them will be deferred under the Deferred Bonus Plan.

g. Of which 25% will be deferred under the Deferred Bonus Plan.

h. Includes a representation allowance, the employer's contribution to the health insurance plan and a car allowance.

i. Includes a representation allowance, the employer's contribution to the health insurance plan, a long-service award, school fees compensation, and tax compensations and reimbursements.

j. Includes a representation allowance, the employer's contribution to the health insurance plan, school fees compensation, and tax compensations and reimbursements.

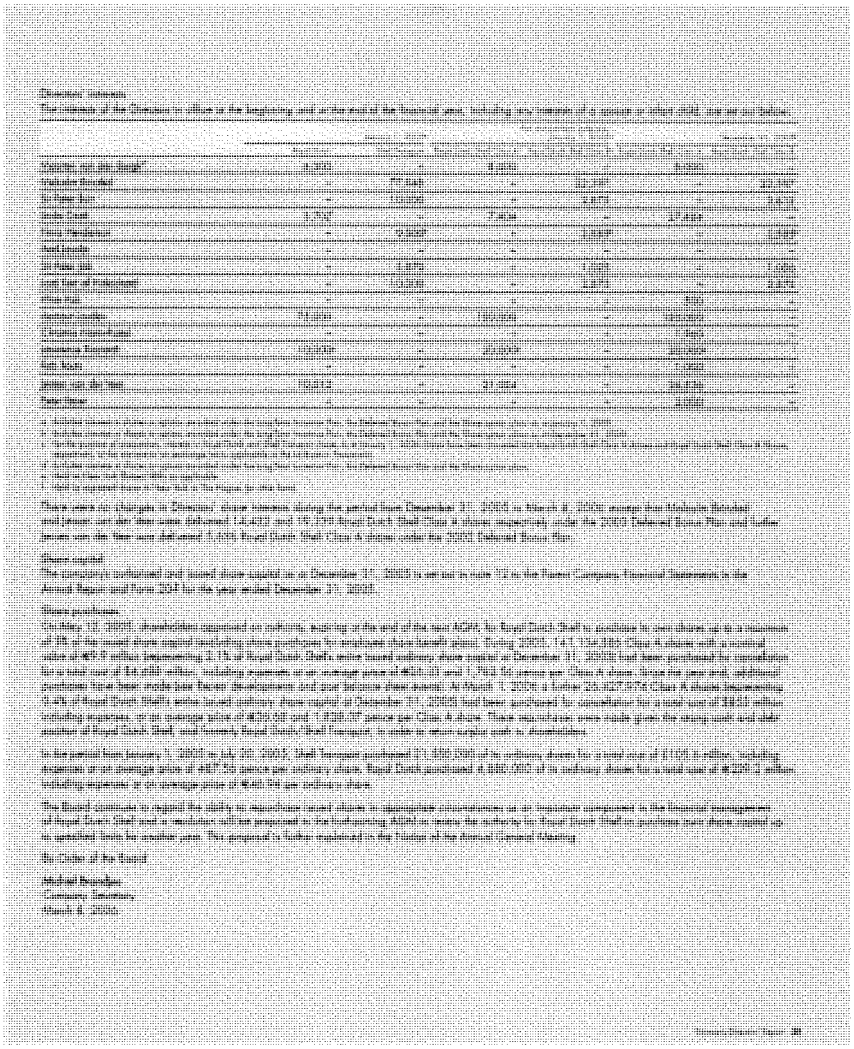
k. Includes a representation allowance, the employer's contribution to the health insurance plan, a car allowance, a mortgage allowance and tax compensations and reimbursements.

l. The car benefit is based on the value employed by the Fiscal Authorities in the Netherlands for company-provided vehicles which is 22% of the original purchase price.

m. Comprises social security premiums paid by the employer.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00088 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.026



SUMMARY CONSOLIDATED FINANCIAL STATEMENTS

These Summary Consolidated Financial Statements are an abridged version of the Consolidated Financial Statements of the Royal Dutch Shell Group and of the Directors' Remuneration Report for 2005. They do not contain sufficient information to allow for a full understanding of the results and the state of affairs of the Royal Dutch Shell Group, and of its policies and of arrangements concerning Directors' remuneration. The auditors' report on the Consolidated Financial Statements and the auditable part of the Directors' Remuneration Report was unqualified. For further information consult the full 2005 Annual Report and Form 20-F (available at **www.shell.com/annualreport** or see the back cover for contact addresses to request a free copy).

Summary Consolidated Statement of Income

		$ million
	2005	2004
Revenue	306,731	266,786
Cost of sales	252,622	223,250
Gross profit	54,109	43,127
Selling, distribution and administrative expenses	15,482	15,098
Exploration	1,286	1,809
Share of profit of equity accounted investments	7,123	5,015
Interest and other income	1,171	1,483
Interest expense	1,068	1,050
Income before taxation	44,567	31,659
Taxation	17,999	12,168
Income from continuing operations	26,568	19,491
Income/(loss) from discontinued operations	(307)	(234)
Income for the period	26,261	19,257
Income attributable to minority interest	950	717
Income attributable to shareholders of Royal Dutch Shell plc	25,311	18,540

Earnings per share

		$
	2005	2004
Basic earnings per share	3.79	2.74
Continuing operations	3.84	2.77
Discontinued operations	(0.05)	(0.03)
Diluted earnings per share	3.78	2.74
Continuing operations	3.83	2.77
Discontinued operations	(0.05)	(0.03)

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00090 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.028

Summary Consolidated Balance Sheet

		$ million
	Dec. 31 2005	Dec. 31 2004
Assets		
Non-current assets		
Intangible assets	4,350	4,528
Property, plant and equipment	87,558	87,918
Investments:		
equity accounted investments	16,905	10,100
financial assets	3,672	2,700
Deferred tax	2,562	2,789
Prepaid pension costs	2,486	2,470
Other	4,091	5,702
	121,624	125,307
Current assets		
Inventories	19,776	15,375
Accounts receivable	66,386	37,473
Cash and cash equivalents	11,730	9,201
	97,892	62,049
Total assets	219,516	187,446
Liabilities		
Non-current liabilities		
Debt	7,578	8,858
Deferred tax	10,763	12,030
Retirement benefit obligations	5,807	6,795
Other provisions	7,385	6,828
Other	5,095	6,803
	36,628	41,211
Current liabilities		
Debt	5,338	5,734
Accounts payable and accrued liabilities	69,613	37,900
Taxes payable	8,782	9,058
Retirement benefit obligations	282	339
Other provisions	1,549	1,812
	84,964	54,852
Total liabilities	121,592	96,063
Equity attributable to shareholders of Royal Dutch Shell plc	90,924	86,070
Minority interest	7,000	5,313
Total equity	97,924	91,383
Total liabilities and equity	219,516	187,446

March 8, 2006

Peter Voser
Chief Financial Officer, for and on behalf of the Board of Directors

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00091 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.029

Summary Remuneration Report

This is a summary of the full Remuneration Report which can be found in the Annual Report and Accounts 2004 and on the Shell website (www.shell.com/annualreport).

Remuneration policy

The Group's remuneration policy is intended to recognise and support the Group's Statement of General Business Principles and strategic direction; as well as the need to attract and retain talented individuals and to motivate and reward Executive Directors for exceptional performance; and to align Executive Directors' interests with those of shareholders.

More than half of an Executive Director's target total remuneration is performance-linked and targeted to the long term. To ensure competitiveness, remuneration levels are set by reference to the practice of similar global companies. Performance mechanisms and reward structures are applied consistently to Executive Directors and senior managers.

Base pay

Base pay is set at a competitive level, appropriate to the scope and complexity of the roles of Chief Executive and Executive Director, and levels are benchmarked against relevant comparator groups.

Annual incentive

Executive Directors are eligible for an annual bonus. Performance during the year is measured against the Group Scorecard and annual bonus awards are made on this basis. There are four components to the 2005 Scorecard: total shareholder return, operational cash flow, operational excellence in each of the businesses and sustainable development. The target level for bonus payments for Executive Directors in 2005 will be 100% of base pay.

Long-term incentives

In 2004, the Remuneration and Succession Review Committee (REMCO) reviewed the Group's long-term incentives for Executive Directors and senior management and the proposals for change are being presented to shareholders for approval at the 2005 General Meeting.

The key recommendations are: to discontinue stock option grants in favour of grants under the amended Long-Term Incentive Plan (LTIP), and to amend the Deferred Bonus Plan to introduce long-term performance conditions to the release of most of the matching shares. These amendments would not lead to an increase in the overall value of compensation for Executive Directors.

Pension policy

Retirement benefit arrangements for all staff are based on local market conditions and the overall value of the remuneration package necessary to attract and retain high-calibre individuals. The latest date on which Executive Directors may retire is June 30, following their 60th birthday. A change in retirement age to 65 from 2006 is being proposed.

Contracts policy

Contracts for Executive Directors are based on country-specific labour laws and market practice. They contain similar terms and conditions as for senior employees in the country concerned. Standard Executive Directors' contracts do not contain any predetermined settlements for early termination.

Shareholdings

Following discussions with shareholders in 2004, a new shareholding policy has been introduced. Executive Directors are expected to build up shareholdings to the value of twice their base pay over five years. Until this target is met, they are required to retain 50% of the shares received through the vesting of future LTIP awards and vested matching shares under the Deferred Bonus Plan and maintain that level until retirement.

Actual remuneration in 2004

Base pay

Salary scales were not increased during 2004. Jeroen van der Veer's base pay was increased from March 3, 2004 to reflect his appointment to the role of Chairman of the Committee of Managing Directors. It was increased on November 1, 2004 to reflect the increased responsibilities of Chief Executive of the Group.

Annual incentive

Executive Directors were eligible for a bonus related to the 2004 financial year reflecting performance against the Group Scorecard. Having regard to the Group's performance against all targets, REMCO recommended and it was decided that the annual bonuses payable to Executive Directors in respect of the year 2004 are 90% of base pay.

Stock options

Stock options granted to Executive Directors in 2004 were 100% performance-linked. Stock options granted in March 2002 were 50% performance-linked and were due to vest in March 2005. Taking into account the financial performance conditions over those three years, the committee decided that none of the 2002 performance vesting stock options should vest.

Long-Term Incentive Plan

REMCO recommended that Executive Directors be made a conditional award of performance shares under the LTIP with a face value of twice the individual's base pay. The actual number of shares received will be determined in 2007.

Pensions

For employees in the Netherlands their 2004 contributions to the plan offered by the Stichting Shell Pensionfonds was 8% of the amount of pensionable salary above the premium threshold. The company contribution rate was 20% during 2004. Company contributions were not required for the US Senior Staff Pension plan during 2004. The employing company's contribution rate for the Shell Pension Plan was 5.1% in 2004. Executive Directors are not required to contribute to these plans.

Contracts

Jeroen van der Veer and Rob Routs have employment contracts with one of the Group Holding Companies that provide entitlement to the statutory notice period of one month for an employee and,

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00092 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.030

depending on the duration of the employment, a maximum of four months for the employer. Their contracts expire on the expected date of retirement or by notice by either party. Walter van de Vijver was employed by one of the Group Holding Companies on similar terms and conditions. Linda Cook's contract is with Shell Expatriate Employment US Inc. on an "at-will" basis.

Walter van de Vijver resigned as a Managing Director of the Company on March 3, 2004. His employment terminated with effect from September 1, 2004. Under the terms of the agreement addressing termination of his employment contract he will be eligible to receive a total of €3.8 million.

Supervisory Board Members

Under the Articles of Association the remuneration of the members of the Supervisory Board is the responsibility of the General Meeting and is determined within the limits set by shareholders. Supervisory Board members receive fees of €55,000 per annum and the Chairman's fee is an additional €15,000 per annum. Fees for each membership of the committees of the Supervisory Board are €7,000.

Emoluments of Managing Directors of Royal Dutch in office during 2004 €

	Salaries	Annual bonus[a]	Payment following severance	Other benefits[b]	Total
Jeroen van der Veer					
2004	**1,281,774[c]**	**1,350,000**	**–**	**18,043**	**2,649,817**
2003	1,120,000	0	–	11,502	1,131,502
2002	1,013,729	1,230,500[d]	–	4,768	2,248,997
Malcolm Brinded					
2004[e]	**148,080**	**160,503[f]**	**–**	**6,156**	**314,829**
2003	800,000	0	–	23,707	823,707
2002[e]	372,500	428,375[g]	–	2,210[h]	803,085
Linda Cook					
2004[h]	**338,892**	**442,000**	**–**	**189,623**	**970,515**
Rob Routs					
2004	**884,516**	**810,000**	**–**	**139,850**	**1,834,366**
2003	405,000	0	–	55,612	460,612
Walter van de Vijver					
2004[i]	**186,774**	**0**	**1,900,000**	**7,074**	**2,093,848**
2003	842,500	0	–	26,060	868,560
2002	735,095	902,750	–	18,091[j]	1,655,936

a The annual bonus is included in the related performance year and not in the following year in which it is paid.
b Includes social security premiums paid by the employer, employer's contribution to the health insurance plan, where applicable school fees and other benefits stated at a value employed by the Fiscal Authorities in the Netherlands.
c Jeroen van der Veer's salary increase with effect from November 1, 2004 did not come into payment until 2005 and will therefore be reported in the 2005 Annual Report and Accounts.
d Of which one-third was deferred under the Deferred Bonus Plan.
e Malcolm Brinded was appointed as a Managing Director of Royal Dutch with effect from July 1, 2002 until March 3, 2004, therefore, where appropriate, the 2002 and 2004 emoluments are prorated.
f Malcolm Brinded's 2004 annual bonus amounted to £634,500 for the full year. His annual bonus from March 4, 2004 to December 31, 2004 has been listed in the 2004 Shell Transport Annual Reports and Accounts. Sterling converted to euro at the quarterly average rate of exchange.
g Exclusive of deferred payment in shares amounting to £386,000 granted in 1999.
h Linda Cook was appointed as a Managing Director of Royal Dutch with effect from August 1, 2004, therefore, where appropriate, the 2004 emoluments are prorated. US dollar converted to euro at the monthly average rate of exchange.
i Rob Routs was appointed as a Managing Director of Royal Dutch with effect from July 1, 2003, therefore, where appropriate, the 2003 emoluments are prorated.
j Walter van de Vijver resigned as a Managing Director of Royal Dutch on March 3, 2004, therefore, where appropriate, the 2004 emoluments are prorated.
k Exclusive of deferred payment in shares amounting to €598,930 granted in 1999.

Emoluments of the Members of the Supervisory Board €

	2004	2003	2002
Aad Jacobs	**77,000**	77,000	58,750
Maarten van den Bergh[a]	**93,468**	89,711	82,021
Wim Kok	**62,000**	31,000	–
Aarnout Loudon	**69,000**	69,000	60,000
Hubert Markl	**62,546**	55,000	23,000
Christine Morin-Postel[b]	**31,000**	–	–
Lawrence Ricciardi	**90,500**	79,875	46,000
Henny de Ruiter[a]	**48,484**	96,711	85,521

a Maarten van den Bergh and Henny de Ruiter received fees from the Group Holding Companies in respect of duties performed by them as Directors of these Companies.
b Appointed as from July 1, 2004.
c Retired on June 30, 2004.

Share interests and stock options in the Company of members of the Supervisory Board and Managing Directors as at December 31, 2004:

	Stock options	Ordinary shares
Supervisory Board		
Aad Jacobs	0	0
Maarten van den Bergh[a]	37,950	4,000
Wim Kok	0	0
Aarnout Loudon	0	75,000
Hubert Markl	0	0
Christine Morin-Postel	0	0
Lawrence Ricciardi	0	10,000
Managing Directors		
Jeroen van der Veer	519,600	10,512
Linda Cook[b]	337,725	217
Rob Routs	302,466	0

Excluding priority shares and shares under the Deferred Bonus Plan, which will be released in principle three years after deferral.

a No options are granted to members of Supervisory Board, but options may be outstanding to members who have formerly been a Managing Director.
b Excludes 26,087 Stock Appreciation Rights.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00093 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.031

Summary Annual Accounts

Profit and Loss Account (€ million)

	2004	2003 As restated	2002 As restated
Share in the net income of companies of the Royal Dutch/Shell Group from continuing operations	7,958	6,398	5,957
Share in the net income of companies of the Royal Dutch/Shell Group from discontinued operations	754	13	119
Share in the net income of companies of the Royal Dutch/Shell Group	8,712	6,411	6,076
less Administrative expenses	8	8	5
	8,704	6,403	6,071
Interest income	10	18	28
Profit before taxation	8,714	6,421	6,099
less Taxation	1	3	8
Profit after taxation	8,713	6,418	6,091

Statement of Appropriation of Profit (€ million)

	2004	2003 As restated	2002 As restated
Profit after taxation	8,713	6,418	6,091
Taken from/(to) Statutory investment reserve	(4,870)	(2,543)	(2,759)
Undistributed profits at beginning of year	2,909	3,650	4,712
Final dividend distributed	(2,125)	(2,084)	(2,042)
(Repurchase)/cancellation of share capital	(375)	9	(847)
Unclaimed dividends forfeited	1	1	1
Available for distribution	4,253	4,451	5,156
less Interim dividend[a]	1,562	1,542	1,506
Undistributed profit at end of year[b]	2,691	2,909	3,650

a. Including 4% cumulative preference dividend for 2004 amounting to €26,880 on priority shares (2003: €26,880; 2002: €26,880).
b. Before second interim dividend of €2,165 million (second interim dividend 2003: €2,125 million; final dividend 2002: €2,084 million).

Earnings per share (€)

	Note	2004	2003 As restated	2002 As restated
Basic earnings per ordinary share from continuing operations		3.94	3.14	2.90
Basic earnings per ordinary share from discontinued operations		0.37	0.01	0.06
Basic earnings per ordinary share	6	4.31	3.15	2.96
Diluted earnings per ordinary share from continuing operations		3.93	3.14	2.90
Diluted earnings per ordinary share from discontinued operations		0.37	0.01	0.06
Diluted earnings per ordinary share	6	4.30	3.15	2.96

Balance Sheet (before appropriation of profit) (€ million)

	Note	Dec 31, 2004	Dec 31, 2003 As restated
Fixed assets			
Financial fixed assets			
Investments in companies of the Royal Dutch/Shell Group		37,018	34,349
Investment in associated company		179	–
Current assets			
Receivables			
Dividends receivable from companies of the Royal Dutch/Shell Group		2,130	2,449
Other receivables from companies of the Royal Dutch/Shell Group		44	363
Other receivables		35	56
Cash and cash equivalents		252	8
		2,461	2,856
Current liabilities			
Other liabilities		13	10
Current assets less current liabilities		2,448	2,846
Total assets less current liabilities		39,645	37,195
Shareholders' equity			
Paid-up capital	5		
Ordinary shares		1,165	1,166
Priority shares		1	1
		1,166	1,167
Share premium reserve		1	1
Investment reserves			
Statutory		25,185	22,707
Currency translation differences		1,848	486
Other		8,739	9,910
		35,772	33,103
Other statutory reserves		15	15
Undistributed profit		2,691	2,909
		39,645	37,195

Statement of Cash Flows (€ million)

	2004	2003	2002
Returns on investments and servicing of finance			
Dividends received from Group companies	4,162	3,401	4,446
Interest received	10	18	32
Other	315	212	(587)
Net cash inflow/(outflow) from returns on investments and servicing of finance	4,487	3,631	3,891
Taxation			
Tax (paid)/recovered	(1)	(4)	(8)
Financing			
Repurchase of share capital, including expenses	(376)	–	(689)
Investment in associated company	(179)	–	–
Dividends paid	(3,687)	(3,626)	(3,536)
Increase/(decrease) in cash and cash equivalents	244	1	(542)
Cash at January 1	8	7	549
Cash at December 31	252	8	7

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00094 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.032

Summary Directors' Remuneration Report

This is a summary of the full Remuneration Report which can be found in the Annual Report and Accounts 2004 and on the Shell website (www.shell.com/annualreport).

Remuneration policy

The Group's remuneration policy is intended to recognise and support the Group's Statement of General Business Principles and strategic direction; as well as the need to attract and retain talented individuals and to motivate and reward Executive Directors for exceptional performance; and to align Executive Directors' interests with those of shareholders.

More than half of an Executive Director's target total remuneration is performance-linked and targeted to the long term. To ensure competitiveness, remuneration levels are set by reference to the practice of similar global companies. Performance mechanisms and reward structures are applied consistently to Executive Directors and senior managers.

Base pay

Base pay is set at a competitive level, appropriate to the scope and complexity of the roles of Chief Executive and Executive Director, and levels are benchmarked against relevant comparator groups.

Annual Incentive

Executive Directors are eligible for an annual bonus. Performance during the year is measured against the Group Scorecard and annual bonus awards are made to reflect that performance. There are four components to the 2005 Scorecard: total shareholder return (TSR), operational cash flow, operational excellence in each of the businesses and sustainable development. The target level for bonus payments for Executive Directors in 2005 will be 100% of base pay.

Long-term incentives

In 2004, the Remuneration and Succession Review Committee (REMCO) reviewed the Group's long-term incentives for Executive Directors and senior management and the proposals for change are being presented to shareholders for approval at the 2005 Annual General Meeting.

The key recommendations are: to discontinue stock option grants in favour of grants under the amended Long-Term Incentive Plan (LTIP); and to amend the Deferred Bonus Plan to introduce long-term performance conditions to the release of most of the matching shares. These amendments would not lead to an increase in the overall value of compensation for Executive Directors.

Pension policy

Retirement benefit arrangements for all staff are based on local market conditions and the overall value of the remuneration package necessary to attract and retain high-calibre individuals. The latest date on which Executive Directors may retire is June 30, following their 60th birthday.

Contracts policy

Contracts for Executive Directors are based on country-specific labour laws and market practice. They contain similar terms and conditions as for senior employees in the country concerned.

Shareholdings

Following discussions with shareholders in 2004, a new shareholding policy has been introduced. Executive Directors are expected to build up shareholdings to the value of twice their base pay over five years. Until this target is met, they are required to retain 50% of the shares received through the vesting of future LTIP awards and vested matching shares under the Deferred Bonus Plan and maintain that level until retirement.

Actual remuneration in 2004

Base pay

Salary scales were not increased during 2004. However, Malcolm Brinded's base pay was increased from March 3, 2004 on his appointment to the role of Vice Chairman of the Committee of Managing Directors.

Annual Incentive

Executive Directors were eligible for a bonus related to the 2004 financial year reflecting performance against the Group Scorecard. Having regard to the Group's performance against all targets, REMCO recommended and it was decided that the annual bonuses payable to Executive Directors in respect of the year 2004 are 90% of base pay.

Stock options

Stock options granted to Executive Directors in 2004 were 100% performance-linked. Stock options granted in March 2002 were 50% performance-linked and were due to vest in March 2005. Taking into account the financial performance conditions over those three years, the committee decided that none of the 2002 performance vesting stock options should vest. None of the Directors of Shell Transport realised any stock options gains during 2004.

Long-Term Incentive Plan

REMCO recommended that Executive Directors be made a conditional award of performance shares under the LTIP with a face value of twice the individual's base pay. During 2004, Malcolm Brinded was awarded 353,383 performance shares, and Peter Voser 252,314. The market price at the date of award was £3.99 and £4.32 respectively. The actual number of shares received will be determined in 2007.

Pensions

In 2004, the employing company contribution rate to the Shell Contributory Pension Fund was 17.7%. Employees' contributions to the Shell Overseas Contributory Pension Fund during 2004 were 30%. Managing Directors contributed 2% up to £30,000 per annum of relevant earnings and 6% of relevant earnings in excess of £30,000 per annum to these plans during the year. The 2004 contribution rates for the Shell Swiss Expatriate Pension Fund were 10% for both company and employees. During 2004, four Managing Directors accrued retirement benefits under defined benefit plans. In 2004, one Managing Director also

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00095 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.033

Emoluments of Managing Directors in office during 2004

£

	Salary and fees	Annual bonus[a]	Payment following severance	Car benefit	Other benefits	Total
Malcolm Brinded						
2004[d]	601,478	525,283[d]	–	12,381	9,261	1,148,403
Judith Boynton[e]						
2004	222,926	0	553,827[f]	0	0	776,753
2003	381,833	0	–	0	18,937	400,770
Peter Voser[g]						
2004	788,935	0	–	0	0	788,935
Sir Philip Watts[h]						
2004	219,196	0	1,057,971	3,773	0	1,280,940
2003	842,021	0	–	21,876	0	864,897
2002	745,969	874,000[i]	–	21,922	0	1,641,891

The aggregate amount of remuneration paid to or accrued to Managing Directors of Shell Transport as a group by Shell Transport and companies of the Group for services in all capacities during the financial year ended December 31, 2004, was £3,992,031.

a The annual bonus is included in the related performance year and not in the following year in which it is paid.

b The car benefit is the notional taxable cash equivalent of the cost of company-provided vehicles.

c Malcolm Brinded was appointed a Shell Transport Managing Director with effect from March 3, 2004. Therefore his Shell Transport emoluments are shown from this date. His emoluments during 2002, 2003 and up to and including March 3, 2004 have been filed in the 2004 Royal Dutch Annual Report and Accounts.

d Malcolm Brinded's 2004 annual bonus amounted to £534,500 for the full year. His annual bonus up to and including March 3, 2004 has been filed in the 2004 Royal Dutch Annual Report and Accounts.

e Judith Boynton was appointed to the Board on July 1, 2003. Judith Boynton stepped down as Group Chief Financial Officer and as Group Managing Director and Managing Director of Shell Transport on April 19, 2004. She remained with the Group in an advisory capacity reporting to the Group Chief Executive, Jeroen van der Veer. Ms Boynton left the Group, by mutual agreement, effective December 31, 2004. Where appropriate, the 2003 and 2004 emoluments are reported. Her benefits include the provision of a housing allowance. The emoluments she received from the Group in respect of this period amounted to £542,367.

f This amount was paid in January 2005 following cessation of Judith Boynton's employment on December 31, 2004. It includes an amount of £35,227 in respect of Shell Transport fees Judith Boynton would have received had she remained as a director until December 31, 2004.

g Peter Voser was appointed a Shell Transport Managing Director with effect from October 4, 2004. Therefore, where appropriate, the 2004 emoluments are reported. His salaries and fees include a one-off retention payment of £645,000 paid on joining the Group. He was not eligible for a 2004 annual bonus.

h Sir Philip Watts resigned as a Shell Transport Managing Director and as an employee on March 3, 2004. Therefore, where appropriate, his 2004 emoluments are reported. His salary and fees include compensation for unused leave days.

i Of which one third was deferred under the Deferred Bonus Plan.

accrued retirement benefits under defined contribution schemes and the aggregate company contributions to these schemes was £43,155.

Contracts

The Managing Directors of Shell Transport have employment contracts with one of the Group Holding or Service Companies. The contracts provide entitlement to notice of three months. Such contracts expire on the expected date of retirement or by notice of either party.

Malcolm Brinded's current contract does not contain any pre-determined settlement agreements for early termination. Peter Voser's contract includes a temporary severance arrangement in the case of a company-initiated termination for reasons other than gross misconduct. Sir Philip Watts' severance payment following his resignation as a Managing Director of Shell Transport, and as an employee, consisted of a lump sum payment of £1,057,971. Judith Boynton who left the Group, by mutual agreement, received a severance payment of $1,000,000 (£518,600).

Performance graph

The graph opposite compares, on the basis required by Schedule 7A to the Companies Act 1985, the TSR of Shell Transport and that of the companies comprising the FTSE100 share index over the five-year period from 2000 to 2004.

Non-executive Directors

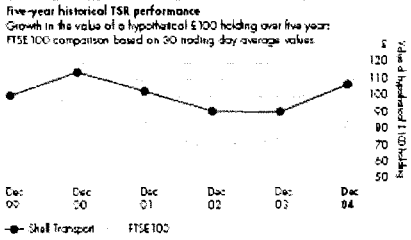
Remuneration policy

Under the Articles of Association the remuneration of all Directors of the Company is determined by the Board within a limit set by shareholders. All Non-executive Directors of Shell Transport are paid an annual fee of £50,000 with additional fees for serving as Chairman of Committees and Chairman of the Board. The aggregate amount of Non-executive Directors' fees paid to or accrued for Non-executive Directors of Shell Transport and companies of the Group for services in all capacities during 2004 was £604,116.

Five-year historical TSR performance

Growth in the value of a hypothetical £100 holding over five years

FTSE100 comparison based on 30 trading day average values



VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00096 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.034

2003 Royal Dutch Petroleum Company

Remuneration

Emoluments of Managing Directors in office during 2003

€

	Salaries	Annual bonus[a]	Other benefits[b]	Total
Jeroen van der Veer				
2003	**1,120,000**	**0**	**11,502**	**1,131,502**
2002	1,013,729	1,230,500[c]	4,768	2,248,997
2001	923,929	619,450[c]	4,620	1,547,999[d]
Malcolm Brinded				
2003	**800,000**	**0**	**23,707**	**823,707**
2002[e]	372,500	428,375[c]	2,210[f]	803,085
Rob Routs				
2003[g]	**405,000**	**0**	**55,612**	**460,612**
Walter van de Vijver				
2003	**842,500**	**0**	**26,060**	**868,560**
2002	735,095	902,750	18,091[h]	1,655,936
2001[i]	342,536	221,330	2,162	566,028

a The annual bonus is included in the related performance year and not in the following year in which it is paid.

b Includes social security premiums paid by the employer, employee's contribution to the health insurance plan, where applicable school fees, and, where applicable, other benefits stated at a value employed by the Fiscal Authorities in the Netherlands.

c Of which one-third was deferred under the Deferred Bonus Plan.

d The total for 2001 as stated in the Annual Report and Accounts 2002 was €1,041,439 and included an amount for realised share option gains upon exercise of €293,440. In 2002, there were no realised share option gains upon exercise. From 2003 these gains will be shown in the Stock options table. The total for 2001, as reported here, has been restated to reflect this change.

e Malcolm Brinded was appointed a Managing Director with effect from July 1, 2002, therefore where appropriate, the 2002 emoluments are provided.

f Exclusive of deferred payment in shares amounting to 1386 000 granted in 1999.

g Rob Routs was appointed a Managing Director with effect from July 1, 2003, therefore, where appropriate, the 2003 emoluments are provided.

h Exclusive of deferred payment in shares amounting to 6688 839 granted in 1999.

i Walter van de Vijver was appointed a Managing Director with effect from July 1, 2001, therefore, where appropriate, the 2001 emoluments are provided.

Stock options

Options Royal Dutch

	Number of options							Expected value of the 2003 stock options granted[b] €	Realisable gains as at Dec 31, 2003[c] €	Realised gains on stock options exercised
	At Jan 1 2003	Granted during the year	Exercised (cancelled) lapsed during the year	At Dec 31 2003	Exercise price[a] €	Exercisable from date	Expiry date			
Jeroen van der Veer	40,850	-	-	40,850	41.16	22.12.01	21.12.08	-	26,144	-
	45,000	-	(11,250)	33,750	59.54	23.03.03	22.03.10	-	0	-
	80,000	-	-	80,000	62.60	26.03.04	25.03.11	-	-	-
	105,000	-	-	105,000	62.10	21.03.05	20.03.12	-	-	-
	-	150,000	-	150,000	36.81	19.03.06	18.03.13	1,214,730	-	-
Malcolm Brinded	50,000	-	-	50,000	62.10	21.03.05	20.03.12	-	-	-
	-	115,000	-	115,000	36.81	19.03.06	18.03.13	931,293	-	-
Rob Routs	20,000	-	-	20,000	41.16	22.12.01	21.12.08	-	12,800	-
	18,000	-	-	18,000	59.54	23.03.03	22.03.10	-	0	-
	50,000	-	-	50,000	62.10	21.03.05	20.03.12	-	-	-
	-	49,400	-	49,400	36.81	19.03.06	18.03.13	400,051	-	-
	-	50,066[d]	-	50,066	40.95	19.08.06	18.08.13	451,045	-	-
Walter van de Vijver	10,000	-	-	10,000	48.92	11.12.00	10.12.07	-	0	-
	20,000	-	-	20,000	41.16	22.12.01	21.12.08	-	12,800	-
	32,000	-	(8,000)	24,000	59.54	23.03.03	22.03.10	-	0	-
	10,000	-	(2,500)	7,500	68.73	23.08.03	22.08.10	-	0	-
	40,000	-	-	40,000	62.60	26.03.04	25.03.11	-	-	-
	75,000	-	-	75,000	62.10	21.03.05	20.03.12	-	-	-
	-	115,000	-	115,000	36.81	19.03.06	18.03.13	931,293	-	-
Maarten van den Bergh[e]	37,950	-	-	37,950	41.16	22.12.01	29.06.05	-	24,288	-
Options Shell Transport					£			£		
Malcolm Brinded	37,500	-	-	37,500	4.39	11.12.00	10.12.07	-	0	-
	159,200	-	-	159,200	3.63	22.12.01	21.12.08	-	73,080	-
	245,000	-	(61,250)	183,750	5.05	23.03.03	22.03.10	-	0	-
	14,000	-	-	14,000	5.60	13.11.03	12.11.10	-	0	-
	278,200	-	-	278,200	5.52	26.03.04	25.03.11	-	-	-

a The exercise price is the average of the opening and closing share prices over a period of five trading days prior to and excluding the day on which the options are granted (ex dividend).

b The expected values of the 2003 stock options grants have been calculated on the basis of the Black-Scholes model valuations provided by Towers Perrin and Kaplan Associates. The values are unaudited. The expected value is equal to 22% of the face value of the grant.

c Represents the value of unexercised stock options at the end of the financial year, which is calculated by taking the difference between the exercise price of the option and the fair market value of Royal Dutch or Shell Transport shares, respectively, at December 31, 2003, and multiplied by the number of shares under option at December 31, 2003. The actual gain, if any, a Managing Director will realise, will depend on the market price of the Royal Dutch or Shell Transport shares at the time of exercise.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00097 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.035

d In 2003, 25% active employees who received Texaco Stock Appreciation Rights (SARs) while employed by the former alliance with Texaco in the USA, were offered a three-for-two replacement of Texaco SARs with Royal Dutch stock options. As a result of his previous employment with the alliance Rob Routs held 33,337 Texaco SARs which were replaced by 50,006 Royal Dutch stock options under the Group Stock Options Plan in August 2003. The exercise price of these options was the average share price over a period of five trading days prior to and including the day on which the options were granted. The options will vest three years after grant and remain exercisable until 10 years after grant.

e Maarten van den Bergh holds share options relating to his former service with the Group.

Long-Term Incentive Plan (LTIP)

	At Jan. 1, 2003	Performance shares conditionally awarded during the year	At Dec. 31, 2003	Market price at date of award[a] €	Start of performance period	End of performance period	Expected value of the 2003 performance shares award[b] €
Jeroen van der Veer	–	57,142	57,142	40.95	01.01.03	31.12.05	1,006,185
Malcolm Brinded	–	41,758	41,758	40.95	01.01.03	31.12.05	735,296
Rob Routs	–	39,560	39,560	40.95	01.01.03	31.12.05	696,592
Walter van de Vijver	–	43,956	43,956	40.95	01.01.03	31.12.05	773,999

a The market price is based on the average of the opening and closing share prices over a period of five trading days prior to and including the day on which the number of shares are determined in accordance with the Plan rules.

b The expected values of the 2003 conditional performance shares awards have been calculated on the basis of a standard valuation approach provided by Towers Perrin and Kepler Associates. The values are uncapped. The expected value based on this approach is equal to 43% of the face value of the award. The end of the performance period is not until December 31, 2005, however, if the agreed performance criteria were to be applied at December 31, 2003, some of the shares would rightfully be released.

Deferred Bonus Plan

	Number of deferred bonus and dividend shares under award as at January 1, 2003	Deferred bonus shares awarded during the year[a]	Market price of deferred bonus shares at award[b] €	Dividend shares accrued during the year[c]	Average market price of dividend shares paid during the year[d] €	Total number of deferred bonus and dividend shares under award as at December 31, 2003
Jeroen van der Veer						
2003 award	–	11,188	36.66	507	39.04	11,695
2002 award	3,549	–	60.09	161	39.04	3,710
Malcolm Brinded						
2003 award	–	6,426	36.66	292	39.04	6,718

Awards made in 2002 and 2003 refer to the portion of the annual bonus deferred in respect of 2001 and 2002 and their related accrued dividends.

a Representing the proportion of the annual bonus that has been deferred and converted into notional share entitlements (deferred bonus shares), which will not result in beneficial ownership until they are released. The value of these deferred bonus shares is also included in the annual bonus figures in the Emoluments of Managing Directors table on page R16.

b The market price is based on the average share price over a period of five trading days prior to and including the day on which the share awards are made.

c Representing dividends paid during the year on the number of shares equal to the deferred bonus shares awarded.

d The market price shown is the average of the date of the 2002 final and 2003 interim annual dividends paid during the year: €37.60 and €40.47, respectively.

Pensions

	Age as at Dec. 31, 2003	Years of Group service as at Dec. 31, 2003	Increase in accrued pension during 2003 € thousand	Accumulated annual pension as at Dec. 31, 2003 € thousand	Pension premium 2003 paid by employer € thousand	Pension premium 2002 paid by employer € thousand
Jeroen van der Veer	56	32	76	675	171	0
Malcolm Brinded	50	29	54[a]	472[b]	622[c]	37
Rob Routs[d]	57	25	8	452	81	–
Walter van de Vijver	48	24	61	375	129	0

a Includes an accrued pension increase and the movement in the exchange rate between sterling and the euro over the period disclosed, sterling converted to euro at the average quarterly rate of exchange.

b Sterling converted to euro against year-end rate of exchange.

c As a result of the 2002 valuation of the SCOPF fund the Actuary requested that an additional one-time company contribution to the fund be paid. The amount stated comprises the basic pension increase and a prorated amount relating to this additional employer contribution. Sterling converted to euro at the average quarterly rate of exchange.

d As from July 1, 2003, RDMCO considered it important to apply the policy of treating Dutch Managing Directors of Royal Dutch in a cohesive and consistent manner, which implied participation in the Dutch pension plan. Rob Routs accrued the majority of his pension rights during his previous employment with Shell Canada. Taking into account his retirement during 2007, it has been decided to provide the same (pension entitlements that he would have received) had he remained in the Canadian plan. A number of his accrued Canadian rights to the Stichting Shell Pensioenfonds required a net additional cash funding by the Group of €3,074 thousand (partly to offset Canadian tax withholdings of 25%), resulting in five additional years of service. This was the most cost-effective resolution within the various relevant national legal and tax regimes.

Pensions

For employees in the Netherlands their contribution to the pension plan offered by the Stichting Shell Pensioenfonds was 5% during the first half year and 8% during the second half year of 2003. The employing company contribution rate was 10% until July 1, 2003 and 20% thereafter. The non-Dutch Managing Director contributed 4% of relevant earnings to the plan offered by the Shell Overseas Contributory Pension Fund during the year. The employing company's contribution rate in 2003 was 30% of relevant earnings.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00098 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.036

2003 Shell Transport & Trading

2003 actual remuneration[1]

Base pay
The salary scales for the Shell Transport Managing Directors were increased by 10% on average with effect from July 1, 2003.

Annual incentive
The target level of bonus for the year 2003 was 100% of base pay, in line with market practice. Having regard to the Group's performance, REMCO recommended that no annual bonuses be payable to Managing Directors in respect of the year 2003.

Stock options
For the grant of stock options in March 2003 REMCO took into account TSR and ROACE based on three-year averages of 2000, 2001, and 2002. This resulted in a grant based on a performance rating of 0.94 (see Remuneration policy – Stock options on page 515 for further information on this rating).

Stock options granted in March 2001 were due to vest in March 2004. The performance period for the options was January 1, 2001 to December 31, 2003. The Royal Dutch/Shell Group ranked fifth on TSR against the industry peer group (three-year average over the period 2001 to 2003). REMCO recommended that the options granted under performance conditions should not vest (50% of the grant). Therefore only the remaining 50% of the options granted in March 2001, which vest over time, vested in March 2004.

Long-Term Incentive Plan
REMCO recommended that each Group Managing Director be made a conditional award of performance shares with a face value of two times the individual's base pay, which took place on August 19, 2003. The actual number of shares received will be determined in 2006 and will be based on the Group's performance and competitive position over the period 2003 to 2005.

Emoluments of Executive Directors in office during 2003 £

	Salaries and fees	Annual bonus[a]	Car benefit[b]	Other benefits	Total
Sir Philip Watts					
2003	**843,021**	**0**	**21,876**	**0**	**864,897**
2002	745,969	874,000[c]	21,922	0	1,641,891[d]
2001	607,398	455,000[c]	20,089	0	1,082,487[d]
Judith Boynton[e]					
2003	**381,833**	**0**	**0**	**18,937**	**400,770**
Paul Skinner[f]					
2003	**646,409**	**0**	**9,435**	**0**	**655,844**
2002	553,830	602,500	13,181	0	1,169,511[g]
2001	504,703	338,000[c]	14,924	0	857,627[g]

a The annual bonus is included in the related performance year and not in the following year in which it is paid.

b The car benefit is the Inland Revenue defined cash equivalent of the cost of company-provided vehicles.

c Of which one-third was deferred under the Deferred Bonus Plan. The deferred bonus shares, dividend shares and conditional matching shares in respect of such deferral are disclosed for 2001 and 2002 in the Deferred Bonus Plan table on page 520.

d The totals for 2002 and 2001 as stated in the Annual Report and Accounts 2002 included amounts for realised share option gains and deferred bonus plan adjustments, and were £1,902,198 and £1,066,488, respectively. The realised share option gains in 2002 and 2001 were £8,238 and £508,167, respectively. From 2003 these are shown in the Stock options table. The deferred bonus plan adjustments were £132,069 and £75,834, respectively. From 2003 these will now appear in the Deferred Bonus Plan table as conditional shareholdings, in accordance with Schedule 7A of the Companies Act 1985. The totals for 2002 and 2001, as reported here, have been restated to reflect these changes.

e Judith Boynton was appointed to the Board on July 1, 2003, therefore, where appropriate, the 2003 emoluments are prorated. She is a beneficiary of the Group expatriate policies, which includes the provision of a housing allowance. She also received executive company travel benefits of which the gross value has been included.

f Paul Skinner retired as a Managing Director on September 30, 2003. His salaries and fees include a taxable, non-pensionable full service bonus of £151,250 (25% of base pay), in line with company policy applicable to all UK employees with qualifying service. His salaries and fees also include a discretionary payment of £43,329 to reflect the fact that he did not receive any additional shares under the Deferred Bonus Plan. He was granted the right to purchase his company car on the same terms as other employees.

g The totals for 2002 and 2001 as stated in the Annual Report and Accounts 2002 included amounts for realised share option gains and deferred bonus plan adjustments and were £1,212,505 and £1,419,803, respectively. The realised share option gains in 2002 and 2001 were £8,238 and £505,902, respectively. From 2003 these are shown in the Stock options table. The deferred bonus plan adjustments were £4,750 and £56,354, respectively. From 2003 these will now appear in the Deferred Bonus Plan table as conditional shareholdings, in accordance with Schedule 7A of the Companies Act 1985. The totals for 2002 and 2001, as reported here, have been restated to reflect these changes.

1 The information in the tables on pages 518 to 522 in this section has been subjected to audit, except for the Expected value relations in the Stock options table and in the Long-Term Incentive Plan table on page 519, which are unaudited.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00099 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.037

Stock options

Options Shell Transport

	Number of 25p Ordinary shares under option									
	At Jan 1, 2003	Granted during the year	Exercised (cancelled/ lapsed) during the year	At Dec 31, 2003	Exercise price[a] £	Exercisable from date	Expiry date	Expected value of the 2003 stock options grant[b] £	Realisable gains at Dec 31, 2003[c] £	Realised gains on stock options exercised
Sir Philip Watts[d]	308,750	-	-	308,750	3.63	22.12.01	21.12.08	-	162,094	-
	341,000	-	(85,250)	255,750	5.05	23.03.03	22.03.10	-	0	-
	465,000	-	-	465,000	5.52	26.03.04	25.03.11	-	-	-
	3,251*	-	-	3,251	5.09	01.02.07	31.07.07	-	-	-
	885,000	-	-	885,000	5.23	21.03.05	20.03.12	-	-	-
	-	1,165,000	-	1,165,000	3.66	19.03.06	18.03.13	938,058	-	-
Sir Mark Moody-Stuart[f]	440,800	-	-	440,800	3.63	22.12.01	29.06.06	-	231,420	-
	487,000	-	(121,750)	365,250	5.05	23.03.03	29.06.06	-	0	-
Paul Skinner[g]	139,200	-	-	139,200	4.39	11.12.00	10.12.07	-	0	-
	194,700	-	-	194,700	3.63	22.12.01	29.09.08	-	102,218	-
	341,000	-	(85,250)	255,750	5.05	23.03.03	29.09.08	-	0	-
	465,000	-	-	465,000	5.52	26.03.04	29.09.08	-	-	-
	1,305*	-	-	1,305	5.09	01.10.03	31.03.04	-	0	-
	660,000	-	-	660,000	5.23	21.03.05	29.09.08	-	-	-
	-	800,000	-	800,000	3.66	19.03.06	29.09.08	644,160	-	-

Options Royal Dutch					€ and $			$		
Judith Boynton	80,000	-	-	80,000	€62.02	21.08.04	20.08.11	-	-	-
	60,000	-	-	60,000	€62.10	21.03.05	20.03.12	-	-	-
	-	70,500	-	70,500	$40.64	19.03.04	18.03.13	630,326	-	-

The stock options listed above relate to Shell Transport Ordinary shares, with the exception of those stock options held by Judith Boynton. Other than the Shell Sharesave Scheme options, they have a 10-year term and are not exercisable within three years of grant. Of the stock options granted to Managing Directors before 2003, 50% are subject to performance conditions and 50% will vest over time. These performance conditions include TSR and other long-term indicators of Group performance over a three-year period. TSR is measured relative to other major integrated oil companies. 100% of the stock options granted in 2003 are subject to performance conditions. Details of these performance conditions can be found in Remuneration policy – Stock options on page 515. The price range of the Shell Transport Ordinary shares during the year was £3.32 to £4.40 and the market price at year-end was £4.16.

The stock options listed above for Judith Boynton, granted to her before she became a Managing Director, relate to Royal Dutch ordinary shares and have a 10-year term. The euro-based options are not exercisable within three years of grant, the US-dollar based options vest in equal tranches over three years. The price range of the Royal Dutch ordinary shares listed at the Euronext Exchange during the year was €33.35 to €44.58 and the market price at year end was €41.80. The price range of the Royal Dutch ordinary shares listed at the NYSE during the year was $36.69 to $52.70 and the market price at year end was $52.39.

There were no other changes in the above interests in share options during the period from December 31, 2003 to May 11, 2004.

a The exercise price is the average of the opening and closing share prices over a period of five trading days prior to and including the day on which the stock options are granted (no discount). For the US-dollar based options of Judith Boynton, the exercise price is the NYSE closing price on the date of grant (no discount). The exercise price of the Shell Sharesave Scheme options is the mid-market price on the day of the launch of the plan in the year concerned.

b The expected values of the 2003 stock options grants have been calculated on the basis of the Black-Scholes model valuations provided by Towers Perrin and Kepler Associates. The values are unrealised. The expected value is equal to 22% of the face value of the grant.

c Represents the value of unexercised stock options at the end of the financial year, which is calculated by taking the difference between the exercise price of the option and the fair market value of Shell Transport or Royal Dutch shares, respectively, at December 31, 2003, multiplied by the number of shares under option at December 31, 2003. The actual gain, if any, a Managing Director will realise, will depend on the market price of the Shell Transport or Royal Dutch shares at the time of exercise.

d As for other employees who receive stock options under the same Group plans, Group Managing Directors may, at the discretion of the company, continue to hold and exercise the options for a further five years after leaving employment. Upon Sir Philip Watts' resignation on March 3, 2004, the exercise dates of his options remain unchanged if the original expiry date was earlier than five years after this date, and change to March 2, 2009, if the original expiry date was later than five years after this date.

e These options are held under the Shell Sharesave Scheme of The Shell Petroleum Company Limited.

f Sir Mark Moody-Stuart holds share options relating to his former service with the Group.

g The exercise dates of Paul Skinner's stock option grants have been adjusted in accordance with plan rules to reflect his retirement.

Long-Term Incentive Plan (LTIP)

	At Jan 1, 2003	Performance shares conditionally awarded during the year	At Dec 31, 2003	Market price at date of award[a] £	Start of performance period	End of performance period	Expected value of the 2003 performance shares award[b] £
Sir Philip Watts[c]	-	427,872	427,872	4.09	01.01.03	31.12.05	752,498
Judith Boynton[d]	-	266,475	266,475	4.09	01.01.03	31.12.05	468,650

100% of the performance shares awarded in 2003 are subject to performance conditions. Details of these conditions can be found in Remuneration policy – Long-Term Incentive Plan (LTIP) on page 515.

a The market price is based on the average of the opening and closing share prices over a period of five trading days prior to and including the day on which the number of shares are determined in accordance with the Plan rules.

b The expected values of the 2003 performance shares awards have been calculated on the basis of a standard valuation approach provided by Towers Perrin and Kepler Associates. The values are unrealised. The expected value based on this approach is equal to 42% of the face value of the award.

c Upon Sir Philip Watts' resignation on March 3, 2004, the agreed performance conditions were applied to the 2003 award and none of the shares qualified for release.

d As part of his remuneration prior to her appointment as a Managing Director, Judith Boynton received 17,000 conditional Royal Dutch ordinary shares on October 1, 2002, these will be released on October 1, 2005.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00100 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.038

2002 Royal Dutch Petroleum Company

Emoluments of Managing Directors €

	2002	2001	2000
Jeroen van der Veer			
Salaries	**1,013,729**	923,929	824,201
Performance-related element[a]	**1,230,500**[b]	619,450[b]	398,601
Total cash	**2,244,229**	1,543,379	1,222,802
Other compensation[c]	**4,768**	4,620	4,486
Realised share option gains upon exercise	**–**	293,440	339,600
	2,248,997	1,841,439	1,566,888
Malcolm Brinded			
Salaries	**372,500**	–	–
Performance-related element[a]	**428,375**[b]	–	–
Total cash	**800,875**	–	–
Other compensation[c]	**2,210**[d]	–	–
Realised share option gains upon exercise	**–**	–	–
	803,085	–	–
Harry Roels			
Salaries	**2,587,973**[e]	743,779	697,598
Performance-related element[a]	**–**	501,430	318,145
Total cash	**2,587,973**	1,245,209	1,015,743
Other compensation[c]	**2,282**	4,553	4,421
Realised share option gains upon exercise	**–**	–	–
	2,590,255	1,249,762	1,020,164
Walter van de Vijver			
Salaries	**733,095**	342,536	–
Performance-related element[a]	**902,750**	221,330	–
Total cash	**1,637,845**	563,866	–
Other compensation[c]	**18,091**[f]	2,162	–
Realised share option gains upon exercise	**–**	–	–
	1,655,936	566,028	–

a The performance-related element is included in the year to which it relates.

b Of which one-third was deferred under the Deferred Bonus Plan.

c Includes social security premiums paid by the employer and employer's contribution to the health insurance plan and, where applicable, other benefits stated at a value employed by the Fiscal Authorities in the Netherlands.

d Exclusive of deferred payment in shares amounting to £385,000 granted in 1999.

e Includes lump sum on departure

f Exclusive of deferred payment in shares amounting to €688,839 granted in 1999.

Pensions € thousand

	Age as at 31.12.02	Years of Group service as at 31.12.02	Increase in accrued pension during 2002	Accumulated annual pension in at 31.12.02	Pension premium 2002 paid by employer
Jeroen van der Veer	55	31	67	599	0
Malcolm Brinded	49	28	7[a]	418	37[a]
Harry Roels[b]	54	30	(18)	435	0
Walter van de Vijver	47	23	27	314	0

a As from July 1, 2002.

b Mr Roels left Group service on June 30, 2002, with a deferred pension payable as from his normal retirement date.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00101 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.039

2002 Shell Transport & Trading

Remuneration of the Directors

Emoluments of Directors in office during 2002 £

	2002	2001	2000
Sir Philip Watts:			
Salaries and fees	**745,969**	607,398	496,302
Car benefit[a]	**21,922**	20,089	17,323
Other benefits	–	–	–
Performance-related element[b]	**874,000**[c]	455,000[c]	225,000
Deferred bonus plan adjustment[d]	**152,069**	75,834	–
	1,793,960	1,158,321	738,625
Realised share option gains	**8,238**	508,167	134,400
	1,802,198	1,666,488	873,025
Paul Skinner:			
Salaries and fees	**553,830**	504,703	458,802
Car benefit[a]	**13,181**	14,924	14,965
Other benefits	–	–	655
Performance-related element[b]	**632,500**	338,000[c]	213,750
Deferred bonus plan adjustment[d]	**4,756**	56,334	–
	1,204,267	913,961	688,172
Realised share option gains	**8,238**	505,902	349,704
	1,212,505	1,419,863	1,037,876
Sir Mark Moody-Stuart[e]:			
Salaries and fees	**–**	583,401	710,427
Directors' fees	**39,375**	–	–
Holding Company fees	**18,314**	–	–
Performance-related element[b]	**–**	232,050	321,300
	57,689	815,451	1,031,727
Realised share option gains	**–**	639,360	892,440
	57,689	1,454,811	1,924,167
Teymour Afrazar: Directors' fees	**45,375**	28,750	28,750
Sir Peter Burt: Directors' fees	**21,795**	–	–
Dr Eileen Buttle: Directors' fees	**39,375**	31,875	30,625
Luis Giusti: Directors' fees	**45,375**	26,875	7,500
Nina Henderson: Directors' fees	**45,375**	17,516	–
Sir Peter Job: Directors' fees	**39,375**	11,042	–
Sir John Kerr: Directors' fees	**21,795**	–	–
Professor Robert O'Neill: Directors' fees	**10,910**	30,000	30,000
Lord Oxburgh: Directors' fees	**42,800**	32,475	36,850
Sir William Purves: Directors' fees	**11,612**	34,333	34,333

a Car benefit is the Inland Revenue defined cash equivalent of the cost of company provided vehicles.

b The performance-related element is included in the year to which it relates.

c Of which one-third was deferred under the Deferred Bonus Plan.

d These amounts are the increases accruing during the year in respect of entitlements under the Deferred Bonus Plan in respect of additional shares that will be granted (provided the participant remains in Group employment for three years following initial deferral or reaches normal retirement age within the three-year period).

e Sir Mark Moody-Stuart retired as Chairman and Managing Director on June 30, 2001. His remuneration in 2001 included a "full service bonus" of £198,000. A bonus under this arrangement is paid on retirement to all UK employees with qualifying service.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00102 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.040

John E. Lowe
Executive Vice President
Exploration & Production

Petroleum 3020
600 North Dairy Ashford (77079-1175)
P.O. Box 2197
Houston, TX 77252-2197
phone 281.293.2281

June 26, 2008

The Honorable Patrick Leahy
Chairman, Committee on the Judiciary
U.S. Senate
224 Dirksen Senate Office Building
Washington, D.C. 20510-6275

Dear Senator Leahy:

I am attaching our company's responses to the written questions from members of the Senate Committee on the Judiciary you forwarded to us in your May 29, 2008 letter. We appreciate you extending the response deadline to June 26, 2008 as it allowed us to spend the time required to address some of the more complex questions.

Please direct any further questions on this response to Jeff Reamy, in our Washington, D.C. office. His telephone number is (202) 833-0922.

We appreciate the opportunity to share our views on the energy security challenges that the U.S. is facing and what our beliefs on what this nation needs to do about it. We look forward to further dialogue with your committee on this important topic.

Sincerely,

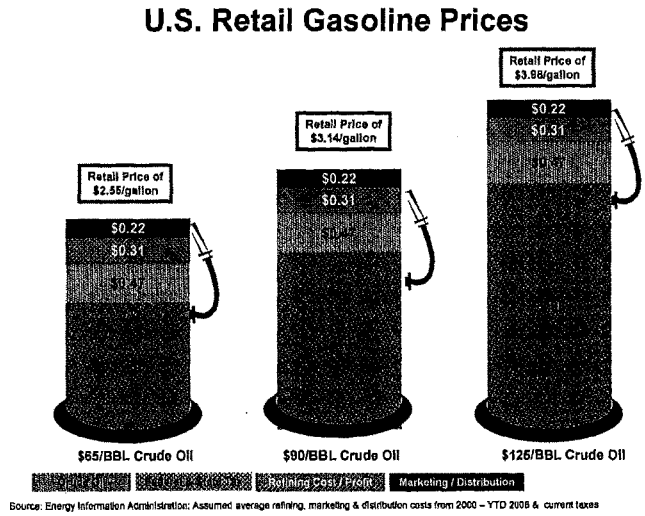
John E. Lowe

43354.041

Questions of Chairman Patrick Leahy
Following the Senate Judiciary Committee Hearing
"Exploring the Skyrocketing Price of Oil"

1. Mr. Hofmeister testified last week that the price of crude oil should be in the range of $35 to $65 a barrel. If the price of crude oil on the world market returned to that competitive level, what could your company charge for a gallon of gas and remain profitable?

It is difficult to assess the level of future gasoline prices at which ConocoPhillips will be profitable because there are many factors that influence profitability. However, the price of gasoline is primarily a function of the price of crude oil as reflected in the chart below.



This chart, based on historical market pricing and the U.S. Department of Energy and other estimates of the components of retail gasoline prices, projects what the retail gasoline price should be at a $65, $90 and $125 per barrel crude oil price. This analysis is simplified for the purposes of explaining the impact of crude price changes. The estimates assume that refining, distribution and marketing costs remain at the average level for 2000 through mid-2008 and federal, state and local sales taxes remain at present levels for all three cases. The chart shows that at a $125 per barrel crude price, crude accounts for $2.98 of the projected pump price of $3.98 per gallon, with the remaining $1.00 per gallon accounting for all other costs and taxes. At a $90 per barrel crude oil price, the crude cost would be $2.14 per gallon and the overall retail price would be $3.14 per gallon. At a $65 per barrel crude oil price, the crude cost would be $1.55 per gallon and the overall retail price would be $2.55 per gallon.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00104 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.042

In the actual market, some of the other cost components vary with the crude price. However, this produces a good approximation.

2. Each of your companies is vertically integrated from oil exploration and production through refining and retail gasoline sales. I understand that the price of crude oil is set on the world market, and that your companies, for the most part, sell the crude oil they produce on the market and then buy back the crude oil that they refine. I further understand that each of your companies refines more oil than it produces.

The efficiencies that come from vertical integration, however, should include the ability to refine the oil that you produce in a manner that is less expensive than if purchased in the commodities market.

(a) What is your company doing to make vertical integration work for consumers?

Although some vertical integration is achieved where it makes business sense, ConocoPhillips is not fully integrated from exploration and production to retail gasoline sales. Currently, we own and operate only 324 retail sites in the United States. With respect to integration of our oil production and refining operations, ConocoPhillips currently refines approximately 38 percent of the crude oil that it produces in the U.S., but this serves as less than 10 percent of our total crude purchases for our U.S. refineries. In many cases, our crude oil production is either too distant from our refineries to be economical or of a quality that cannot be run or that would not enable us to maximize production volumes and values based on our refinery configuration.

We have, and continue to make, substantial investments in our production operations and in our refineries to make the efficiencies of vertical integration improve supply security and reduce our costs of gasoline and other products. We are, for example, trying to utilize our U.S. refining position to secure attractively-priced Canadian oil sands production and enhance the energy security of the United States. For example, in 2007 ConocoPhillips formed a joint venture with EnCana, a Canadian oil sands producer, to make two 50 / 50 operating businesses. One of them includes two of their large oil sands projects. The other includes two of our U.S. refineries. This joint venture is presently working to expand the capabilities of the Wood River refinery in Illinois to handle additional volumes of crude oil from the Canadian oil sands. We applied for a permit for this expansion in May 2006 and are still awaiting approval. The permitting process needs to be reviewed and streamlined in order to promote security of supply for the U.S. and jobs for U.S. contractors and labor.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00105 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.043

The global crude oil market is highly liquid and efficient, with the refining values of particular types of crude oil established through transactions negotiated by many buyers and sellers. The result is a market value established for a given type of crude oil at a given location. Thus, consumers should be indifferent about whether we refine our own crude oil or purchase similar crude oil in the open market. However, consumers would be worse off if we did not process the optimal crude for each refinery, which is what would occur if we processed only our equity crudes in our refineries.

(b) If your company refined only the oil that it actually produced, rather than buying and selling on the world market, what price could it charge for a gallon of gas today and remain profitable?

It is not feasible for ConocoPhillips to rely solely on its own oil production to produce refined products. In 2007, ConocoPhillips produced approximately 360,000 barrels of oil per day in the United States, but processed approximately 1.9 million barrels per day in its U.S. refinery operations. In addition, refinery configurations, equipment, process complexity, metallurgy, etc. vary between refineries so certain crude oil types may process well in one refinery but not be suitable for processing in another.

Moreover, if we and other refineries processed only the crude we produced, there would be a mismatch between the quality and location of the crude versus what is optimal for each refinery. As a consequence, our costs of production would increase and our ability to produce as much of the gasoline and diesel fuel that the market demands would decline, leading to supply short-falls and higher prices.

ConocoPhillips purchases crude that best matches each refinery's configuration while seeking to minimize transportation cost. Thus, we generally refine the crude oil that is the best fit for a specific refinery regardless of whether we or someone else produce it.

The global crude oil market is highly liquid and efficient, with the refining values of particular types of crude oil established through transactions negotiated by many buyers and sellers. The result is a single market value established for a given type of crude oil at a given location. Thus, consumers should be indifferent about whether we refine our own crude oil or purchase similar crude oil in the open market. Consumers would be worse off if we do not process the optimal crude for each refinery, which is what would occur if we processed only our equity crudes in our refineries.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00106 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.044

3. How much has each of your companies spent, directly or indirectly, on studies and reports on climate change? Please specify the studies and reports produced with your companies direct or indirect support.

ConocoPhillips has funded directly, either on our own or in partnership with others, studies and reports that could be considered related to climate change. See the table on the next page for a listing of ConocoPhillips-funded studies and reports. These studies and reports cover a variety of topics including economics, policy and technology. To the best of our knowledge, none of the studies and reports that ConocoPhillips has funded directly relate to the science of global warming. We have not included the studies that we have conducted related to technology development or evaluations of ways to reduce emissions and improve energy efficiency in our operations. Nor have we included membership dues or unrestricted contributions to trade groups or educational institutions.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00107 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.045

ConocoPhillips Direct Funding of Climate Change-related Studies and Reports			
Study / Report	**Year**	**Authors / Study conducted by**	**USD (COP Share)**
Funded only by COP			
Energy Market Consequences of An Emerging U.S. Carbon Management Policy	2008	Baker Institute	$200,000
Market Conditions and the Pass-Through of Compliance Costs in a Carbon Emission Cap-and-Trade Program	2008	NERA	$75,000
Confidential Internal Impact & Risk Assessment Study	2006-08	CH2MHill	$349,433
Funded by COP in Partnership with Others			
Various climate change policy studies	2007-08	Duke University Climate Change Policy Partnership (CCPP)	$500,000
California Chamber Study - Cost effectiveness of AB32	2006	American Council for Capitol Formation	$1,000
California Chamber Study - Economic Analysis of CA Climate Action Team proposals	2006	Sacramento Regional Research Institute	$1,600
Various industry trade association studies on climate policy and economics	2007-08	Various	$134,200
CoalFleet Program	2006-08	Electric Power Research Institute (EPRI)	$100,000
ICO2N - Integrated CO2 Network (a proposed CCS system)	2007-08	ICO2N	$100,000
UK: A Carbon Capture and Storage Network for Yorkshire and Humber	2007-08	Yorkshire Forward (UK local government Regional Development Authority) and 7 partner companies	$14,000
UK: Scottish Carbon Capture & Storage Study	2008-09	Scottish government and industry partners	$30,000
Best Practice Guidance on Modeling of Carbon Dioxide Releases from Transportation Pipelines	2007-08	UK Energy Institute and partner companies	$10,000

5

43354.046

SENATOR KOHL'S FOLLOW-UP QUESTIONS FOR HEARING ON "EXPLORING THE SKYROCKETING PRICE OF OIL"

For John E. Lowe

1. We all recognize that the anti-competitive actions of the OPEC cartel have an important role to play in higher gas prices. In your estimation what would a gallon of gas cost if there was no supply limits imposed by the OPEC cartel?

The primary reason that crude prices are relatively high today is because of the tight oil supply and demand balance and concerns about the sufficiency of future supplies. While OPEC can influence prices by increasing or decreasing production, the ability of OPEC members to quickly lower prices is limited. Most analysts agree that with the exception of Saudi Arabia, OPEC is producing at or near its limit today. In recent years, the sharp increases in economic and oil demand growth in developing countries and supply disruptions in countries like Nigeria and Iraq have resulted in OPEC nations having limited excess crude production capacity. Therefore, we expect that OPEC nations have limited ability in the near-term to lower prices by increasing supply.

2. The FTC has testified to the Antitrust Subcommittee that 85 % of the variability in the cost of gasoline is caused by changes in the price of crude oil. Do you agree?

We agree that changes in the price of crude oil are responsible for most of the variability in the cost of gasoline. We have not done any independent research on this subject but we are aware of a study from the Colorado School of Mines that concludes that 97 percent of the variation in the pre-tax price of gasoline between 1918 and 2006 was caused by changes in crude oil prices.[1]

3. In your opinion, how much of the price of crude oil is due to the speculation by oil traders?

We believe that some investors are diversifying financial risks in their stock and bond portfolios by investing in crude oil and other commodity futures but we have no way of quantifying how much, if any, impact they are having on the price.

[1] Carol Dahl, Colorado School of Mines, "What Goes Down Must Come Up: A Review of the Factors Behind Increasing Gasoline Prices, 1999-2006," April 2007

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00109 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.047

The underlying cause of most of the price increase, however, is that oil supply growth is challenged in the face of significant demand growth in developing countries. One of the primary reasons for this dynamic is that major energy companies such as ConocoPhillips have direct access to only 7 percent of the world's oil and natural gas resources, down from 85 percent in the 1960s. If U.S. policymakers want to increase supply availability and decrease dependence on foreign sources of energy, they should improve access to resources in the United States and refrain from actions that would reduce the competitiveness of U.S. oil and gas companies. Using more domestic resources would also improve the nation's economic security. The $11 trillion-dollar market value of these potential resources at current prices could be far better utilized here at home to gainfully employ thousands of Americans, rather than be transferred to other countries to pay for oil imports.

4. Many experts believe that one important reason for excessive speculation in oil is low margin requirements in oil commodity trading. Unlike with respect to many other commodities and the stock market, a trader can speculate in this market with very small amounts of money, as margin requirements are as low as 8 percent. Do you agree with these experts that margin requirements should be increased in oil trading markets in order to reduce speculation?

We understand the margin to which you are referring to be the initial margin requirement for traders opening a position in crude oil futures. It is important to understand that, as a trader accumulates a loss in his or her position, additional margin requirements are generally imposed on the trader. It is possible that increasing the margin for traders would only impact the smaller participants that are not well capitalized or drive more traders to the non-regulated OTC (over-the-counter) market.

Margin requirements should be set based on the needs of the clearing mechanism, which is designed to protect individual market participants from potential defaulting counterparties. Effecting margin requirements for other purposes could have unintended consequences that harm the market.

5. Much of the crude oil ConocoPhillips and the other U.S. oil companies refine into gasoline and other petroleum products comes from their own oil fields. Overall, the U.S. produces about 40% of the crude oil it consumes. The cost to produce this oil domestically should not be affected in any way by the rising worldwide price of crude oil. So why should the rising price of crude oil on the international markets lead to higher prices with respect to petroleum products refined from your own domestically produced oil? Are the oil companies just profiteering with respect to the oil that comes from the oil fields they own in the United States?

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00110 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.048

The question seems to incorrectly assume that producers of oil in the United States encounter significantly lower marginal production costs and should, therefore, be selling that production at prices less than the prevailing market price. Costs in the United States are among the highest in the world. According to J.S. Herold, finding and developing costs in the U.S. are more than double the average for the world. Basins available to the industry are very mature. New developments are smaller, more remote from existing infrastructure and more technologically complex. More often the oil and natural gas is of poorer quality and from deeper accumulations. It also takes a large amount of capital to maintain production in small fields with declining production. Deep water offshore oil is expensive to develop and requires new infrastructure and complex technologies and processes. With Arctic conditions, operating and development costs in Alaska are very high and the newer fields have heavier oil (less valuable) and are more distant from the pipeline. It would help if the government made new areas available where leasing has been off limits or restricted.

The vast majority of ConocoPhillips' refined products in the United States are produced from crude oil purchased on the worldwide open market rather than from crude oil that we produce in the United States. For example, in 2007, ConocoPhillips produced approximately 360,000 barrels per day of crude oil in the United States, but only 38 percent of that volume was processed in ConocoPhillips' U.S. refineries or nearly 140,000 barrels per day. Given that we processed approximately 1.9 million barrels per day in our U.S. refineries, less than 10 percent of the barrels we processed constituted our equity crude.

We generally do not refine crude oil that we produce unless that crude is the best fit for a specific refinery and transportation costs are economical. If we refined all the crude that we produced, there would be a mismatch between the quality and location of the crude versus what is optimal for each of our refineries, leading to supply short-falls, reductions in refining capacity as a consequence of the mismatched crude characteristics, higher transportation costs and therefore higher prices.

In order to purchase the remaining crude oil for our U.S. refineries, we turn to the open market, where crude oil is bought and sold on a global basis, and market prices are established by many buyers and sellers based on their perceptions of current and future supply and demand fundamentals. Production costs also play an important role in price, because economics dictate that long-term oil prices will settle at the highest cost required to supply incremental barrels of oil needed to satisfy demand. Several financial analysts have calculated that marginal reserve replacement costs today are at $85-$90 per barrel and continuing to rise. Thus, while temporary changes in supply and demand fundamentals may result in prices above or below the long-term "equilibrium" level, the long-term "equilibrium" price is significantly higher than it has been in the past. As with other commodities bought and sold on a worldwide basis, all buyers pay essentially the same market price, adjusted for differences in transportation costs and quality, regardless of where it is produced or consumed. Were that not the case, domestic buyers could not compete with foreign buyers and the U.S. would experience oil shortages.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00111 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

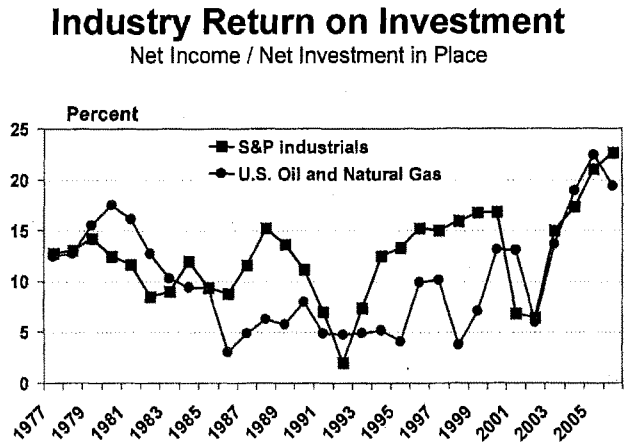
43354.049

It is also incorrect to assume that the cost of producing crude oil in the United States—or the cost of producing refined products—is not affected by worldwide oil prices. Higher worldwide oil prices have led to significant increases in exploration and production activities around the world, as producers seek to add supply in response to increased demand. Similarly, higher oil and refined products prices have led to significant increases in refinery expansions, both in the United States and around the world. This increased development activity has led to significant inflation in costs for, among other things, steel, drilling rigs, compressors, pumps and contractor services. For example, steel costs have doubled since 2001. Higher energy prices have also led to increases in refining costs, as refineries are large consumers of natural gas and electricity. As a consequence, production and refining costs in the United States have risen significantly.

Despite the higher crude prices in recent years, the oil and natural gas industry's earnings as a percentage of sales and returns on investments are in line with other industries as shown in the two figures below.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00112 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.050



Source: U.S. Department of Energy, Energy Information Administration, Performance Profiles of Major Energy Producers, various issues and 2006 S&P figure compiled by PWC from Compustat data

6. In the last 15 years there has been a tremendous amount of consolidation in the oil industry – in its 2004 report, the GAO counted 2600 mergers and acquisitions in this industry since the 1990s alone. Indeed, almost all the companies represented here today are a product of these mergers. During this time, the FTC has approved most of the oil industry mergers it has reviewed, including the gigantic ones like Exxon/Mobil, Chevron/Texaco, and Conoco/Phillips. While each one of these mergers may not have seemed problematic when reviewed, taken as a whole these mergers have greatly increased concentration in the industry. And the GAO concluded that these mergers have raised gasoline prices. The GAO is currently updating its 2004 study at the request of me and some of my colleagues.

What is your view of the effects of these mergers on competition in your industry and the price of petroleum products? And please predict whether we are likely to see even more consolidation in the years ahead.

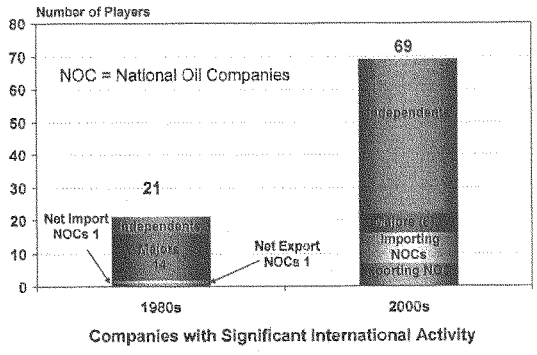
We believe that it is implausible that mergers have enabled oil and gas firms to influence prices. Global competition is much greater today than it was before these mergers, even though there are fewer major integrated oil companies. In the 1980s, for example, there were 21 active global competitors dominated by publicly-traded majors. In the 2000s, there are more than three times the number of global competitors, and the majors constitute a minority (see figure on the next page). In addition, rising resource nationalism and the growing sophistication and reach of national oil companies outside of their borders will make it even more difficult for publicly-traded international oil companies to compete for opportunities around the world.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00113 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.051

Global Competition: 1980s vs. 2000s

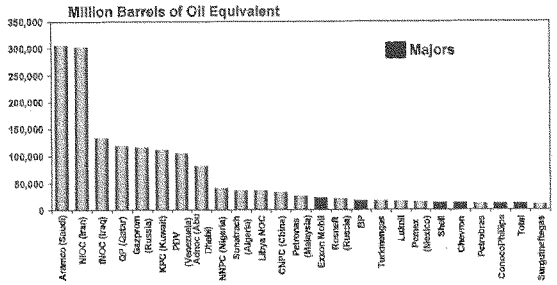
Emergence of NOCs & Independents as International Competitors



Source: PFC Energy & Internal Company data

There is a common misperception that the oil majors control a substantial portion of the world's oil and natural gas reserves. However, the figure below shows that major international oil companies are not so large compared to the national oil companies. In fact, the top six major companies together hold only 4.5 percent of the world's oil and natural gas reserves.

Top 25 Oil, NGL and Natural Gas Reserves



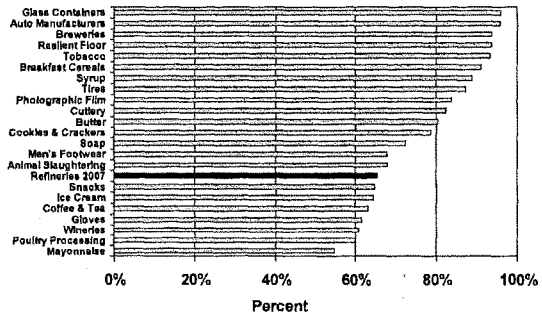
Source: Energy Intelligence Group, Ranking the World's Oil Companies 2008

Concentration in domestic crude oil production and ownership of crude oil reserves remained at very low levels between 1990 and 2002 as measured by the Herfindahl-Hirschman Index (HHI), which equals the sum of the squared market shares of all market participants in the relevant product and geographic market. An HHI of 1,000 or less is considered to be unconcentrated. In 2002, domestic crude oil production had an HHI of 297, up only slightly from 284 in 1990.[2] While we do not have data for all market participants to calculate an HHI for 2007, we can say that the top eight domestic crude oil and natural gas liquids producers had a 42 percent share of domestic production, which is lower than the percent shares for all of the industries shown on the industry concentration chart below. In fact, all of the 43 oil producers in the U.S. covered in the data base,[3] account for only 54 percent of domestic oil production. There are a large number of small producers in the United States.

The U.S. refining industry is also highly competitive and relatively unconcentrated. In 2006, the Federal Trade Commission (FTC) concluded that "the refining industry remains relatively unconcentrated" and that "no refiner has a substantial share of crude oil distillation refining capacity, either nationally or regionally."[4] In addition, as the chart below shows, concentration in the refining industry is much lower than for many other industries in the United States.

Eight Firm Concentration (2002)

Percent of Market Composed of the Eight Largest Firms



Source: Energy Information Administration for Refineries 2007, U.S. Department of Commerce for all others

[2] Timothy J. Muris and Richard G. Parker, "A Dozen Facts You Should Know About Antitrust and the Oil Industry," June 2007, pages 11 and 13

[3] Evaluate Energy

[4] Federal Trade Commission, "Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases," Spring 2006, page 16

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00115 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.053

In addition, we disagree with the assertion that mergers have increased gasoline prices. The FTC criticized the GAO's 2004 report for, "(1) methodological mistakes that make the Report's quantitative analysis wholly unreliable, (2) critical factual assumptions that are both unstated and unjustified, and (3) conclusions that lack any quantitative foundation."[5] The FTC was established in 1914 to be the vanguard on uncompetitive practices. In comparison, GAO's expertise in this subject matter is limited. The GAO study did not take into account the numerous other factors besides mergers that caused gasoline prices to increase during the period studied (e.g., supply disruptions, seasonality, boutique fuels, higher cost of manufacturing clean fuels).

On the contrary, we believe that the efficiency improvements resulting from the mergers have probably lowered consumer prices relative to what they would have been otherwise. In my written testimony, I addressed in detail how the merger of Conoco Inc. and Phillips Petroleum Company has benefited consumers by reducing costs, improving the efficiency of our business, and increasing supplies of petroleum products for American consumers. In fact, we estimated cumulative cost and efficiency savings of approximately $1.9 billion in 2004 resulting from this merger.

Mergers have been driven by eroding resource access and the need for companies to continue to undertake increasingly large and complex exploration and development projects in order to keep pace with rising world demand. For U.S. companies to compete in an environment of mega projects, increasingly non-conventional and complicated oil and natural gas reservoirs and increasing national oil company control of resources, they require scale, technical innovation and financial resources commensurate with the size, complexity and risk of those projects. These market conditions have been the primary motivation for past mergers; if those conditions persist, it is possible companies will need to become even larger and more diverse in order to compete with the national oil companies.

[5] Federal Trade Commission letter to GAO, "Energy Markets: Effects of Mergers and Market Concentration in the U.S. Petroleum Industry," May 2004, Appendix IV, page 153

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00116 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.054

U.S. Senate Judiciary Committee
Hearing on "Exploring the Skyrocketing Price of Oil"
Written Questions from Senator Richard J. Durbin

Questions for all witnesses

1. Please provide a table displaying, for each year since 2000:
• the names of the top five most highly compensated individuals in your company for that year (with compensation defined to include salary, bonuses, benefits, stock options, in-kind gifts, deferred compensation, and other remuneration); and
• the amount of compensation received by each of those individuals, broken down by amount and type of compensation.

We report the compensation of our CEO, CFO and three other most highly compensated officers in accordance with the rules and regulations promulgated by the Securities and Exchange Commission ("SEC") each year in our publicly available filings with the SEC. In response to your request, we have included, as Exhibit A, information which reflects the compensation reported for these executives in the Summary Compensation Table of our proxy statements relating to our annual meeting of stockholders for all years since 2000. In our publicly available filings, our Summary Compensation Tables include important information in the accompanying narrative and footnotes to the Summary Compensation Table and, therefore, we would direct your attention to this information in our proxy statements. To assist your review of this information, please note the following related to changes in our business and in the SEC rules applicable since 2000.

- For years prior to 2003, the compensation amounts reproduced relate to compensation paid to executives of Phillips Petroleum Company, the predecessor company predating the merger of Conoco Inc. and Phillips Petroleum Company.

- For years prior to 2004, beneath the compensation amounts reproduced, we report the number of options awarded to each executive, as the SEC rules did not, at that time, call for the dollar value of an executive's option awards to be included in the summary compensation table for those periods.

- For all years, compensation amounts voluntarily deferred or contributed by the Company to a deferred compensation plan by the specified executives are included in the Summary Compensation Table; however, in accordance with SEC rules, earnings on these deferred amounts are only included for years subsequent to 2005.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00117 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.055

- For years after 2005, the amounts considered by our Compensation Committee for annual or program-specific awards both in setting targets and making awards are not necessarily reflected in the amounts shown on the "Stock Awards" and "Option Awards" rows of the Summary Compensation Tables reproduced in Exhibit A. This difference occurs primarily because the numbers in the "Stock Awards" and "Option Awards" rows do not reflect solely the values of awards made for a particular year while the amounts considered by our Compensation Committee reflect solely the values of awards made for a particular year or program. These numbers in these rows include the Financial Accounting Standards Board Statement No. 123(R), "Share-Based Payment" (FAS 123(R)) expense recognized by us in the year for all outstanding stock and option awards, which, because of the current "hold-until-retirement" feature of our restricted stock/restricted stock unit programs, can be a substantial amount. Because we currently require our executives to hold restricted stock and restricted stock unit awards for an extended holding period (until retirement for program periods commencing prior to 2009 or, for program periods ending after 2010, the earlier of retirement and at least five years following completion of the program period), any appreciation in our stock price during a given year results in our recognizing the value of such appreciation with respect to certain previously-earned awards in our financial statements, and therefore, in the compensation amounts reported above. Therefore, for your convenience, we have also included, as Exhibit B, supplemental tables reproduced from our proxy statement in each of the last two years reconciling the targeted and awarded amounts considered by our Compensation Committee under each of our compensation programs for each of the executives with the amount that is required to be reported for these periods under the SEC rules for the Summary Compensation Tables, as reproduced in Exhibit A.

With respect to benefits afforded these individuals, our senior executives participate in the same basic benefits package as our other U.S. salaried employees. This includes a basic benefits package consisting of retirement, medical, dental, vision, life insurance and accident insurance plans, as well as flexible spending arrangements for health care and dependent care expenses. Perquisites provided to these individuals, that are not broadly available to U.S. salaried employees, make up a portion of "All Other Compensation" in Exhibit A.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00118 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.056

Summary Compensation Table Disclosure

Exhibit A

2000 (2001 Proxy)	J.J.Mulva Chairman of the Board & CEO	J.A. Carrig SVP, CFO & Treasurer	T.C. Morris Special Assignment to CEO	B.Z. Parker EVP	J.B. Whitworth EVP, General Counsel & Chief Admin Officer
Salary	$ 1,045,833	$ 294,082	$ 441,500	$ 497,253	$ 396,497
Bonus	$ 4,518,875	$ 677,273	$ 877,209	$ 553,041	$ 960,962
Long-Term Incentive Payout	$ 3,102,763	$ 283,985	$ 697,867	$ 725,257	$ 961,582
Restricted Stock Awards	$ 2,195,854	$ 1,000,012	$ -	$ -	$ 800,009
All Other Compensation	$ 100,808	$ 16,415	$ 16,619	$ 15,769	$ 16,619
Total	$ 10,962,133	$ 2,271,767	$ 2,333,195	$ 1,791,320	$ 3,137,669
Options granted[1]	335,600	46,600	48,400	63,200	53,000

2001 (2002 Proxy)	J.J.Mulva Chairman of the Board & CEO	J.A. Carrig SVP & CFO	J.E. Lowe SVP	B.Z. Parker EVP	J.B. Whitworth EVP, General Counsel & Chief Admin Officer
Salary	$ 1,281,250	$ 366,656	$ 368,856	$ 522,450	$ 492,623
Bonus	$ 3,630,000	$ 653,172	$ 581,326	$ 450,073	$ 680,089
Long-Term Incentive Payout	$ 3,839,655	$ 639,483	$ 493,553	$ 951,787	$ 1,061,766
Restricted Stock Awards	$ 12,955,000	$ -	$ -	$ -	$ -
All Other Compensation	$ 151,155	$ 41,677	$ 17,995	$ 17,145	$ 17,995
Total	$ 21,857,060	$ 1,601,188	$ 1,459,732	$ 1,941,455	$ 2,252,673
Options granted[1]	478,000	2,800	2,800	-	6,200
Special Award - Stock Options*	3,000,000	70,200	70,200	84,000	85,400

2002 (2003 Proxy)	J.J.Mulva President and CEO	A.W. Dunham Chairman	R.E. McKee III EVP, Exploration and Production	J.W. Nokes EVP, Refining, Marketing, Supply and Transportation	R.A. Harrington SVP, Legal, and General Counsel
Salary	$ 1,375,000	$ 1,356,338	$ 670,000	$ 666,000	$ 409,360
Bonus	$ 1,612,000	$ 26,640,502	$ 22,900,621	$ 20,272,096	$ 715,000
Long-Term Incentive Payout	$ 14,977,500	$ -	$ -	$ -	$ -
Restricted Stock Awards	$ -	$ 2,687,543	$ 386,358	$ 386,358	$ -
Other Annual Compensation	$ 71,086	$ 271,487	$ 26,455	$ 20,172	$ 16,710
All Other Compensation	$ 108,675	$ 163,251	$ 80,400	$ 79,920	$ 49,123
Total	$ 18,144,261	$ 31,101,119	$ 24,064,034	$ 21,424,546	$ 1,190,193
Options granted[1]	425,600	3,881,536	285,298	285,298	128,916

2003 (2004 Proxy)	J.J.Mulva President and CEO	A.W. Dunham Chairman	J.W. Nokes EVP, Refining, Marketing, Supply and Transportation	W.B. Berry EVP, Exploration and Production	J.A. Carrig EVP, Finance and CFO
Salary	$ 1,479,167	$ 1,479,168	$ 775,000	$ 540,000	$ 575,833
Bonus	$ 3,500,000	$ 10,340,890	$ 1,289,921	$ 1,051,383	$ 982,153
Long-Term Incentive Payout	$ 1,632,363	$ 1,632,363	$ 523,648	$ 387,355	$ 299,621
Other Annual Compensation	$ 161,504	$ 203,620	$ 13,126	$ 2,648	$ 987
All Other Compensation	$ 126,749	$ 126,749	$ 65,090	$ 230,440	$ 47,554
Total	$ 6,899,783	$ 13,782,590	$ 2,666,187	$ 2,211,726	$ 1,906,148
Options granted[1]	608,000	606,000	251,600	151,800	122,200

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00119 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.057

Summary Compensation Table Disclosure

Exhibit A

2004 (2005 Proxy)	J.J.Mulva Chairman, CEO & President	A.W. Dunham Chairman (to September 30, 2004)	J.W. Nokes EVP, Refining, Marketing, Supply and Transportation	W.B. Berry EVP, Exploration and Production	J.A. Carrig EVP, Finance and CFO
Salary	$ 1,500,000	$ 1,521,782	$ 812,500	$ 830,000	$ 806,000
Bonus	$ 4,100,000	$ 3,084,210	$ 1,576,775	$ 1,368,420	$ 1,123,983
Long-Term Incentive Payout	$ -	$ 7,026,746	$ -	$ -	$ -
Other Annual Compensation	$ 133,753	$ 553,929	$ 13,980	$ 96,855	$ 3,232
All Other Compensation	$ 128,641	$ 100,736	$ 69,678	$ 220,808	$ 51,952
Total	$ 5,862,394	$ 12,267,402	$ 2,472,933	$ 2,314,083	$ 1,785,167
Options granted[1]	745,200	745,200	214,140	193,800	126,200
Grant date value of options granted	$ 6,611,128	$ 6,611,128	$ 1,834,503	$ 1,789,504	$ 1,153,468

2005 (2006 Proxy)	J.J.Mulva Chairman, CEO & President	J.A. Carrig EVP, Finance and CFO	J.E. Lowe EVP, Strategy Planning and Corporate Affairs	J.W. Nokes EVP, Refining, Marketing, Supply and Transportation	W.B. Berry EVP, Exploration and Production
Salary	$ 1,500,000	$ 851,000	$ 538,333	$ 846,500	$ 709,167
Bonus	$ 6,800,274	$ 2,178,761	$ 1,925,174	$ 1,500,980	$ 1,138,397
Long-Term Incentive Payout	$ 22,533,686	$ 3,598,486	$ 3,079,343	$ 6,285,580	$ 3,952,472
Other Annual Compensation	$ 112,355	$ 3,099	$ 1,121	$ 11,417	$ 7,737
All Other Compensation	$ 155,305	$ 67,433	$ 55,766	$ 87,684	$ 73,483
Total	$ 31,101,620	$ 6,494,779	$ 5,599,737	$ 8,732,141	$ 5,879,256
Options granted	392,800	104,800	70,200	144,600	144,600
Grant date value of options granted	$ 4,898,216	$ 1,304,362	$ 876,394	$ 1,803,162	$ 1,803,162

2006 (2007 Proxy)	J.J.Mulva Chairman, CEO & President	J.A. Carrig EVP, Finance and CFO	J.L. Gallogly EVP, Refining, Marketing and Transportation	R.L. Limbacher EVP, Exploration and Production	W.B. Berry EVP, Exploration and Production
Salary	$ 1,500,000	$ 695,000	$ 612,747	$ 613,668	$ 817,000
Non-Equity Incentive Plan Compensation	$ 3,383,775	$ 1,017,967	$ 682,037	$ -	$ 804,377
Option Awards	$ 6,340,259	$ 1,898,868	$ 532,879	$ 342,870	$ 1,368,747
Stock Awards	$ 26,398,778	$ 6,238,285	$ 1,867,784	$ 2,580,936	$ 379,829
Change in Pension Value and Nonqualified Deferred Compensation Earnings	$ 5,449,910	$ 1,931,140	$ 103,786	$ 894,505	$ 2,289,243
All Other Compensation	$ 373,302	$ 101,195	$ 170,455	$ 131,079	$ 111,845
Total	$ 43,444,024	$ 11,682,435	$ 4,169,689	$ 4,562,861	$ 5,790,641

2007 (2008 Proxy)	J.J.Mulva Chairman, CEO & President	J.A. Carrig EVP, Finance and CFO	J.L. Gallogly EVP, Refining, Marketing and Transportation	J.E. Lowe EVP, Exploration and Production	S.L. Cornelius SVP, Strategy Planning and Corporate Affairs
Salary	$ 1,500,000	$ 817,500	$ 858,666	$ 660,400	$ 515,000
Non-Equity Incentive Plan Compensation	$ 3,442,500	$ 1,186,291	$ 1,237,699	$ 886,638	$ 596,607
Option Awards	$ 5,542,175	$ 1,632,457	$ 2,301,421	$ 670,000	$ 466,048
Stock Awards	$ 37,949,152	$ 11,224,184	$ 3,261,590	$ 2,834,613	$ 1,584,780
Change in Pension Value and Nonqualified Deferred Compensation Earnings	$ 1,727,552	$ 1,424,708	$ 1,046,381	$ 705,492	$ 1,088,378
All Other Compensation	$ 367,647	$ 131,239	$ 135,002	$ 119,749	$ 84,684
Total	$ 50,549,026	$ 16,416,379	$ 8,840,758	$ 5,876,892	$ 4,335,495

(1) On June 1, 2005, our common stock split on a 2-for-1 basis by means of a 100% stock dividend payable to stockholders of record as of May 16, 2005. As a result, the number of shares that may be acquired upon exercise of the stock options reported herein reflects the stock split.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00120 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.058

Supplement to Summary Compensation Table

Exhibit B

2006

	J.J. Mulva		J.A. Carrig		J.J. Gallogly		R.L. Limbacher		W.B. Berry	
	Target	Actual	Target	Actual	Target	Actual	Target	Actual	Target	Actual
Salary	$ 1,500,000	$ 1,500,000	$ 695,000	$ 695,000	$ 612,750	$ 612,747	$ 612,750	$ 613,668	$ 617,000	$ 617,0
VCIP - Feb 2007	2,025,000	3,383,775	674,150	1,017,967	694,367	882,037	-	-	792,490	804,3
Stock Options - 2006	4,330,368	4,330,368	1,264,635	1,264,635	1,137,600	1,137,600	-	-	1,466,953	1,466,9
Stock Award	-	-	-	-	-	-	4,228,105	4,228,105	-	-
PSP II - Feb 2007	3,520,000	17,367,967	766,920	4,243,300	-	-	-	-	1,045,800	3,508,8
Total Compensation Awarded in 2006	$ 11,375,368	26,582,110	$ 3,400,705	7,220,902	$ 2,344,717	2,632,384	$ 4,840,855	4,841,773	$ 4,142,243	6,617,1
Items attributable to FAS 123(R):										
-Mark to market and reconciliations on prior awards	N/A	12,813,060	N/A	2,313,962	N/A	-	N/A	202,627	N/A	(1,017,5
-Accruals on future stock awards	N/A	5,484,114	N/A	1,698,270	N/A	1,667,764	N/A	-	N/A	1,663,9
-Amounts recognized in other periods on PSP II or restricted stock awards	N/A	(9,268,353)	N/A	(2,017,267)	N/A	-	N/A	(1,849,796)	N/A	(3,795,5
-Expense for prior year option awards	N/A	2,009,891	N/A	468,721	N/A	-	N/A	342,673	N/A	665,5
-Amount to be recognized in future years on stock option awards	N/A	-	N/A	(34,488)	N/A	(604,721)	N/A	-	N/A	(763,7
Other items:										
Change in pension value	N/A	5,449,910	N/A	1,931,140	N/A	103,786	N/A	894,505	N/A	2,269,2
All other compensation	N/A	373,302	N/A	101,195	N/A	170,455	N/A	131,079	N/A	111,6
Amount per Summary Compensation Table	N/A	$ 43,444,024	N/A	$ 11,682,435	N/A	$ 4,168,688	N/A	$ 4,562,861	N/A	$ 5,790,6

2007

	J.J. Mulva		J.A. Carrig		J.J. Gallogly		J.E. Lowe		S.L. Cornelius	
	Target	Actual	Target	Actual	Target	Actual	Target	Actual	Target	Actual
Salary	$ 1,500,000	$ 1,500,000	$ 817,500	$ 817,500	$ 858,666	$ 858,665	$ 660,400	$ 660,400	$ 515,000	$ 515,000
VCIP - Feb 2008	2,025,000	3,442,500	792,975	1,186,291	832,906	1,237,698	605,365	888,638	417,150	596,867
Stock Options - 2007	4,937,500	4,938,290	1,442,125	1,443,088	1,695,275	1,696,700	975,150	975,150	638,400	639,388
PSP III - Feb 2008	4,620,000	18,161,828	1,317,803	5,189,498	989,000	3,887,856	907,168	3,566,226	592,933	2,330,994
Total Compensation Awarded in 2007	13,082,500	28,042,616	4,370,403	8,627,377	4,375,847	7,680,820	3,148,083	6,090,420	2,163,483	4,081,989
Items attributable to FAS 123(R):										
-Mark to market, amortization and true-ups on prior awards	N/A	25,498,172	N/A	5,344,202	N/A	-	N/A	2,634,813	N/A	1,233,849
-Accruals on future awards	N/A	5,314,976	N/A	1,652,377	N/A	1,734,122	N/A	-	N/A	350,831
-Amount to be recognized in other periods on PSP III	N/A	(11,025,822)	N/A	(852,893)	N/A	(2,360,088)	N/A	(3,566,226)	N/A	(2,330,994)
-Amortization of prior year option awards	N/A	603,885	N/A	189,369	N/A	604,721	N/A	378,353	N/A	243,986
-Amount to be recognized in future years on stock option award	N/A	-	N/A	-	N/A	-	N/A	(683,508)	N/A	(417,326)
Other items:										
Change in pension value	N/A	1,727,552	N/A	1,424,708	N/A	1,046,381	N/A	705,492	N/A	1,086,376
All other compensation	N/A	387,847	N/A	131,239	N/A	135,002	N/A	119,749	N/A	84,684
Amount per Summary Compensation Table	N/A	50,549,026	N/A	16,416,379	N/A	8,840,758	N/A	5,678,892	N/A	4,335,495

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00121 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.059

2. Please provide a table displaying the following information for your company for each year since 2000:

- **revenue**
- **net income**
- **return on equity**
- **total capital investment**
- **oil development investment**
- **refinery investment**
- **alternative energy research and development**
- **cash holdings**
- **marketing expenses**

$Millions unless otherwise noted	2007	2006	2005 (1)	2004 (1)	2003 (1)	2002 (1,2)	2001 (1,2)	2000 (1,2)
Revenue	187,437	183,650	179,442	135,076	104,246	56,748	24,892	22,155
Net income	11,891	15,550	13,529	8,129	4,735	(295)	1,661	1,862
Return on equity	14%	23%	28%	21%	14%	-1%	15%	31%
Total capital investment	12,898	16,377	11,895	9,663	6,232	4,480	3,044	2,225
Oil development investment (3)	10,988	10,248	6,947	5,297	4,508	3,276	2,516	1,677
Refinery investment (4)	1,440	3,016	1,747	1,371	1,179	840	428	217
Alternative energy research and development (5)	65	71	74	84	68	65	26	26
Cash holdings	1,456	817	2,214	1,387	490	307	142	149
Marketing expenses (6)	84	87	84	96	30	3	7	-

(1) Does not include Burlington Resources Inc. , which was acquired in 2006
(2) Pre-merger - Phillips Petroleum Company only
(3) Includes both oil and natural gas investments
(4) Includes refinery, marketing and transportation investments
(5) Does not include non-R&D spending for alternative energy
(6) The period from 2001 to 2003 includes advertising & promotional expenses for Corporate and Refining & Marketing business segments, which traditionally account for the majority of such expenses. Data for 2000 is currently unavailable.

Additional information

$Millions unless otherwise noted	2007	2006	2005 (1)	2004 (1)	2003 (1)	2002 (1,2)	2001 (1,2)	2000 (1,2)
Net income/Revenues (cents per $ of sale)	6.3	8.5	7.5	6.0	4.5	(0.5)	6.7	8.4
Reserve Replacement (%) (3)	159%	305%	230%	206%	106%	750%	135%	1127%
Reinvestment rate (%)	108%	105%	88%	119%	132%	-	183%	120%
Taxes paid	14,383	15,165	9,826	5,884	3,883	2,054	2,067	1,527

(1) Does not include Burlington Resources Inc., which was acquired in 2006
(2) Pre-merger - Phillips Petroleum Company only
(3) 2007 excludes the expropriation of the company's Venezuelan oil projects, 2006 includes the Burlington acquisition and 2002 included the impact of the merger of Conoco Inc. and Phillips Petroleum Company

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00122 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.060

It is important to understand that the absolute dollars of profit reflect the large size and scale of companies in this industry, which is required to make the enormous capital investment necessary to replenish depleting supplies. For example, a single large offshore platform in the Gulf of Mexico designed to operate in thousands of feet of water costs more than $1 billion to develop. Our earnings need to be large in absolute terms to support the scale of investment required.

The exploration and production business has an additional challenge of needing to increase reserves sufficiently every year to offset the natural decline in production and to grow. The second table above indicates that ConocoPhillips has generally been more than replacing its production.

In order to replace reserves and grow production, most of our earnings need to be reinvested in the business. ConocoPhillips earned nearly $12 billion in 2007, but spent close to $13 billion in capital expenditures and investments as shown in the first table above. We provided a second table with data that you did not request but that is relevant to our response. The second table shows our capital reinvestment rate as a percentage of net income. Between 2003 and 2007, our average reinvestment rate was 106 percent of our net income.

In addition, ConocoPhillips' rate of profitability – or its profit margin – is well below that of firms in other industries. ConocoPhillips' profit margin (net income / revenues) in 2007 of 6.3 cents per dollar of sales (shown on the second table) is approximately 14 percent below the 7.3 cent average profit margin for the entire manufacturing sector in 2007. As similarly outlined in my written testimony, the return on investment for the oil and natural gas industry, while currently comparable to average returns for the S&P industrials, lagged those returns for many years. Since 1977, the refining segment in particular has suffered from weaker returns on investment than S&P 500 industrial companies for nearly all years and actually had negative returns in several years, most recently in 2002.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00123 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.061

We also included our taxes paid on the second table to demonstrate that our industry is already heavily taxed. The table shows that ConocoPhillips paid an estimated $14 billion in taxes during 2007, which was more than 20 percent higher than our net income. In a recent survey of 80 diverse American companies, ConocoPhillips' effective tax rate between 2004 and 2006 of 43.6 percent was the highest, about 14 percent higher than the average. Income taxes paid by domestic energy producers have already increased by 519 percent between 2002 and 2006.[6] Income taxes are only one of the ways we contribute to government revenues. We also pay royalties, production and excise taxes, and lease bonuses, the latter of which are paid whether a company discovers hydrocarbons or not. When you take all these other forms of government payment into account, our effective tax rates are much higher. For example, our incremental fiscal-take rate[7] in Alaska is about 90 percent at recent oil prices.

3. Several weeks ago, the Wall Street Journal's *Market Watch* quoted an industry analyst as estimating that about $25 to $30 of the price per barrel of crude oil may be attributed solely to speculation.

a) Does your internal research support that analysis?

We do not conduct internal research on this issue. However, we believe that some investors are diversifying financial risk in their stock and bond portfolios by investing in crude oil and other commodity futures but we have no way of quantifying how much impact, if any, they are having on the price.

The underlying cause of most of the price increase, however, is that oil supply growth is challenged in the face of significant demand growth in developing countries. One of the primary reasons for this dynamic is that major energy companies such as ConocoPhillips have direct access to only 7 percent of the world's oil and natural gas resources, down from 85 percent in the 1960s. If U.S. policymakers want to increase supply availability and decrease dependence on foreign sources of energy, they should improve access to resources in the United States.

b) What in your view is the price per barrel that can be justified purely by the supply and demand in the market?

The price for crude oil is determined by the extremely active global oil market, which includes many buyers and sellers and ample liquidity. It is not possible for anyone to know what prices "should be" in an unregulated market or "would be" under a specified set of conditions.

---

[6] U.S. Department of Energy, Energy Information Administration, "Performance Profiles of Major Energy Producers 2006," Table B12 ($14.6 billion in 2002 to $90.4 billion in 2006)

[7] The amount of an incremental dollar in revenue that is paid to the government (state and federal) in the form of production taxes, royalties, federal and state income taxes and any other taxes; incremental rate in Alaska is 90% at $115/bbl oil price

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00124 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.082

c) What steps do you think should be taken to protect consumers from the effects of excessive speculation in the trading markets for oil?

Regulatory bodies need to have both the resources and information to execute their responsibilities. We continue to believe anything done to increase transparency in the markets is positive as long as it maintains liquidity and is justified by a fair and transparent cost/benefit analysis.

4. In your testimony, you claim that consolidation in the oil industry has been necessary to enable your company to compete globally. However, a 2004 GAO study found that consolidation and mergers in the oil refinery industry, "generally led to higher wholesale gasoline prices in the United States." As a result of all the mergers, the largest five oil companies now control 55% of the refining market, and the largest 10 dominate 81%.

a) In your view, how has market concentration in the refinery industry affected the price of gasoline?

The price of gasoline is primarily a function of the price of crude oil. The cost of crude oil is the largest single component of retail gasoline prices, representing about 70 percent of the pump price in the first quarter of 2008. Historical analysis also shows that changes in crude oil prices explained about 97 percent of the variation in the pre-tax price of gasoline between 1918 and 2006.[8]
Given the relatively low market concentration of refining, we do not believe mergers have negatively affected the price of gasoline. Rather, we believe that the efficiency improvements resulting from the mergers have probably lowered consumer prices relative to what they would have been otherwise.

The Federal Trade Commission (FTC) concluded that "the refining industry remains relatively unconcentrated" and that "no refiner has a substantial share of crude oil distillation refining capacity, either nationally or regionally."[9] In addition, the refining industry is not very concentrated relative to many other industries in the U.S. The chart on the next page shows that the market share of the eight largest firms for refining is much lower than for many other industries in the United States.

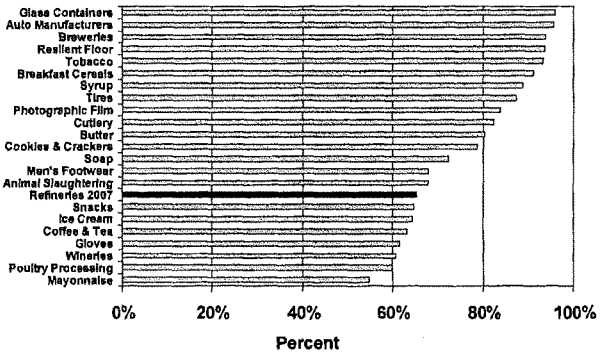
[8] Carol Dahl, Colorado School of Mines, "What Goes Down Must Come Up: A Review of the Factors Behind Increasing Gasoline Prices, 1999-2006," April 2007
[9] Federal Trade Commission, "Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases," Spring 2006, page 16

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00125 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.063

Eight Firm Concentration (2002)

Percent of Market Composed of the Eight Largest Firms



Source: Energy Information Administration for Refineries 2007, U.S. Department of Commerce for all others

The FTC criticized the GAO referenced report for, "(1) methodological mistakes that make the Report's quantitative analysis wholly unreliable, (2) critical factual assumptions that are both unstated and unjustified, and (3) conclusions that lack any quantitative foundation."[10] The GAO study was flawed because it did not control for the numerous other factors besides mergers that caused gasoline prices to increase during the period studied (e.g., supply disruptions, seasonality, boutique fuels, higher cost of manufacturing clean fuels).[11]

[10] Federal Trade Commission letter to GAO, "Energy Markets: Effects of Mergers and Market Concentration in the U.S. Petroleum Industry," May 2004, Appendix IV, page 153
[11] Federal Trade Commission letter to GAO, "Energy Markets: Effects of Mergers and Market Concentration in the U.S. Petroleum Industry," May 2004, Appendix IV, page 153

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00126 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.064

b) Do you see a link between market concentration and reduced refinery production?

No. In fact, refinery crude runs have increased since the mergers that occurred in the industry in the 1990s and early 2000s. In 1983, crude runs were about 11.7 million barrels per day. In 2007, they exceeded 15 million barrels per day. That 30 percent increase was driven by continuous incremental capacity expansions and improved efficiency. It also occurred despite the number of operable refineries in the United States falling from 319 in 1980 to 149 in 2007. The refineries that closed were primarily small, inefficient refineries that could not survive after the elimination of special federal incentives in 1981 as well as by the large capital expenditures that were required to meet government-mandated product specifications (such as clean fuels) and emissions reductions. The lack of economies of scale significantly disadvantaged the small refiner. The average size of the current U.S. refinery is about 125,000 barrels per day, and some of the new global refineries being built are being sized at about 400,000 barrels per day. When it is completed, there will be a refining complex in India with a capacity of 1.2 million barrels per day.

c) How much would increased refinery production lower gasoline and diesel prices?

We do not have any models capable of quantifying the impact on prices of increased refinery production. It is possible that increases in refinery production, as well as increases in imports, could lower gasoline and diesel prices somewhat. However, the main driver of higher gasoline prices today is higher crude prices, and increasing supplies of gasoline and diesel will not address that issue.

ConocoPhillips is trying to expand our U.S. refineries. In 2008 alone, ConocoPhillips plans to invest $2.8 billion in our global refining, marketing and transportation operations. Of that amount, 74 percent will be invested in the United States and 69 percent will be invested in global refining. Unfortunately, we are running into substantial delays in permitting refinery expansions in the United States, including at our Wood River refinery in Illinois.

5. In the last couple of weeks, we have seen the release of a handful of reports that claim that our use of ethanol has displaced a certain amount of gasoline from the nation's pool of transportation fuels, and that the displacement of more expensive gasoline with less expensive ethanol has resulted in lower consumer prices at the gas pump. These experts say that the savings have been between 15-20%, which would translate into about $400-$600 of savings per family or about $50 billion to $75 billion saved nationwide.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00127 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.065

a) What is the effect on retail gasoline prices of cheaper ethanol being blended into gasoline?

At current crude price and ethanol levels, ethanol is extending the gasoline pool without imposing an economic penalty (excluding any food inflationary impacts), thereby reducing the overall fuel price. The specific effect is dependent on the relative prices of crude oil, and thus gasoline prices, delivery costs, and ethanol. However, according to Credit Suisse, from 2003 to 2007, ethanol sold for an average of 43 cents per gallon more than wholesale gasoline.[12] Absent government subsidies, gasoline blended with ethanol would be more costly in this situation. Also, while the prices per gallon are one measure of value, consider also that ethanol contains about two-thirds the energy of hydrocarbon gasoline and thus, additional volume is needed to travel equivalent distances when using ethanol blends.

There are also other costs associated with corn-based ethanol use outside of fuel prices. Ethanol production requires a substantial government subsidy and additional delivery infrastructure, with potential inflationary impacts on food prices and other indirect environmental consequences (e.g., soil erosion, water usage). In addition, corn-based ethanol production does not offer much of an improvement in carbon footprint versus conventional gasoline. We believe that our country needs to develop second generation biofuels that have improved potential in these sensitive areas. While ConocoPhillips is supporting research on these new fuels, they are not commercially available today. We also believe that our nation should eliminate the current 54-cent-per-gallon tariff on imported ethanol. If the nation is concerned about reducing fuel costs and carbon emissions, policies and taxes that discourage lower-cost and less carbon-intensive imports, such as sugar-based ethanol from Brazil, are counter-productive.

b) If the renewable fuels mandate were waived this year and nine billion gallons of ethanol were removed from the market, additional petroleum would need to be "found" to replace this fuel. Some economists say that prices would increase by as much as 50 cents to 80 cents per gallon based on standard calculations. Based on your historical observations, would you expect to see that large of an increase?

We do not have predictive models for such cases. In our experience, the results are too dependent on factors external to domestic supply and demand to allow for accurate predictions (global crude and clean product balance, global refinery utilization, imports, etc.).

[12] Credit Suisse, "Corn = Energy Whether We Like It or Not," May 14, 2008, page 16

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00128 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.086

If waiving the renewable fuel standard reduced the available gasoline pool, taking into account the lower energy content of ethanol, the effect would likely be an increase in price. However, some light end hydrocarbon products that were excluded to meet vapor pressure specifications when ethanol was blended (ethanol has a relatively high vapor pressure) could be restored to the gasoline pool in some areas of the country. This would diminish any price increase.

Another complication in answering this question is that waiving the renewable fuel standard would likely not materially affect the amount of ethanol being blended today unless there were to be a ban on its use. With the high crude prices and ethanol subsidies, there is currently an economic incentive to produce and blend ethanol where infrastructure can be brought on-line to support ethanol use.

c) One of the challenges to making production and the mandate sync up is associated with the infrastructure needed to develop the biofuels industry. What is your position regarding higher blend levels of ethanol and the deployment of pumps capable of dispensing E-85?

We agree that infrastructure – including biomass gathering and transportation to conversion, biofuel distribution, blending, retailing and the vehicle fleet – will be the most important factor in the long-term market success for biofuels. ConocoPhillips is allowing E-85 fuel to be marketed under our branded canopy provided the marketer meets certain image, safety and fuel-quality guidelines. The feedback we have received from our branded gas stations who have installed E-85 dispensers is that there is insufficient demand to justify the expense of the conversion. The problem is that only about 3 percent of the U.S. passenger fleet possesses flexible fuel capability today and consumers who own these vehicles are often unaware of it. In addition, consumers are concerned about the roughly 25-percent reduction in gas mileage experienced when using E-85 fuel versus conventional gasoline.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00129 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.067

In order to meet the targets established in the Energy Independence and Security Act's renewable fuels standard, blends higher than E-10 will be required. The U.S. Department of Energy and the Environmental Protection Agency, along with industry support, are currently evaluating the ability of the existing infrastructure to utilize blends as high as E-20. The domestic automakers' expansion of flex fuel vehicles that allow blends of greater than 10 percent can enable greater biofuel use. However, today's vehicle fleet has not been designed or validated to satisfactorily use ethanol blends above E-10. Such blends are currently illegal to use in conventional vehicles (97 percent of the fleet) and not approved by vehicle manufacturers (will void fuel-related warranties) or the federal government based on unknown consequences to existing vehicle operations and emission impacts.

Another concern is the lack of pumps with UL-certified dispenser equipment and lack of updated E-85 fuel standards that include fuel detergency needed to avoid the formation of damaging deposits in vehicles fueled with E-85. Other specification aspects of E-85 fuel need to be addressed.

A final concern is the lack of data on the emissions impact of vehicles transitioning from low-ethanol blend to high-ethanol blend fuels. Increases in emissions will complicate various states' efforts to address ozone non-attainment designations.

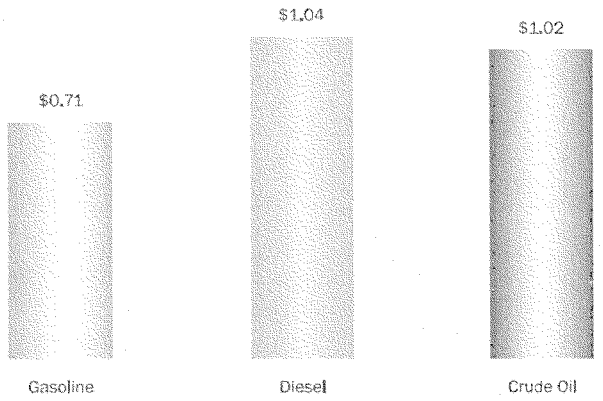
Ethanol already requires a separate bulk transportation system. E-85 fuel would require an additional infrastructure investment at the retail site level, 97 percent of which are not owned by major oil companies. This investment is expensive for the retailer and would be rendered unnecessary if a single higher blend target were established.

For these reasons we believe that policy should be directed toward identifying a higher national blend allowance (such as E-15 or E-20) that can reasonably fit within the existing infrastructure limitations rather than expecting E-85 fuel to "sync up" to the market.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00130 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.088

Average Price Increases Year to Date (cents per gallon) — **January 1 to May 8**



Source: NYMEX (WTI crude oil) and AAA (gasoline and diesel)

The price of West Texas Intermediate crude oil has increased by $1.02 per gallon for the period from January 1 through May 8th of this year compared to the same period last year. Diesel prices are averaging $1.04 more per gallon and gasoline 71 cents per gallon more.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00131 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.089

Oil sands can also be developed in an environmentally sensitive manner. ConocoPhillips's oil sands portfolio is primarily steam-assisted gravity drainage (SAGD), which is an in-situ extraction method occurring within the reservoir deep underground and requires only a limited surface footprint for the plant site and well pads. It does not have tailings, diversion of rivers, or withdrawals from or discharges to rivers or lakes. In our Surmont project, we are currently recycling 90 percent of the water used in the process, and we are reducing the water intensity and using non-potable water. We were also an early adopter of low-impact seismic practices that substantially reduce the amount of forest cleared and accelerate reforestation. Environmental mapping is done to place facilities away from any sensitive eco-sites, and we have ongoing research to improve construction and reclamation practices.

ConocoPhillips is also spending significantly to improve heavy oil production technologies and practices and reduce the resulting environmental and carbon footprint. ConocoPhillips Canada is a member of the Integrated CO_2 Network (ICO_2N), an industry and government consortium researching development of pipeline infrastructure to transport carbon dioxide from oil sands development sites to locations where it can be used in enhanced oil recovery, or potentially sequestered. ConocoPhillips Canada is also a participant in the Alberta Saline Aquifer Project, an industry collaborative formed to develop a large-scale carbon capture and storage project. We have also invested in research and development projects that study alternate recovery technologies, which reduce both our energy requirements and carbon footprint. ConocoPhillips and its partners plan to fund about $500 million of heavy oil technology and studies over the next five years, including technology to reduce greenhouse gas emissions, water use and land disturbance.

The Canadian oil sands are projected to become an increasingly important source of oil for the United States, particularly considering recent declines in heavy oil production in Mexico, Venezuela and California. U.S. refineries are configured to process heavier, high sulfur crude oils, and with the decline of these types of crude oils, the Canadian heavy crude oils are a very good fit to keep the U.S. crude supply secure and stable. The Canadian oil sands are projected to approach 20 percent of U.S. oil supplies by 2020.

There is a global competition for resources today and the U.S. should be careful not to take actions to discourage the flow of oil produced from oil sands to this country. American consumers benefit from having this secure supply source and ConocoPhillips is committed to producing and refining it in an environmentally responsible manner.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00132 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.070

Questions of Senator Sheldon Whitehouse
Following the Senate Judiciary Committee Hearing
on
"Exploring the Skyrocketing Price of Oil"

Questions for Entire Panel:

1. Has your company, any subsidiary, or any entity acting under common ownership or control, financially contributed to any organizations that study global warming or climate change? If so, which are those organizations and how much in total has your company given to each one?

Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the American Legislative Exchange Council? If so, how much has it contributed? Does your company agree with the American Legislative Exchange Council's opinion that increasing levels of carbon dioxide are not causing glaciers to retreat?

Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Cato Institute? If so, how much has it contributed? Either way, does your company agree with Cato Institute commentary that "science no longer provides justification for any rush to pass drastic global warming legislation."?

Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Committee for a Constructive Tomorrow? If so, how much has it contributed? Does your company agree with the Committee for a Constructive Tomorrow that "recent glacial retreats, sea-level rise and migrations of temperature sensitive species are all within the bounds of known natural variability."?

Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Annapolis Center for Science-Based Public Policy? If so, how much has it contributed? Does your company agree with an Annapolis Center for Science-Based Public Policy report that states "climate models may never be able to make greenhouse-warming predictions with certainty?"

Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Acton Institute for the Study of Religion and Liberty? If so, how much has it contributed? Does your company agree with Acton Institute for the Study of Religion and Liberty commentary that it is a "myth that [global warming] is an emergency that demands a drastic cutback in CO-2 emissions" and that "making a case against CO-2 without making a case against nature is like making an omelet without breaking the proverbial egg. It is impossible."?

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00133 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.071

Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Center for the Study of Carbon Dioxide and Global Change? If so, how much has it contributed? Does your company agree with the Center for the Study of Carbon Dioxide and Global Change that "there is no compelling reason to believe that the rise in temperature was caused by the rise in CO2."?

Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Frontiers of Freedom Institute? If so, how much has it contributed? Does your company agree with the Frontiers of Freedom Institute that S.2191, America's Climate Security Act, is "a hyped-up rallying cry against a 'problem' that scientists can't even agree exists in the first place."?

Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the George C. Marshall Institute? If so, how much has it contributed? Does your company agree with the George C. Marshall Institute that there is a "shattered consensus" on the state of global warming?

Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Heartland Institute? If so, how much has it contributed? Does your company agree with the Heartland Institute that "there is no consensus about the causes, effects, or future rate of global warming," and that "most climate scientists doubt the reliability of computer models and the accuracy of land-based temperature records," and that "reports by the IPCC are unreliable due to political editing and rewriting of the reports' conclusions," and that "some of the key evidence cited in past IPCC reports has been shown to be fraudulent."?

Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Institute for Energy Research? If so, how much has it contributed? Does your company agree with the Institute for Energy Research that global climate change is a "craze...fueled by alarmist rhetoric and trumped up scientific claims."?

ConocoPhillips is not aware of any direct contribution to the climate-change related activities of any of the organizations that you listed. We have contributed $48,500 between 2003 and 2008 to the American Legislative Exchange Council to support nonpartisan research and policy development for a variety of issues, as well as drafting and advocating model legislation.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00134 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.072

ConocoPhillips has acknowledged the scientific consensus that human activity, including the burning of fossil fuels, is contributing to increased concentrations of greenhouse gases in the atmosphere that can lead to adverse changes in global climate. We have not taken a position on the accuracy of external perspectives on the science of climate change that you list. ConocoPhillips is committed to taking action to reduce greenhouse gas emissions. We support a mandatory national framework in the U.S. for reducing carbon dioxide emissions that is linked internationally, establishes a value for carbon, is transparent, fair, encourages technology deployment and energy efficiency and avoids undue harm to the economy.

2. At a time when gasoline prices were near record highs, your five companies earned record-breaking profits last year: $116 billion. ExxonMobil made $40.6 billion last year, which is more than the all federal highway spending and about as much as the entire credit card industry earned that year. Since 2002, your five companies have consistently broken profit records. If you continue to profit this year at the pace you did in the first quarter, you are once again poised to smash profit records, not just for your industry, but for all industries. Please explain why what, in raw numbers, may be the most profitable industry in history needs the multi-billion dollar Section 199 domestic manufacturing tax breaks enacted in 2004. Why aren't those profits adequate to provide access to capital without those tax incentives?

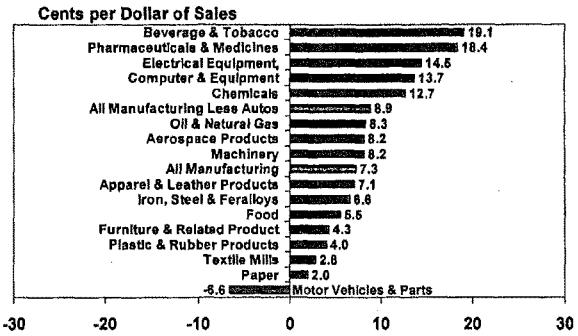
We disagree with the characterization of the profitability of the oil and natural gas industry. The size of oil and gas industry earnings reflects the size and scale of our companies required to replenish and expand the world's oil and natural gas supplies. This size is required to undertake large, capital-intensive projects which take years to develop, and to effectively compete with government-supported national oil companies. A single large offshore platform in the Gulf of Mexico designed to operate in thousands of feet of water costs more than $1 billion to develop. Our earnings need to be large in absolute terms to support the scale of investment required. We report profits before reinvestment. Then we invest to explore and replace the energy we produce so we can be long-term sustainable suppliers of energy to the world. Most of our earnings are reinvested in the business to replace reserves and grow production. In fact, ConocoPhillips earned nearly $12 billion in 2007, but spent close to $13 billion in capital expenditures and investments.

Many times people confuse the absolute size of earnings with financial performance. Profit margins, or earnings per dollar of sales (measured as net income divided by revenues), provide one useful way to compare financial performance among industries of all sizes. The latest published data for 2007 (see figure on the next page) show the oil and natural gas industry earned 8.3 cents for every dollar of sales compared to 7.3 cents for all U.S. manufacturing and 8.9 cents for U.S. manufacturing, excluding the financially-challenged automotive industry.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00135 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.073

2007 Earnings by Industry
Net Income / Sales



Source: Based on company filings with the federal government as reported by U.S. Census Bureau and Oil Daily

As outlined in my written testimony, the return on investment for the oil and natural gas industry, while currently comparable to average returns for the S&P industrials, lagged those returns for many years. Since 1977, the refining segment in particular has suffered from weaker returns on investment than S&P 500 industrial companies for nearly all years and actually had negative returns in several years, most recently in 2002.

The House proposal to repeal the Section 199 domestic manufacturing deduction for the five largest oil companies would discriminatorily deny the benefit of a tax deduction that is available to every other industry and other large oil companies. In our case, this provision of the tax code encourages more domestic U.S. oil and natural gas production, which increases our energy security and helps preserve U.S. jobs.

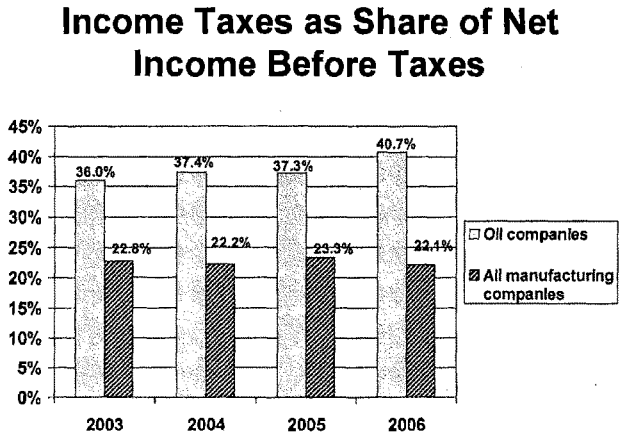
The cost for exploration and production of oil and natural gas in the U.S. is among the highest in the world due to the maturity of U.S. basins and the need to move into deep water in the Gulf of Mexico. The Section 199 tax deduction will help domestic oil and gas production compete with lower-cost international opportunities. Repealing the deduction will increase our dependence on foreign imports.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00136 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.074

Major oil companies are already heavily taxed. In a recent survey of 80 diverse American companies, ConocoPhillips' effective tax rate between 2004 and 2006 of 43.6 percent was the highest, about 14 percent higher than the average. We also pay royalties, production and excise taxes, and lease bonuses, the latter of which are paid whether a company discovers hydrocarbons or not. When you take all these other forms of government payment into account, our incremental fiscal-take rate[13] in Alaska is about 90 percent at recent oil prices.

The chart below, based on U.S. Department of Energy data, indicates that the oil and gas industry's 2006 income tax expenses (as a share of net income before income taxes) averaged 40.7 percent, compared to 22.1 percent for U.S. manufacturing companies. It also shows that income tax payments as a percentage of net income have been rising in recent years for the oil industry, while they have been relatively static for all manufacturing companies.



Source: U.S. Department of Energy, EIA, *Performance Profiles of Major Energy Producers*; U.S. Census Bureau, Quarterly Financial Reports

[13] The amount of an incremental dollar in revenue that is paid to the government (state and federal) in the form of production taxes, royalties, federal and state income taxes and any other taxes; incremental rate in Alaska is 90% at $115/bbl oil price

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00137 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.075

3. The petroleum industry operates in an unusual fashion. Your five corporations are integrated oil giants that control all stages of production and distribution. From the exploration and mining to the refinement and transportation to the moment the customer swipes her Exxon or Shell charge card at the pump, you control everything. Are you aware of any other industries that operate in this fashion? How would you respond to the suggestion that it may be time to examine whether the vertically integrated ownership structure facilitates price gouging and harms consumers? Would you support a Congressionally-directed study to examine the effects of your ownership structure?

We question the need to again study the effects of our industry's ownership structure. Since 1973, the FTC has conducted over 100 investigations examining every facet of the oil industry. Indeed, the petroleum industry receives closer scrutiny from antitrust authorities than other industries. An FTC review of merger investigations and enforcement actions from 1996 to 2005 concluded that the Commission brought more merger cases with lower levels of market concentration in the petroleum industry than any other industry.[14] During the period of oil industry mergers in the late 1990s, the FTC's Bureau of Competition spent almost one-fourth of its enforcement budget on investigations in the energy industry.[15]

FTC investigations have continued to be a staple of our industry in recent years, including an investigation specifically addressing mergers and other structural changes in the industry[16] and several other exhaustive non-merger investigations. Among other things, the FTC's 2004 investigation into industry structure found that, "[d]espite increases in concentration at some production levels over [the last two decades], particularly since the mid-1990s, most sectors of the petroleum industry at the national, regional, or state level generally remain unconcentrated or moderately concentrated."[17] In 2006, the FTC again noted that "industry developments have lessened the incentive to vertically integrate throughout all or most levels of production, distribution and marketing. Several significant refiners have no crude oil production, and integrated petroleum companies today tend to depend less on their own crude oil production. In addition, a number of independent retailers purchase refined products on the open market."[18] The FTC also specifically examined the merger of Conoco Inc. and Phillips Petroleum Company in 2002.

---

[14] Michael A. Salinger, "Petroleum Industry Consolidation: Prepared Statement of the Federal Trade Commission Before the Joint Economic Committee of the U.S. Congress," May 23, 2007, page 3
[15] Ibid., page 8
[16] Bureau of Economics, Federal Trade Comm'n, *The Petroleum Industry: Mergers, Structural Change, and Antitrust Enforcement* (August 2004) 129-31 (hereinafter *Oil Merger Report*).
[17] *Id.* at 15.
[18] William E. Kovacic, Commissioner, Federal Trade Commission, "Prepared Statement of the Federal Trade Commission on Petroleum Industry Consolidation Before the Committee on the Judiciary, U.S. Senate," February 1, 2006, pages 5-6

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00138 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.076

Despite the mergers that have taken place, ownership of refining capacity has shifted slightly away from the U.S. integrated majors to independents. In 2007, independents had a 56 percent market share in refining, up from 53 percent in 1995. There have been many new entrants into the retail business. Over the past decade, giant grocery stores chains and hypermarkets have increased their share from 1 percent to 13 percent. Independents have also grown their brand share from 32 percent to 38 percent over the last decade. Major oil companies have a much smaller participation in the ownership and operation of retail stores. According to the Association for Convenience and Petroleum Retailing, the major integrated oil companies own and operate fewer than 3 percent of all retail locations in the United States.[19] In fact, ConocoPhillips only owns 324 retail stores in the United States today.

Thus, we disagree with your contention that ConocoPhillips or other companies in the industry control all stages of production and distribution. Rather, the industry is highly competitive and, as further outlined in my written testimony, one that is less concentrated than many other industries in the United States.

Moreover, in all of its investigations of the industry, to our knowledge, the FTC has never found evidence of collusion or market manipulation. The FTC has also conducted several investigations of pricing anomalies but has not found that illegal conduct caused any of them.[20]

4. The attached graph illustrates that the growth in profits of your five companies over the past six years has outpaced even the sharp increase in the price of gasoline. Why is your profit margin rising at a rate that is so much higher than the price of your product?

For profit margin to rise at a consistent rate with the selling price of a product, the cost of producing the product must also rise at a consistent rate with the selling price. The graph accompanying Senator Whitehouse's questions demonstrates that, in fact, energy companies' production costs have increased at a lesser rate than sales revenues from crude oil production. Crude prices have risen at a faster rate than our costs. In this environment, the percentage increase of profit margin will outpace the percentage increase in product selling prices.

An example to illustrate this concept:

---

[19] Testimony of Bill Douglass on Behalf of the National Association of Convenience Stores Before the House Judiciary Committee, Anti-Trust Task Force, Hearing to Examine the Consumer Effects of Rising Gas Prices, May 7, 2008, page 2

[20] Timothy Muris (former Chairman of the FTC) and Richard Parker (former Director of the FTC's Bureau of Competition), "A Dozen Facts You Should Know About Antitrust and the Oil Industry," June 2007, pages i-ii

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00139 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.077

In year one, a company sells 100 units at a selling price of $10 per unit. The production cost associated with producing the product is $8 per unit, for a year one gross profit of $20 (calculated as $100 in revenue (100 x $10) minus $80 in costs (100 x $8)). In year two, market forces outside the control of the company drive the selling price of the product to $15 per unit. However, this increase did not immediately impact the production cost of the product, which only increased to $9 per unit. Thus year two gross profit is $60 (calculated as $150 in revenue (100 x $15) minus $90 in costs (100 x $9)). When compared on a percentage basis, the product selling price increased 50 percent (from $10 to $15), while gross profit increased 200 percent (from $20 to $60).

There tends to be a several-year lag between changes in oil prices and changes in industry costs. Costs eventually follow oil prices up because in a higher price environment, companies invest more and bid up the cost of drilling rigs and oil services. An upstream capital cost index published by Cambridge Energy Research Associates indicates that industry capital costs have approximately doubled since 2000, reflecting higher costs for materials, equipment and personnel.

In addition, returns in the oil industry, like other capital-intensive industries, are highly cyclical. Margins are low for a period of years until demand growth tightens the supply and demand balance. Then new capacity additions are required to satisfy strong demand growth. The rising price is an important economic signal to suppliers to expand production to satisfy rising demand.

5. a) How much has your company invested in research and development of coal to liquids technology for use as transportation fuel in each of the past five years?

Over the last five years, ConocoPhillips invested $175 million in the research and development of coal-to-liquids technology and the company has expended over $750 million over the last fifteen years.

Coal-to-Liquids	2003	2004	2005	2006	2007	**Total**
$ Millions	29	58	39	25	24	**175**

b) How much has your company invested in research and development of hydrogen technology for use as transportation fuel in each of the past five years?

Over the last five years, ConocoPhillips has invested $15 million on hydrogen technology research and development. These expenditures do not include funds related to the production of hydrogen at our refineries.

Hydrogen	2003	2004	2005	2006	2007	**Total**
$ Millions	3	4	3	3	2	**15**

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00140 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.078

c) How much has your company invested in research and development of non-fossil fuel renewable energy sources for use as transportation fuel, excluding hydrogen technology, in each of the last five years?

Over the last five years, ConocoPhillips has invested $20 million in research and development of non-fossil fuel renewable energy sources.

Non-Fossil Fuels	2003	2004	2005	2006	2007	**Total**
$ Millions	1	1	1	5	12	**20**

6. How much has your company invested in research and development of wind, solar, and geothermal energy in each of the last five years?

Over the last five years, ConocoPhillips has invested $5 million in research and development of wind, solar and geothermal energy. Our company has approached these investments cautiously given our past experience of purchasing a position in a large solar energy company (Acurex Solar Corporation) in the 1980s just after fuel prices spiked and then having the business operating at a significant loss until we sold it several years later.

Wind/solar/geothermal	2003	2004	2005	2006	2007	**Total**
$ Millions	3	0.5	0.5	0.5	0.5	**5**

7. Compare the answer to each of the three above questions with the aggregate compensation of your top 10 executives and, separately, your budget for travel, entertainment, and other fringe benefits.

We report the compensation of our CEO, CFO and three other most highly compensated officers in accordance with the rules and regulations promulgated by the Securities and Exchange Commission ("SEC") each year in our publicly available filings with the SEC. In response to your request, we have included, as Exhibit A, information which reflects the compensation reported for these executives for each of the past five years in the Summary Compensation Table of our proxy statements relating to our annual meeting of stockholders. In our publicly available filings, our Summary Compensation Tables include important information in the accompanying narrative and footnotes to the Summary Compensation Table and, therefore, we would direct your attention to this information in our proxy statements. To assist your review of this information, please note the following related to changes in SEC rules applicable since 2003.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00141 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.079

- For 2003, beneath the compensation amounts reproduced, we report the number of options awarded to each executive, as the SEC rules did not, at that time, call for the dollar value of an executive's option awards to be included in the summary compensation table for those periods.

- For all years, compensation amounts voluntarily deferred or contributed by the Company to a deferred compensation plan by the specified executives are included in the Summary Compensation Table; however, in accordance with SEC rules, earnings on these deferred amounts are only included for years subsequent to 2005.

- For years after 2005, the amounts considered by our Compensation Committee for annual or program-specific awards both in setting targets and making awards are not necessarily reflected in the amounts shown on the "Stock Awards" and "Option Awards" rows of the Summary Compensation Tables reproduced in Exhibit A. This difference occurs primarily because the numbers in the "Stock Awards" and "Option Awards" rows do not reflect solely the values of awards made for a particular year while the amounts considered by our Compensation Committee reflect solely the values of awards made for a particular year or program. These numbers in these rows include the Financial Accounting Standards Board Statement No. 123(R), "Share-Based Payment" (FAS 123(R)) expense recognized by us in the year for all outstanding stock and option awards, which, because of the current "hold-until-retirement" feature of our restricted stock/restricted stock unit programs, can be a substantial amount. Because we currently require our executives to hold restricted stock and restricted stock unit awards for an extended holding period (until retirement for program periods commencing prior to 2009 or, for program periods ending after 2010, the earlier of retirement and at least five years following completion of the program period), any appreciation in our stock price during a given year results in our recognizing the value of such appreciation with respect to certain previously-earned awards in its financial statements, and therefore, in the compensation amounts reported above. Therefore, for your convenience, we have also included, as Exhibit B, supplemental tables reproduced from our proxy statement in each of the last two years reconciling the targeted and awarded amounts considered by our Compensation Committee under each of our compensation programs for each of the executives with the amount that is required to be reported for these periods under the SEC rules for the Summary Compensation Tables, as reproduced in Exhibit A.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00142 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.080

With respect to benefits afforded these individuals, our senior executives participate in the same basic benefits package as our other U.S. salaried employees. This includes a basic benefits package consisting of retirement, medical, dental, vision, life insurance and accident insurance plans, as well as flexible spending arrangements for health care and dependent care expenses. Perquisites provided to these individuals, that are not broadly available to U.S. salaried employees, make up a portion of "All Other Compensation" in Exhibit A.

Our travel and entertainment expenses for 2007 were approximately $211 million. The majority of these expenses consist of the cost of airfare, hotels and meals while on business travel. ConocoPhillips does not compile "fringe benefits" or utilize that term in the ordinary course of its business.

The proportion of capital devoted to alternative energy investments seems small only because of the vast scale of our existing oil and natural gas businesses. As we move beyond research and development on these projects, we anticipate that our capital investments will increase significantly. This spending is not directly comparable to compensation, travel and entertainment because the latter are business expenses for our entire company that are not related to how much we spend on any given activity. The travel and entertainment expenses cover all of our approximately 32,800 employees in our company.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00143 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.081

Summary Compensation Table Disclosure

Exhibit A

2003 (2004 Proxy)	J.J.Mulva President and CEO	A.W. Dunham Chairman	J.W. Nokes EVP, Refining, Marketing, Supply and Transportation	W.B. Berry EVP, Exploration and Production	J.A. Carrig EVP, Finance and CFO
Salary	$ 1,479,167	$ 1,479,168	$ 775,000	$ 540,000	$ 575,833
Bonus	$ 3,500,000	$ 10,340,690	$ 1,289,321	$ 1,051,383	$ 982,153
Long-Term Incentive Payout	$ 1,632,383	$ 1,632,363	$ 523,648	$ 387,355	$ 299,621
Other Annual Compensation	$ 161,504	$ 203,820	$ 13,128	$ 2,548	$ 987
All Other Compensation	$ 126,749	$ 126,749	$ 85,090	$ 230,440	$ 47,554
Total	$ 6,899,783	$ 13,782,590	$ 2,686,187	$ 2,211,726	$ 1,906,148
Options granted[1]	506,000	606,000	251,600	151,800	122,200

2004 (2005 Proxy)	J.J.Mulva Chairman, CEO & President	A.W. Dunham Chairman (to September 30, 2004)	J.W. Nokes EVP, Refining, Marketing, Supply and Transportation	W.B. Berry EVP, Exploration and Production	J.A. Carrig EVP, Finance and CFO
Salary	$ 1,500,000	$ 1,621,782	$ 812,500	$ 630,000	$ 606,000
Bonus	$ 4,100,000	$ 3,064,210	$ 1,576,775	$ 1,368,420	$ 1,123,983
Long-Term Incentive Payout	$ -	$ 7,026,746	$ -	$ -	$ -
Other Annual Compensation	$ 133,753	$ 553,929	$ 13,980	$ 96,655	$ 3,232
All Other Compensation	$ 128,641	$ 100,735	$ 69,678	$ 220,808	$ 51,952
Total	$ 5,862,394	$ 12,267,402	$ 2,472,933	$ 2,314,083	$ 1,785,167
Options granted[1]	745,200	745,200	214,140	193,600	126,200
Grant date value of options granted	$ 6,611,128	$ 6,611,128	$ 1,834,503	$ 1,769,504	$ 1,153,466

2005 (2006 Proxy)	J.J.Mulva Chairman, CEO & President	J.A. Carrig EVP, Finance and CFO	J.E. Lowe EVP, Strategy Planning and Corporate Affairs	J.W. Nokes EVP, Refining, Marketing, Supply and Transportation	W.B. Berry EVP, Exploration and Production
Salary	$ 1,500,000	$ 651,000	$ 536,333	$ 848,500	$ 709,167
Bonus	$ 6,800,274	$ 2,176,761	$ 1,925,174	$ 1,500,980	$ 1,136,397
Long-Term Incentive Payout	$ 22,533,686	$ 3,596,486	$ 3,079,343	$ 6,285,580	$ 3,952,472
Other Annual Compensation	$ 112,355	$ 3,099	$ 1,121	$ 11,417	$ 7,737
All Other Compensation	$ 155,305	$ 67,433	$ 55,766	$ 87,664	$ 73,483
Total	$ 31,101,620	$ 6,494,779	$ 5,599,737	$ 8,732,141	$ 5,879,256
Options granted	392,800	104,800	70,200	144,600	144,600
Grant date value of options granted	$ 4,896,215	$ 1,304,362	$ 875,394	$ 1,803,162	$ 1,803,162

2006 (2007 Proxy)	J.J.Mulva Chairman, CEO & President	J.A. Carrig EVP, Finance and CFO	J.L. Gallogly EVP, Refining, Marketing and Transportation	R.L. Limbacher EVP, Exploration and Production	W.B. Berry EVP, Exploration and Production
Salary	$ 1,500,000	$ 695,000	$ 612,747	$ 613,668	$ 817,000
Non-Equity Incentive Plan Compensation	$ 3,383,775	$ 1,017,967	$ 882,037	$ -	$ 604,377
Option Awards	$ 6,340,259	$ 1,698,868	$ 532,879	$ 342,673	$ 1,388,747
Stock Awards	$ 26,396,776	$ 6,238,265	$ 1,687,784	$ 2,560,936	$ 379,629
Change in Pension Value and Nonqualified Deferred Compensation Earnings	$ 5,449,910	$ 1,931,140	$ 103,786	$ 894,505	$ 2,289,243
All Other Compensation	$ 373,302	$ 101,195	$ 170,455	$ 131,079	$ 111,645
Total	$ 43,444,024	$ 11,682,435	$ 4,189,688	$ 4,562,861	$ 5,790,641

2007 (2008 Proxy)	J.J.Mulva Chairman, CEO & President	J.A. Carrig EVP, Finance and CFO	J.L. Gallogly EVP, Refining, Marketing and Transportation	J.E. Lowe EVP, Exploration and Production	S.L. Cornelius SVP, Strategy Planning and Corporate Affairs
Salary	$ 1,500,000	$ 817,500	$ 856,666	$ 860,400	$ 515,000
Non-Equity Incentive Plan Compensation	$ 3,442,500	$ 1,188,291	$ 1,237,898	$ 888,638	$ 596,607
Option Awards	$ 5,542,175	$ 1,632,457	$ 2,301,421	$ 670,000	$ 458,049
Stock Awards	$ 37,949,152	$ 11,224,184	$ 3,261,590	$ 2,634,613	$ 1,584,780
Change in Pension Value and Nonqualified Deferred Compensation Earnings	$ 1,727,552	$ 1,424,708	$ 1,046,381	$ 705,492	$ 1,088,376
All Other Compensation	$ 387,647	$ 131,239	$ 135,002	$ 119,749	$ 84,684
Total	$ 50,549,026	$ 16,418,379	$ 8,840,758	$ 5,678,892	$ 4,335,495

(1) On June 1, 2005, our common stock split on a 2-for-1 basis by means of a 100% stock dividend payable to stockholders of record as of May 18, 2005. As a result, the number of shares that may be acquired upon exercise of the stock options reported herein reflects the stock split.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00144 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.082

Supplement to Summary Compensation Table

Exhibit B

2006

	J.J. Mulva		J.A. Carrig		J.J. Gallogly		R.L. Limbacher		W.B. Berry	
	Target	Actual	Target	Actual	Target	Actual	Target	Actual	Target	Actual
Salary	$ 1,500,000	$ 1,500,000	$ 695,000	$ 695,000	$ 612,750	$ 612,747	$ 612,750	$ 613,668	$ 817,000	$ 817,0
VCIP - Feb 2007	2,025,000	3,383,775	674,150	1,017,967	594,367	882,037	-	-	792,490	804,3
Stock Options - 2006	4,330,368	4,330,368	1,264,635	1,264,635	1,137,600	1,137,600	-	-	1,486,953	1,486,9
Stock Award	-	-	-	-	-	-	4,228,105	4,228,105	-	-
PSP II - Feb 2007	3,520,000	17,367,967	766,920	4,243,300	-	-	-	-	1,045,800	3,508,8
Total Compensation Awarded in 2006	$ 11,375,368	26,582,110	$ 3,400,705	7,220,902	$ 2,344,717	2,632,384	$ 4,840,855	4,841,773	$ 4,142,243	6,617,1
Items attributable to FAS 123(R):										
-Mark to market and reconciliations on prior awards	N/A	12,813,060	N/A	2,313,962	N/A	-	N/A	202,827	N/A	(1,017,5
-Accruals on future stock awards	N/A	5,464,114	N/A	1,696,270	N/A	1,867,784	N/A	-	N/A	1,683,9
-Amounts recognized in other periods on PSP II or restricted stock awards	N/A	(9,258,363)	N/A	(2,017,267)	N/A	-	N/A	(1,849,796)	N/A	(3,795,5
-Expense for prior year option awards	N/A	2,009,891	N/A	466,721	N/A	-	N/A	342,673	N/A	655,5
-Amount to be recognized in future years on stock option awards	N/A	-	N/A	(34,486)	N/A	(604,721)	N/A	-	N/A	(783,7
Other items:										
Change in pension value	N/A	5,449,910	N/A	1,931,140	N/A	103,786	N/A	894,505	N/A	2,269,2
All other compensation	N/A	373,302	N/A	101,195	N/A	170,458	N/A	131,079	N/A	111,6
Amount per Summary Compensation Table	N/A	$ 43,444,024	N/A	$ 11,682,435	N/A	$ 4,169,668	N/A	$ 4,562,861	N/A	$ 5,790,6

2007

	J.J. Mulva		J.A. Carrig		J.J. Gallogly		J.E. Lowe		S.L. Cornelius	
	Target	Actual	Target	Actual	Target	Actual	Target	Actual	Target	Actual
Salary	$ 1,500,000	$ 1,500,000	$ 817,500	$ 817,500	$ 858,866	$ 858,866	$ 860,400	$ 860,400	$ 515,000	$ 515,000
VCIP - Feb 2008	2,025,000	3,442,500	792,975	1,166,291	832,906	1,237,698	605,365	888,538	417,150	596,607
Stock Options - 2007	4,937,500	4,938,290	1,442,125	1,443,086	1,095,275	1,096,700	975,150	975,156	638,400	639,388
PSP III - Feb 2008	4,620,000	18,161,826	1,317,803	5,180,498	989,000	3,887,556	907,168	3,566,226	592,933	2,330,994
Total Compensation Awarded in 2007	13,082,500	28,042,616	4,370,403	8,627,377	4,375,847	7,880,820	3,148,083	6,090,420	2,163,483	4,081,988
Items attributable to FAS 123(R):										
-Mark to market, amortization and true-ups on prior awards	N/A	25,498,172	N/A	5,344,202	N/A	-	N/A	2,634,613	N/A	1,233,949
-Accruals on future awards	N/A	5,314,976	N/A	1,562,377	N/A	1,734,122	N/A	-	N/A	350,931
-Amount to be recognized in other periods on PSP III	N/A	(11,025,822)	N/A	(852,893)	N/A	(2,360,088)	N/A	(3,566,226)	N/A	(2,330,994)
-Amortization of prior year option awards	N/A	603,885	N/A	189,369	N/A	604,721	N/A	378,353	N/A	243,986
-Amount to be recognized in future years on stock option award	N/A	-	N/A	-	N/A	-	N/A	(683,509)	N/A	(417,328)
Other items:										
Change in pension value	N/A	1,727,552	N/A	1,424,708	N/A	1,046,381	N/A	705,492	N/A	1,088,376
All other compensation	N/A	387,847	N/A	131,239	N/A	135,002	N/A	119,749	N/A	84,664
Amount per Summary Compensation Table	N/A	50,549,026	N/A	16,416,379	N/A	8,840,758	N/A	5,678,892	N/A	4,335,495

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00145 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.083

Hearing of the Senate Committee on the Judiciary
"Exploring the Skyrocketing Price of Oil"
May 21, 2008
Questions for the Record
Senator Dianne Feinstein

Questions for all witnesses:

1. According to the May 15th Congressional testimony of the CFTC's Chief Economist and the CFTC's Director of Market Surveillance, oil companies are driving up the price of oil. These experts stated: "Our studies consistently find that when new information comes to the market and prices respond, it is the commercial traders (such as oil companies, utilities, airlines) who react first by adjusting their futures positions. When these commercial traders adjust their futures positions, it is speculators who are most often on the other side of the trade. Price changes that prompt hedgers to alter their futures positions attract speculators who change their positions in response. Simply stated, there is no evidence that position changes by speculators precede price changes for crude oil futures contracts." CFTC believes that oil companies are driving up prices in futures markets, not speculators. Yet, during the Judiciary Committee hearing on May 21, Mr. Stephen Smith of Exxon Mobil asserted that his firm "does not speculate." Does your firm buy or sell positions in crude oil futures markets? If your firm participates in futures markets, can you refute CFTC's assertion that your firms are driving up oil prices?

ConocoPhillips' traders both buy and sell crude oil on the futures market. Our futures contract positions are typically intended to offset the price risk associated with physical commodity purchase and sale transactions that are required to run our refineries and supply consumers. We do not believe our futures market transactions have any net effect on the price of oil. Our reading of the testimony from the Chief Economist of the CFTC is that commercial traders react to new information by adjusting their positions (this could be either up or down). Therefore, new information is driving prices, not commercial traders.

2. Your firms vehemently oppose legislation – such as the 2007 energy bill tax amendment and Senator Reid's recent legislation to tax windfall oil company profits – that would increase the tax burden on oil and gas companies, arguing that increased taxation will lead to higher gas prices for consumers. However, you argued before the Judiciary Committee that your companies are unable to lower the price of oil. You say that you simply take the price in this global marketplace, instead of offering oil for sale at a set price and set mark-up. These two positions seem inconsistent. Do the economics of your firms influence oil prices, and will oil prices go up if your taxes go up? Or do the economics of your firms stand independent of oil prices, and will oil prices be set by demand regardless of the enormous size of your profits? It can't possibly be both.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00146 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.084

Oil prices are set by present and future expected supply and demand. Windfall profits taxes reduce dollars available for investment and thereby reduce future supply. Since the resource basins available for drilling in the U.S. are very mature and high cost, windfall profits taxes may also make U.S. prospects uneconomic. That will reduce U.S. production specifically, and make this country more dependent upon imports. That is what happened after the windfall profits tax of the early 1980s. According to the Congressional Research Service, U.S. crude production fell by up to 6 percent and imports rose by up to 16 percent. Lowering future oil supplies will increase crude prices. Given that crude prices are currently about 70 percent of the cost of gasoline, the increase in crude oil prices will raise gasoline prices for consumers.

3. The expense and technical challenge of developing new oil resources in harsh environments such as the Arctic is a frequently heard rationale for large oil industry mergers. Are these projects working out as planned? Can we expect to see large new petroleum resources coming on line in the next few years as a result of mergers?

For U.S. companies to compete in an environment of mega projects, increasingly non-conventional and complicated oil and natural gas reservoirs and increasing national oil company control of resources, they require scale, technical innovation, and financial resources commensurate with the size, complexity and risk of those projects, including those in harsh and challenging locations like the Arctic. We are working on a number of projects and pursuing new opportunities in the Arctic which have the potential to provide more energy resources and enhance the nation's energy security.

At our mature Kuparuk and Prudhoe Bay fields in Alaska we are focused on maximizing the light oil potential that remains and expanding our satellite developments from the Alpine field to the west and into the National Petroleum Reserve (NPR-A).

For the longer term, we are focused on commercializing the large existing gas resources on the Alaskan North Slope and in the Canadian Mackenzie Delta. In April this year, we announced that ConocoPhillips and BP had joined in a multi-year, multi-billion dollar effort to construct the Denali pipeline to move approximately four billion cubic feet of natural gas per day from Alaska to North American markets.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00147 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.085

We are also pursuing heavy oil opportunities at our Kuparuk and Prudhoe fields in Alaska, where we are applying our heavy oil experience and technology in an effort to commercialize this large, but very challenged, heavy oil resource. Our ability to unlock the estimated 18 billion barrels of heavy oil resources in the West Sak and Ugnu reservoirs will draw on the combined knowledge, experience and asset positions of many of the heritage companies (i.e. Conoco Inc., Phillips Petroleum Company, Arco Alaska, Gulf Canada, Burlington Resources Inc.) that have made ConocoPhillips what it is today. Several pilot test developments are planned over the coming decade with the hope of achieving large scale production rates in 10-20 years.

On the exploration front, we see significant remaining potential throughout the Arctic region. However, exploration access remains a key issue. Wood Mackenzie predicts 6 billion barrels of oil equivalent of yet-to-find resources are present throughout the Alaskan Arctic region. However, much of this is currently off limits for exploration. If we are to arrest Alaska's steady decline in base production, new petroleum resources must be brought on line and new areas must be opened up for exploration.

Over the last four years the state of Alaska has changed their tax structure to significantly increase taxes on the oil and gas industry three different times. This not only increases the costs associated with oil and gas production and developments, but also adds uncertainty to the predictability of the fiscal structure in Alaska going forward. These tax increases have had and will continue to have an impact on investment in Alaska. Some major projects have been cancelled or deferred in late 2007 and early 2008, due at least in part to tax impacts.

The Qatargas 3 LNG project (QG3) is another example of how the merger between Conoco Inc. and Phillips Petroleum Company benefited from the combination of the companies' complementary competencies. It brought Conoco Inc.'s U.S. gas marketing and Phillips Petroleum Company's LNG expertise together to allow us to do a mega project to develop remote natural gas supplies. QG3 is one of the world's largest liquefied natural gas (LNG) developments and is expected to produce an average of roughly 1 billion cubic feet per day of LNG, including approximately 70,000 barrels a day of liquid product (condensate and LPG) over its 25-year project life. ConocoPhillips will be the sole purchaser of the LNG from QG3, except for approved diversions or third-party sales. As many as 20,000 people will be needed to complete the four-year construction project, with a total of 70 million man-hours. This truly is a mega-project which has drawn on the full size, scale and scope of ConocoPhillips (technically, financially and commercially), and which would not likely have been possible for either of the heritage companies to undertake alone.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00148 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.086

ConocoPhillips is also participating in developing the Kashagan field, located in the Kazakhstan sector of the land-locked Caspian Sea. This mega project was viewed to be so challenging by the Soviet Union that they decided not to pursue it. It is now being developed by a group of the largest international oil companies. Kashagan is located in a remote, environmentally sensitive area. The reservoir is deep, with very high pressure and high contents of hydrogen sulfide. This field tests new boundaries such as injecting high sulfur natural gas at very high pressure. The human and capital resource required for development is probably unparalleled in the industry. When it is completed, its maximum production could reach 1.5 million barrels per day.

4. To what extent are your refineries able to defer planned maintenance if and when refined product markets are tight? Has your company ever deferred refinery maintenance to meet a tight marketplace? If so, how frequently has your firm deferred maintenance? At what refineries and on what dates?

4a) To what extent are your refineries able to defer planned maintenance if and when refined product markets are tight?

Maintenance activities and turnarounds are normally planned a year or more in advance and require significant resources. These activities are required for the continued safe and efficient operation of our refineries and to assure sustainable crude refining capabilities and production of transportation fuels. There is limited flexibility to change the schedule once set. We typically plan maintenance during the fall and winter seasons, which historically exhibit lower demand. This keeps prices lower during the high-demand summer driving season.

Most refineries operate many processing units and only shut down portions of their refineries during maintenance periods. During the maintenance activities, refinery production capability is only partially reduced. This makes it possible to continue the production of transportation fuels at reduced volumes.

Maintenance turnarounds require significant pre-planning, labor, equipment and materials resources and product supply alternatives. It should be noted that the labor, equipment and materials resources are in particularly high demand throughout North America since they are competing with the resource demands of large refinery construction projects. Such resources are commonly scheduled and committed more than a year in advance, so changes to turnaround timing are likely to result in the planned, prepared and necessary resources being unavailable. Substituting resources is likely to result in decreased productivity, increased quality and safety risk along with higher cost for the turnaround, with commensurate longer duration (i.e. production outage) extensions and production reliability impairments upon return to operation. Additionally, since major turnarounds can result in lower production, supply alternatives are typically secured well in advance.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00149 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.087

We work to improve efficiencies that will lessen the number and duration of scheduled maintenance outages. These efficiency improvements would help maximize the supply of transportation fuels during high-demand seasons.

4b) Has your company ever deferred refinery maintenance to meet a tight marketplace? If so, how frequently has your firm deferred maintenance? At what refineries and on what dates?

Yes, on an infrequent basis and only if it does not compromise the safety of our people and the integrity of our equipment. The most notable changes occurred in the aftermath of Hurricanes Katrina and Rita in the fall of 2005, when our company worked diligently to defer maintenance where we could do so, without compromising safety and quality of work in order to supply additional product to the market.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00150 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.088

These changes are shown in the table below.

Refinery	Unit	Plan	Actual	Reason
Ponca City, OK	Crude/FCC	Sep '05	Mar '06	Hurricane
Sweeny, TX	Reformer	Oct '05	Jan '06	Hurricane
Trainer, PA	Vacuum	Sep '05	Nov '05	Hurricane
Wood River, IL	HCU	Sep '05	Oct '05	Hurricane

5. With constraints on the expansion of refinery capacity in California, how do you foresee meeting demand for gasoline and diesel in the future?

ConocoPhillips is expanding capacity to make clean fuels at our Rodeo refinery outside of San Francisco. We also plan to import gasoline and diesel blending components, finished gasoline and diesel fuel either through our Southern and Northern California refineries or through third-party terminals to meet California's growing fuel requirements. This assumes that ConocoPhillips will continue to have access to existing docks and storage tanks in the ports of Los Angeles, Richmond, Rodeo and Selby. Sources of product imports include the Pacific Northwest, the U.S. Gulf Coast, Asia Pacific and Europe. All of these import sources require longer lead time to deliver to the California market, making it much more difficult to respond to a supply deficit that can arise quickly from an operational upset at a local refinery. There are also a limited number of refineries outside of California that can meet California's unique product specifications.

Most ethanol is produced in the U.S. Midwest or South America and transported to California by rail and ship. The logistical infrastructure that supports ethanol delivery and supply to product terminals is presently operating at capacity and will require investment before blending volumes can be increased. Delays in permitting these capital improvements will limit blended gasoline supply.

6. According to initial research by the Government Accountability Office conducted at my request, the San Francisco Bay area has a significant degree of refinery market concentration. San Francisco also consistently has some of the highest gasoline prices in the United States – higher than other regions of California that must use the same reformulated gasoline. Do you believe that the high degree of market concentration among refineries in the San Francisco Bay Area is causing higher gasoline prices in this area?

We do not believe that refinery concentration explains the difference between gasoline prices in San Francisco and Los Angeles because we do not see any appreciable difference in market concentration between northern and southern refinery districts.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00151 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.089

The April 2000 GAO study on California Gasoline Price Behavior indicated that retail gasoline prices were 11 cents higher in San Francisco than in Los Angeles for the period from January 1992 through December 1999 due to differences in local supply and demand conditions. The supply and demand conditions included (1) the number and location of retail gasoline stations, (2) the costs of building and operating gasoline stations, and (3) consumers' incomes.[21] A spring 2006 study conducted by the California Energy Commission for the Governor of California corroborated these results. The study indicated that "cities such as ... San Francisco ... can be characterized as having above average land values that may affect the retail price."[22]

7. How do pipeline and port constraints affect your ability to provide adequate supplies of fuel to consumers?

Increases in port constraints and operational permit limitations add to the cost of supplying crude oil to our California refineries and to the cost of importing gasoline and diesel fuel blendstocks and finished products to meet supply shortfalls. With California domestic crude production in decline at an average annual rate of 3-5 percent, ConocoPhillips and other California refiners have a growing need to increase waterborne receipts of crude to process in local refineries. Capacity growth is limited for most crude terminals due to emission permit limits, berth water depth (draft) and dock length as well as channel depth. Limited berth and channel depth prevents the large and most efficient crude oil tankers (Very Large Crude Carriers or VLCCs) from discharging efficiently in California. Instead, additional cost is incurred to lighter smaller vessels to deliver crude from VLCCs or to use smaller-sized and less efficient ships. Some docks are almost at full capacity today and additional berth capacity is needed to accommodate crude being shipped in from other regions or countries to replace the declining crude production in California. Without additional crude import capacity, local refineries will not be able to run at full operating rates over time. Also, with the shift from predominantly receiving small parcels or batches of domestic crude via California pipelines to receiving more frequent larger volume waterborne supply, refineries will require additional storage to be able to receive larger parcels of crude at one time. The years of delay in attaining construction and operating permits for the much needed Pier 400 berth in the Port of Los Angeles, associated tankage and pipeline connections to existing crude pipeline networks has escalated the cost to construct it, which increases the cost of waterborne crude deliveries to local refineries.

J.S. General Accounting Office, "California Gasoline Price Behavior," April 2000, pages 4-5
California Energy Commission, "Spring 2006 Petroleum Fuels Price Spike: Report to the Governor," gust 2006, page 61

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00152 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.090

The importation of products into Southern California is already at capacity due to the constrained logistical infrastructure at the ports. Facilitating appropriate product and blendstock imports will become even more challenging in the near future in Los Angeles as the port is proposing to consolidate at least two existing operating docks into one. Moving the volumes associated with two docks into one dock will exacerbate scheduling conflicts between products and customers and create supply delays. In addition, it will not allow for import growth that will be required in the future. Dock scheduling bottlenecks will not only increase the cost of supply as barges and vessels incur demurrage waiting to discharge but they will also create short-term supply shortages and subsequent price spikes as staging windows to supply pre-committed pipeline cycles will be missed more frequently.

In Northern California, the Kinder Morgan Energy common carrier product gathering system is close to full capacity and requires additional pumping capacity and pipe connections to facilitate incremental supply reaching outlying terminal distribution facilities. Delays in permitting these improvements would prevent incremental supply from local refineries and imports from reaching the market efficiently. Delays in permitting approval to increase volume throughput limits at distribution terminals, constructing additional tankage and truck loading lanes throughout the state could also contribute to supply outages.

8. Given the importance of free market competition to the energy sector, what is your view of the current 54 cent a gallon tariff on ethanol imports into the United States? Do you believe Congress should reduce the tariff, at least to the $0.45 per gallon level that blenders receive for using ethanol in the United States? Would you endorse legislation to do this?

We believe the tariff on imported ethanol should be eliminated. If the nation is concerned about reducing fuel costs and carbon emissions, policies and taxes that discourage lower-cost and less carbon-intensive imports, such as sugar-based ethanol from Brazil, are counter-productive. We would endorse legislation to do this.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00153 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.091

9. It would appear that Russia is currently working to lay claim to the North Pole and its natural resources. How would you like to see the situation resolved? What role should the U.S. government play?

ConocoPhillips believes energy security is a crucial issue for the United States. Therefore, the ardent and persistent protection of U.S. sovereign territories, U.S. rights of access to resources, and other U.S. interests would seem to be a fundamental role and responsibility of the Government of the United States of America on behalf of all U.S. citizens. As a corporate citizen of the United States, ConocoPhillips urges the U.S. government to fulfill this role and responsibility to its citizens. As an important part of this effort, the United States government should strongly support responsible energy activities conducted in those areas of the Arctic and other regions in which it already has clear rights, namely, the U.S. Outer Continental Shelf and the lands that abut them. Much of the information about the scope and extent of subsea geology and geography in the Arctic (and the technologies required for detailed mapping) will be quickly acquired by the U.S. government through the timely exploration of these areas by its corporate citizens having the experience and capabilities, such as the private energy sector. Furthermore, the U.S. is the world leader in environmentally-sound energy development in the Arctic and is best placed to ensure environmental stewardship and sustainability in the development of these energy resources, benefiting not only U.S. citizens but the global community. By promoting responsible development in our own Arctic areas recently leased in the Chukchi Sea and Outer Continental Shelf, the United States can also demonstrate to the world that it is best qualified to develop natural resources in the Arctic beyond the Outer Continental Shelf.

10. Over half, and in some cases, roughly 75% of the proven reserves of a number of American oil companies are located abroad. Looking at, say, Venezuela as an example, it seems possible that we are beginning to see a new wave of energy resource nationalizations. How is your company working to protect shareholders from the adverse consequences of such actions?

The increasing trend in energy resource nationalization is another big concern of ConocoPhillips'. This is especially troubling when the nationalizing government neither honors its promises nor the contract terms it offered as an incentive to ConocoPhillips for making enormous and otherwise risky investments of capital, technical knowledge, personnel, and time in the development of their natural resource and their economy in general. Although of great harm to the shareholders of ConocoPhillips, we believe the increasing number of partial and total nationalizations of energy resources may have an even greater negative consequence for energy security and the economic well being of U.S. citizens.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00154 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.092

In deciding to make these multi-billion dollar investments, ConocoPhillips balances the likely and potential rewards from its investments against the risks of nationalization, inflationary forces affecting costs of development and long-term production, strength of the U.S. dollar, geological and other resource risks, recessions and other product demand destroyers, and many other risks. These risks can sometimes be mitigated for our shareholders by (1) making investments in states and countries which have a stable fiscal policy and a reputation for honoring their promises, (2) obtaining enforceable contract commitments from the host government to stabilize its fiscal take for the long-term investment, to resolve all disputes arising from the investment through international arbitration, and to make its assets available for attachment within the signatory nations of the New York Convention to satisfy an arbitration award, and (3) making the investment under the protection of a bilateral or multilateral investment treaty which is suitable for long-term energy projects.

Although we can potentially mitigate the risks for shareholders, we cannot mitigate the risks for the energy-consuming public. U.S. energy consumers need the U.S. Congress to complement our efforts by increasing access to secure sources of supply in the United States.

Our responses to the requests made by the Committee on the Judiciary of the U.S. Senate contain forward-looking statements within the meaning of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. Actual outcomes and results may differ materially from what is expressed or forecast in such forward-looking statements. Economic, business, competitive and regulatory factors that may affect ConocoPhillips' business are generally as set forth in ConocoPhillips' filings with the Securities and Exchange Commission.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00155 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.093

Questions of Chairman Patrick Leahy
Following the Senate Judiciary Committee Hearing

"Exploring the Skyrocketing Price of Oil"

Questions for Entire Panel:

1. Mr. Hofmeister testified last week that the price of crude oil should be in the range of $35 to $65 a barrel. If the price of crude oil on the world market returned to that competitive level, what could your company charge for a gallon of gas and remain profitable?

The largest single component of retail gasoline price is the price of crude oil. In fact, DOE reported data from 1985 – 2007 show that 95% of the variability in gasoline prices is due to changes in crude oil prices. However, future gasoline prices will also be influenced by refinery performance, the introduction of biofuels and the level of imported product. Using industry composite statistics compiled by EIA and API, a crude price of $65 may indicate a retail gasoline price of approximately $2.57/gallon. This is detailed below:

Crude oil cost ($65/bbl)	*$1.55/gallon*
Federal, State excise taxes	*$0.47*
Refining costs	*$0.30*
Distribution/Marketing	*$0.25*
Composite gasoline price	*$2.57/gallon*

2. Each of your companies is vertically integrated from oil exploration and production through refining and retail gasoline sales. I understand that the price of crude oil is set on the world market, and that your companies, for the most part, sell the crude oil they produce on the market and then buy back the crude oil that they refine. I further understand that each of your companies refines more oil than it produces.

The efficiencies that come from vertical integration, however, should include the ability to refine the oil that you produce in a manner that is less expensive than if purchased in the commodities market.

(a) What is your company doing to make vertical integration work for consumers?

(b) If your company refined only the oil that it actually produced, rather than buying and selling on the world market, what price could it charge for a gallon of gas today and remain profitable?

(a) As an integrated oil company, BP is in a position to invest billions of dollars in high-risk, long-term investments for exploration, development and technology. In most years, oil companies do not receive a very large return on those investments. On average, the returns realized by oil companies are significantly below those of biotechs, financial firms and computing industries in particular and all industry in general, despite the level of risk undertaken. By making these investments, BP can then work to insure that it has a secure

43354.094

supply of crude oil and other energy sources to better supply its customers.

(b) The price for crude oil is set by global forces of supply and demand, rather than the cost of production. In his April 3, 2008 testimony before the Senate Committee on Energy and Natural Resources, CFTC Chief Economist Jeffrey Harris stated:

> *Given the relative stability of the makeup of participants and their positions in the markets and the absence of evidence that speculation has caused oil price changes, it appears that fundamentals provide the best explanation for crude oil price increases. These fundamentals can be either broad factors that affect many markets—like the value of the dollar or general inflation fears—or factors particular to a market—such as strong demand from China and India for crude oil and other commodities. In addition, geopolitical events, such as tensions involving Venezuela, Nigeria, Iran, Iraq, Turkey and the Kurds have affected commodity markets, especially the energy and precious metals markets.*

BP's refining business in the U.S. purchases most of the crude oil it processes from third parties, and it must pay the prevailing market prices for that crude. Similarly BP's refining business pays the prevailing market price when it uses BP's equity crude production. For BP's exploration and production business to unilaterally lower its equity crude prices to its refineries would leave BP vulnerable to claims relating to royalty payments owed to state and federal governments, severance taxes owed statte governments, , below-cost pricing, unfair business competition, bad faith, and other reputational issues from governments, distributors, and competitors. Furthermore, BP does not and cannot set the retail price of gasoline at the vast majority of its branded outlets – the retail price is set by independent business persons such as jobbers and dealers who own those sites. If BP wholesaled the gasoline to those independent business persons at below market prices, there would be no assurance the retail price would be set below the market price in the trade area. It would most likely result as increased margin for the station owners.

3. How much has each of your companies spent, directly or indirectly, on studies and reports on climate change? Please specify the studies and reports produced with your companies direct or indirect support.

BP has been active in promoting national, mandatory, entity wide climate policies and provided funding to academic organizations in support of these goals; over the course of the period 2002 - 2007, BP has provided approximately $27 million dollars to organizations such as Princeton, Stanford, and MIT to research options for addressing the issue of climate change. BP believes that human activity is contributing to CO2 increases and global climate change. BP supports the Intergovernmental Panel on Climate Change (IPCC) peer reviewed science and conclusions. We also support the adoption of a mandatory, national, economy-wide climate policy to address future CO2 emissions.

43354.095

Hearing of the Senate Committee on the Judiciary
"Exploring the Skyrocketing Price of Oil"
May 21, 2008

Questions for the Record
Senator Dianne Feinstein

Questions for all witnesses:

1. According to the May 15th Congressional testimony of the CFTC's Chief Economist and the CFTC's Director of Market Surveillance, oil companies are driving up the price of oil. These experts stated: "Our studies consistently find that when new information comes to the market and prices respond, it is the commercial traders (such as oil companies, utilities, airlines) who react first by adjusting their futures positions. When these commercial traders adjust their futures positions, it is speculators who are most often on the other side of the trade. Price changes that prompt hedgers to alter their futures positions attract speculators who change their positions in response. Simply stated, there is no evidence that position changes by speculators precede price changes for crude oil futures contracts." CFTC believes that oil companies are driving up prices in futures markets, not speculators. Yet, during the Judiciary Committee hearing on May 21, Mr. Stephen Smith of Exxon Mobil asserted that his firm "does not speculate." Does your firm buy or sell positions in crude oil futures markets? If your firm participates in futures markets, can you refute CFTC's assertion that your firms are driving up oil prices?

As a commercial participant in the energy markets with daily needs to buy and sell energy products in order to meet it customers' requirements, BP buys and sells crude oil futures contracts as part of its energy trading activity. It is a normal function of the market for commercial traders such as oil companies to react to new information by adjusting futures positions as necessary.

The CFTC has not stated that the oil companies are driving up prices in futures markets. In fact, in his April 3, 2008 testimony before the Senate Committee on Energy and Natural Resources, CFTC Chief Economist Jeffrey Harris stated:

> *Given the relative stability of the makeup of participants and their positions in the markets and the absence of evidence that speculation has caused oil price changes, it appears that fundamentals provide the best explanation for crude oil price increases. These fundamentals can be either broad factors that affect many markets—like the value of the dollar or general inflation fears—or factors particular to a market—such as strong demand from China and India for crude oil and other commodities. In addition, geopolitical events, such as tensions involving Venezuela, Nigeria, Iran, Iraq, Turkey and the Kurds have affected commodity markets, especially the energy and precious metals markets.*

2. Your firms vehemently oppose legislation – such as the 2007 energy bill tax amendment and Senator Reid's recent legislation to tax windfall oil company profits – that would increase the tax burden on oil and gas companies, arguing that increased taxation will lead to higher gas prices for consumers. However, you argued before the Judiciary Committee that your companies are unable to lower the price of oil. You say that you simply take the price in this global marketplace, instead of offering oil for sale at a set price and set mark-up. These two positions seem inconsistent. Do the economics of your firms influence oil prices, and will oil prices go up if your taxes go up? Or do the economics of your firms stand independent of oil prices, and will oil prices be set by demand regardless of the enormous size of your profits? It can't possibly be both.

43354.096

Over the last 5 years, BP has invested $31.5 billion in development of US energy supply – almost dollar for dollar of our US profits. Thus, for every dollar of increased tax on our operations, there is one fewer dollar to invest in projects that will deliver increased energy to US consumers – whether it is oil, gas, solar, wind, biofuels or other alternatives. Taxing one form of energy to fund development of another doesn't ensure greater supplies of energy to the consumer. This should be the primary criteria of any energy policy adopted by Congress.

3. The expense and technical challenge of developing new oil resources in harsh environments such as the Arctic is a frequently heard rationale for large oil industry mergers. Are these projects working out as planned? Can we expect to see large new petroleum resources coming on line in the next few years as a result of mergers?

Finding and producing oil and gas today requires greater scale to meet the challenges posed by greater technical, logistical, financial and permitting hurdles. BP's merger with Amoco and subsequent acquisition of Arco has increased our ability to compete. Nevertheless, BP remains a small player in this global business. Foreign national oil companies control more than 50 percent of global oil and gas production and almost 80 percent of the world's oil and gas reserves. By comparison, BP represents roughly 3 percent of global oil and gas production, and less than one percent of global oil and gas reserves.

BP has recently announced a partnership with ConocoPhillips to build the Denali Natural Gas pipeline project. At a cost of nearly $40 billion, this project will be the largest private sector construction project ever built in North America, and the first major commercialization of Alaska North Slope gas. BP is also investing in its refining capability, investing $4 billion to upgrade our Whiting, IN refinery and entering into a joint venture with Canada's Husky Energy to invest more than $4 billion to develop its Sunrise oil sands field and upgrade our Toledo, OH refinery.

BP is also using investment to find new oil and gas reserves in the deep water Gulf of Mexico; this exploration would most likely have overwhelmed a smaller company. These projects are extreme in every way – extremely risky, extremely large, extremely deep and extremely costly – and present unprecedented technical challenges.

4. To what extent are your refineries able to defer planned maintenance if and when refined product markets are tight? Has your company ever deferred refinery maintenance to meet a tight marketplace? If so, how frequently has your firm deferred maintenance? At what refineries and on what dates?

BP's refineries are geared towards maximizing output primarily to meet BP's marketing and supply needs. Maintenance occurs on a day-to-day activity and on a large scale in the form of a turnaround, where entire units are brought down for refurbishment. Turnarounds are scheduled and planned usually years ahead of time in order to secure available resources including labor. In a tight and highly specialized labor market required for refinery turnaround, deferring it is very costly. For these reasons, BP refineries are not in the practice of deferring this kind of large scale planned maintenance. BP refineries at times have deferred turnarounds to level labor and engineering demands, but have not deferred maintenance to meet tight marketplace demand. During turnarounds, our supply group obtains alternative resources to make sure BP's demands are met.

43354.097

5. With constraints on the expansion of refinery capacity in California, how do you foresee meeting demand for gasoline and diesel in the future?

BP estimates that legislation such as the CAFÉ standards, Renewable Fuel Standard and Low Carbon Fuels Standard will all serve to reduce the demand for gasoline in California in the future and at the same time increase demand for diesel. BP also estimates that increases in population and GDP will increase demand for gasoline and diesel. We estimate that the net impact of these changes is that total refined product demand in California will remain constant with today albeit with a reduction in gasoline demand and increase in diesel demand. BP generally seeks to match its production capability in its two West Coast refineries to its own marketing demand, with the minor imbalances sourced from/sold to local markets or imports as appropriate. This approach has seen numerous minor modifications to increase production capacity over the history of the refinery as demand has grown. Even as recently as this spring, our fluid catalytic cracking unit was modified to increase its capability to make gasoline. With little overall growth in total oil demand now expected, we expect to continue to implement minor modifications to match production to demand. In this environment, BP will most likely try to increase our flexibility to respond to a change in the mix of transport fuels by implementing modifications which increase our ability to switch production between gasoline, jet fuel and diesel.

6. According to initial research by the Government Accountability Office conducted at my request, the San Francisco Bay area has a significant degree of refinery market concentration. San Francisco also consistently has some of the highest gasoline prices in the United States – higher than other regions of California that must use the same reformulated gasoline. Do you believe that the high degree of market concentration among refineries in the San Francisco Bay Area is causing higher gasoline prices in this area?

BP does not own or operate any refineries in the Bay Area and so it will not speculate about this issue. The price of gasoline has been primarily affected by price of supplies, including crude oil, electrical power, and organic and inorganic materials used to make gasoline. In fact, the American Petroleum Association ("API") recently reported that the FTC has found that concentration in the industry remains low to moderate and vertical integration has been decreasing.[1]

7. How do pipeline and port constraints affect your ability to provide adequate supplies of fuel to consumers?

BP strives to adequately supply fuel to its customers. BP supplies fuel to its customers via various proprietary and 3rd party pipelines and terminals. BP has invested significantly in its port, pipeline and terminal assets in recent years and delivers a high degree of supply reliability to its customers and is not facing any material issues in meeting its contractual demand as a result of port or logistical constraints.

8. Given the importance of free market competition to the energy sector, what is your view of the current 54 cent a gallon tariff on ethanol imports into the United States? Do you believe Congress should reduce the tariff, at least to the $0.45 per gallon level that blenders receive for using ethanol in the United States? Would you endorse legislation to do this?

As a general rule, BP supports free markets. The new renewable fuels mandate established large biofuel blending levels and a very aggressive implementation timetable. There are questions

[1] "America's Oil and Natural Gas Industry: The Facts About Oil Industry Mergers, Market Power and Fuel Prices: An API Primer," May 12, 2008, page 5.

43354.098

regarding the ability of US biofuels manufacturers to meet these production targets. The presence of a tariff directionally discourages investment worldwide to supply biofuels to the US market. It also maintains higher consumer price levels than would otherwise exist in the marketplace. BP supports the elimination of the ethanol import tariff or its equalization with the current blenders tax credit as a means of minimizing potential market dislocations.

9. It would appear that Russia is currently working to lay claim to the North Pole and its natural resources. How would you like to see the situation resolved? What role should the U.S. government play?

As a commercial operation BP does not take positions on specific national boundary issues. However in the interest of enhancing world energy security we do hope that, in cases where countries disagree on territorial claims, peaceful resolutions can be found that allow exploration for and production of needed natural resources.

10. Over half, and in some cases, roughly 75% of the proven reserves of a number of American oil companies are located abroad. Looking at, say, Venezuela as an example, it seems possible that we are beginning to see a new wave of energy resource nationalizations. How is your company working to protect shareholders from the adverse consequences of such actions?

This is a known risk in the energy sector which impacts all companies operating in that host country. While a company cannot prevent nationalization, we can remain relevant and aligned with the resource holder. Prevention is partly by holding deep relationships with host governments where we operate and where we hope to operate. BP has a track record of developing resources responsibly - some of which are in OPEC nations and some are not. Therefore, each side brings something to the table - we bring one of the best proven track records, technology, experience, and knowledge. Similarly, BP maintains a diverse portfolio of energy options in many different geographic locations to manage risk and pursue unique development opportunities.

Questions for British Petroleum

1. In late 2007, BP settled a case in which the CFTC and the Department of Justice accused BP of manipulating and cornering propane prices in the United States. BP had to pay more than $300 million in fines to settle this case. One of your traders was also convicted on his own accord. In California, we don't have much sympathy for energy market manipulators. What has BP done that can reassure the people of California that BP has cleaned up its act?

We are ashamed that traders working for us manipulated the TET propane market in 2004 and attempted to do so in 2003. We've apologized for what occurred. The traders involved have been disciplined and no longer work for the company.

Our goal is to be an industry leader when it comes to assuring our participation in the nation's energy markets is appropriate. BP has invested heavily over the past several years in building a world class compliance framework to support our trading activities in the U.S. and globally. In North America, we have almost 40 compliance professionals dedicated to supporting our trading businesses. The Compliance organization is independent from the business and reports through the Compliance and Ethics organization. These compliance professionals independently monitor and investigate our trading activity and provide advice on an ongoing basis.

We have extensive annual training requirements to ensure awareness of the laws, regulations, policies, and guidelines related to our trading and market facing activity, including BP's code of conduct. We are working diligently with regulators and an independent monitor to ensure that we are addressing the appropriate compliance issues and to ensure that we are building a deep compliance culture.

43354.099

U.S. Senate Judiciary Committee
Hearing on "Exploring the Skyrocketing Price of Oil"
Written Questions from Senator Richard J. Durbin

Questions for all witnesses

1. Please provide a table displaying, for each year since 2000:

• the names of the top five most highly compensated individuals in your company for that year (with compensation defined to include salary, bonuses, benefits, stock options, in-kind gifts, deferred compensation, and other remuneration); and

• the amount of compensation received by each of those individuals, broken down by amount and type of compensation.

Please see separate pdf attachment for response to Q1.

2. Please provide a table displaying the following information for your company for each year since 2000:

• revenue
• net income
• return on equity
• total capital investment
• oil development investment
• refinery investment
• alternative energy research and development
• cash holdings
• marketing expenses

$millions unless noted	2000	2001	2002	2003	2004	2005	2006	2007
Revenue	148,062	174,218	187,721	164,653	192,024	239,792	265,906	284,365
Net Income	10,435	8,755	6,333	12,666	17,007	22,111	21,104	18,941
Return on Equity	16.4%	13.4%	9.8%	19.1%	23.3%	28.2%	25.6%	21.2%
Total Capital Investment	11,107	13,167	13,303	13,597	13,810	13,938	16,910	19,194
Oil Development Invest.	4,545	6,849	7,224	7,537	7,270	7,678	9,109	10,153
Refinery Investment	572	826	1,066	835	825	843	1,270	2,274
Alternative Energy R&D	15	15	16	19	16	35	40	91
Cash Holdings	1,831	1,808	1,735	2,056	1,359	2,960	2,590	3,562
Marketing Expenses*	na	na	na	418	470	507	447	541

*This reflects all advertising, sponsorship, promotions, trade marketing and market research

3. Several weeks ago, the Wall Street Journal's Market Watch quoted an industry analyst as estimating that about $25 to $30 of the price per barrel of crude oil may be attributed solely to speculation.

a) Does your internal research support that analysis?
b) What in your view is the price per barrel that can be justified purely by the supply and demand in the market?

43354.100

c) What steps do you think should be taken to protect consumers from the effects of excessive speculation in the trading markets for oil?

BP agrees with the CFTC, which has concluded that "there is little evidence that changes in speculative positions are systematically driving up crude oil prices." In his April 3, 2008 testimony before the Senate Committee on Energy and Natural Resources, CFTC Chief Economist Jeffrey Harris stated:

> *Given the relative stability of the makeup of participants and their positions in the markets and the absence of evidence that speculation has caused oil price changes, it appears that fundamentals provide the best explanation for crude oil price increases. These fundamentals can be either broad factors that affect many markets—like the value of the dollar or general inflation fears—or factors particular to a market—such as strong demand from China and India for crude oil and other commodities. In addition, geopolitical events, such as tensions involving Venezuela, Nigeria, Iran, Iraq, Turkey and the Kurds have affected commodity markets, especially the energy and precious metals markets.*

The price of crude oil reflects the forces of supply and demand as they exist at any given time – it is not possible to say what the price of crude oil "should be" apart from those market forces of supply and demand.

BP believes that the market oversight and enforcement powers exercised by the CFTC, as described in the April 3, 2008 testimony of Mr. Harris, are effective tools to protect the public from unlawful manipulation of prices. In addition, BP generally supports regulatory proposals that make the markets we trade in more efficient, more liquid and more transparent.

4. In your testimony, you claim that consolidation in the oil industry has been necessary to enable your company to compete globally. However, a 2004 GAO study found that consolidation and mergers in the oil refinery industry, "generally led to higher wholesale gasoline prices in the United States." As a result of all the mergers, the largest five oil companies now control 55% of the refining market, and the largest 10 dominate 81%.

a) In your view, how has market concentration in the refinery industry affected the price of gasoline?
b) Do you see a link between market concentration and reduced refinery production?
c) How much would increased refinery production lower gasoline and diesel prices?

BP agrees with the Federal Trade Commission that the GAO report should not be relied upon in making policy. As stated by the FTC:

> *The GAO report still contains major methodological mistakes that make its quantitative analyses wholly unreliable. It relies on critical factual assumptions that are both unstated*

43354.101

> *and unjustified, and it presents conclusions that lack a quantitative foundation. Simply stated, the GAO report is fundamentally flawed.*[1]

Even if you take the conclusions of the GAO Report at face value, the GAO concluded that two of the transactions studied led to decreases in wholesale prices and the results from one of the transactions was inconclusive. This suggests that in at least some cases, integration can lead to lower prices. In the absence of any clear metric as to which transactions will lead to lower prices and which will lead to higher prices, any disincentive for further integration has the potential to lead to economic inefficiencies and higher costs for consumers.

(a) It is not market concentration that has affected the price of gasoline, but the price of supplies, including crude oil, electrical power, and organic and inorganic materials used to make gasoline. In fact, the American Petroleum Association ("API") recently reported that the FTC has found that concentration in the industry remains low to moderate and vertical integration has been decreasing.[2]

(b) No. According to API, there has been increased production even though there are fewer refineries. In its recent report, the API stated:

> *Since 1985, U.S. refining capacity has increased by 20 percent even though there are 57 fewer refineries. Because the infrastructure to bring crude in and get products out is in place, it is more cost effective to add on to a refinery than to build a new one. The elimination of subsidies under the government price and allocation controls in 1981 led to the closure of many smaller, less efficient refineries throughout the 1980s and 1990s.*
>
> *According to the U.S. Energy Information Administration, current domestic refinery expansion plans will boost domestic refining capacity by another 800,000 per day by 2012, the equivalent of four new refineries. Moreover, a number of refinery modification or expansions have been announced to handle increased processing of heavier crude oils, including oil derived from Canadian oil sands. This additional crude from Canada – a reliable, nearby source – should enhance our domestic energy security.*[3]

(c) No refinery can run full out all the time. As I testified, BP's refineries are currently running at 88 – 89% of available capacity. Without a change in the price of basic supplies, including crude, as well as change in the worldwide demand for gasoline, diesel and other transportation products, refinery production levels will not have a significant impact on the price of gasoline.

5. In the last couple of weeks, we have seen the release of a handful of reports that claim that our use of ethanol has displaced a certain amount of gasoline from the nation's pool of transportation

---

[1] Prepared Statement of the Federal Trade Commission titled "Market Forces, Anticompetitive Activity, and Gasoline Prices: FTC Initiatives to Protect Competitive Markets, presented by William E. Kovacic, General Counsel, Before The Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs Committee on Government Reform United States House of Representatives (July 7, 2004) at 8.

[2] "America's Oil and Natural Gas Industry: The Facts About Oil Industry Mergers, Market Power and Fuel Prices: An API Primer," May 12, 2008, page 5.

[3] Id., page 9.

43354.102

fuels, and that the displacement of more expensive gasoline with less expensive ethanol has resulted in lower consumer prices at the gas pump. These experts say that the savings have been between 15-20%, which would translate into about $400-$600 of savings per family or about $50 billion to $75 billion saved nationwide.

a) What is the effect on retail gasoline prices of cheaper ethanol being blended into gasoline?

While growing volumes of ethanol in US gasoline reduce oil consumption, it is difficult to calculate the direct impact of these volumes on retail gasoline prices. The degree of savings depends on the price of the respective inputs: Ethanol, which depend on corn prices; and gasoline, which depend on crude oil prices.

- *Greater use of ethanol could in theory benefit consumers two ways: Through lower cost (if ethanol is cheaper than gasoline) and through the impact of reduced oil demand on oil prices.*
- *With the two fuels competing, economic theory tells us that prices for the two should tend to equalize—which is what we say today (see below).*

Currently ethanol prices (per gallon) are lower than gasoline prices. However, the fact that ethanol has one-third less energy per gallon than conventional gasoline must be taken into account when assessing the cost-competitiveness of the respective fuels. DOE/EIA data shows that the wholesale price of conventional gasoline at the US Gulf Coast now stands at $3.27/gal (May 28).

- *Spot ethanol prices can vary widely by location; at the US Gulf Coast ethanol costs about $2.55/gallon (source: Ecowin). Adjusting for the lower energy content, this is equivalent to a wholesale gasoline price of $3.83/gallon.*
- *When ethanol's advantaged tax treatment is taken into account, this suggests that, on an energy-adjusted basis, ethanol is priced very close to gasoline, at least on the US Gulf Coast.*
- *Relative prices have been volatile in recent years, in part due to sharp swings in both corn and crude oil prices. In 2006, for example, ethanol was more expensive than gasoline.*

The second benefit for US consumers could come via reducing oil demand and therefore reducing oil prices.

- *Current ethanol use in the US averages roughly 550,000 barrels per day (b/d). After correcting for the lower energy content of ethanol, this is equivalent to displacing about 370,000 b/d of gasoline—roughly 0.5% of world oil consumption.*
- *At the margin, lower oil consumption should result in lower oil prices, but the net effect depends on whether reduced consumption is offset by supply reductions by OPEC producers.*

b) If the renewable fuels mandate were waived this year and nine billion gallons of ethanol were removed from the market, additional petroleum would need to be "found" to replace this fuel. Some economists say that prices would increase by as much as 50 cents to 80 cents per gallon based on standard calculations. Based on your historical observations, would you expect to see that large of an increase?

43354.103

See response to 5(a) above. The market impact of removing ethanol from the gasoline supply pool will be the reverse of the effect seen above and will be largely determined by OPEC's ability to respond to the increase call on oil to supplement the loss of ethanol volumes.

c) One of the challenges to making production and the mandate sync up is associated with the infrastructure needed to develop the biofuels industry. What is your position regarding higher blend levels of ethanol and the deployment of pumps capable of dispensing E-85?

BP supports research efforts to demonstrate the compatibility of ethanol blends greater than 10% on the in-use vehicle fleet. Higher blend rates will be important to allow the industry to meet the progressively higher RFS mandate levels since penetration of E-85 compatible vehicles will not be sufficient to allow the industry to meet its RFS requirements with only an E-85 supply option. BP currently doesn't offer an E-85 branded product but allows branded distributors and retailers to offer an unbranded product under the canopy, in properly labeled, stand-alone dispensers. Similarly, BP does allow advertising of an unbranded E-85 product. Currently, no new E-85 pumps have been approved for installation as Underwriter Laboratories has yet to certify the safety of dispensers for E-85 service. We expect installations to resume once UL certification is received.

Questions for Robert A. Malone

1. What carbon offset options has BP considered for the BP Whiting refinery expansion?

BP will address carbon emissions at the Whiting refinery when the Congress creates a framework that allows a fair and transparent carbon price to be established so that affected industries may make informed decisions concerning control options, infrastructure investments and operational parameters.

BP has long advocated for the creation of a single, mandatory US greenhouse gas emissions registry and a national policy that would establish a market price for carbon. Market-based programs will deliver the greatest and fastest reductions at the least cost. Individual project carbon offsets are not a surrogate for a comprehensive national carbon policy and would create competitive distortions in the market-place.

43354.104

Executive Director Remuneration Data from Annual Report/20-F

Amounts in Thousands

	2007 (Source: 2007 20-F) (in currency received by individual)								2007 (Converted to US$ at Year Average Exchange Rate)							
	Salary	Bonus	Other Benefits	Total Annual	Long Term	Total Direct	Pensions	Total Comp	Salary	Bonus	Other Benefits	Total Annual	Long Term	Total Direct	Pensions	Total Comp
Executive Directors																
Dr. A B Hayward	£877	£1,262	£14	**£2,153**	£0	£2,153	£3,925	**£6,078**	$1,754	$2,524	$28	**$4,306**	£0	$4,306	$7,850	**$12,156**
Dr. D C Allen	£500	£539	£13	**£1,052**	£0	£1,052	£250	**£1,302**	$1,000	$1,078	$26	**$2,104**	£0	$2,104	$500	**$2,604**
I C Conn	£581	£698	£45	**£1,324**	£0	£1,324	£865	**£2,189**	$1,162	$1,396	$90	**$2,648**	£0	$2,648	$1,730	**$4,378**
Dr. B E Grote	$1,175	$1,551	$10	**$2,736**	$0	$2,736	$311	**$3,047**	$1,175	$1,551	$10	**$2,736**	$0	$2,736	$311	**$3,047**
A G Inglis	£556	£800	£188	**£1,544**	£0	£1,544	£1,677	**£3,221**	$1,112	$1,600	$376	**$3,088**	£0	$3,088	$3,354	**$6,442**
Directors Leaving the Board in 2007																
Lord Browne of Madingly X	£531	£821	£85	**£1,237**	£436	£1,673	£(148)	**£1,525**	$1,062	$1,242	$170	**$2,474**	£872	$3,346	($296)	**$3,050**
J A Manzoni Y	£323	£311	£33	**£667**	£0	£667	£1,234	**£1,901**	$646	$622	$66	**$1,334**	£0	$1,334	$2,468	**$3,802**

US$/GBP Exchange Rate used to convert GBP data to US$ = 2.00

Components of 2007 Remuneration
Salary
Bonus 2007 Annual Performance Bonus
Other Benefi Non-Cash Benefits and Other Emoluments
Total Annual Total Annual Remuneration (Salary + Bonus + Non-Cash)
Long Term 2005-2007 Share Element of LTIP
Pensions Increase in Transfer Value of Pensions less Director Contributions
Total Total Compensation (Subtotal + Long Term + Pensions)

X Lord Browne, as stated in the above, was awarded a lump sum ex-gratia payment of one year's salary (£1,575,000).

Y Mr. Manzoni, in addition to the above, was awarded compensation for loss of office equal to one year's salary (£485,000). He also received £30,000 in respect of statutory rights and entered his company car

Amounts in Thousands

	2006 (Source: 2006 20-F) (in currency received by individual)								2006 (Converted to US$ at Year Average Exchange Rate)							
	Salary	Bonus	Other Benefits	Total Annual	Long Term	Total Direct	Pensions	Total Comp	Salary	Bonus	Other Benefits	Total Annual	Long Term	Total Direct	Pensions	Total Comp
Executive Directors																
Lord Browne of Madingly	£1,531	£900	£95	**£2,526**	£2,644	£5,170	£1,121	**£6,291**	$2,912	$1,656	$175	**$4,646**	$2,761	$8,469	$3,107	**$11,575**
Dr. A B Hayward	£463	£250	£20	**£733**	£956	£1,339	£609	**£1,948**	$852	$460	$37	**$1,349**	$1,115	$2,463	$1,121	**$3,584**
Dr. D C Allen	£463	£250	£13	**£726**	£586	£1,312	£593	**£1,905**	$852	$460	$24	**$1,336**	$1,079	$2,415	$1,090	**$3,505**
I C Conn	£463	£250	£42	**£755**	£343	£1,098	£336	**£1,434**	$852	$460	$77	**$1,389**	$629	$2,018	$621	**$2,639**
J A Manzoni	£463	£250	£45	**£758**	£206	£1,064	£443	**£1,807**	$852	$460	$83	**$1,395**	$1,116	$2,510	$815	**$3,325**
Dr. B E Grote	$973	$525	$1	**$1,499**	$1,138	$2,637	$910	**$3,547**	$973	$525	$1	**$1,499**	$1,138	$2,637	$910	**$3,547**

US$/GBP Exchange Rate used to convert GBP data to US$ = 1.84

Components of 2006 Remuneration
Salary
Bonus 2006 Annual Performance Bonus
Other Benefi Non-Cash Benefits and Other Emoluments
Total Annual Total Annual Remuneration (Salary + Bonus + Non-Cash)
Long Term 2004-2006 Share Element of LTIP
Pensions Increase in Transfer Value of Pensions less Director Contributions
Total Total Compensation (Subtotal + Long Term + Pensions)

Caveats: Due to the Executive Director compensation most readily available in the 20-F, Bribes not consider other higher remunerated employees (e.g. traders). Bribes not count exercise of share options.

DRAFT 1
June 3, 2008

Executive Director Remuneration Data from Annual Report/20-F

Amounts in Thousands	2005 (Source: 2005 20-F) (in currency received by individual)								2005 (Converted to US$ at Year Average Exchange Rate)								
	Salary	Bonus	Other Benefits	Total Annual	Long Term	Total Direct	Pensions	Total Comp	Salary	Bonus	Other Benefits	Total Annual	Long Term	Total Direct	Pensions	Total Comp	
Executive Directors																	
Lord Browne of Madingly	£1,451	£1,750	£90	£3,291	£3,202	£6,493	£2,809	£9,302	$2,539	$3,063	$158	$5,759	$5,604	£11,363	$4,916	$16,279	
Dr. A B Hayward	£431	£460	£14	£905	£998	£1,903	£728	£2,631	$754	$805	$25	$1,584	$1,747	£3,330	$1,274	$4,604	
Dr. D C Allen	£431	£480	£12	£923	£998	£1,921	£679	£2,600	$754	$840	$21	$1,615	$1,747	£3,362	$1,188	$4,550	
I C Conn	£421	£450	£43	£914	£461	£1,375	£582	£1,957	$737	$788	$75	$1,600	$807	£2,406	$1,019	$3,425	
J A Manzoni	£431	£440	£47	£918	£998	£1,916	£560	£2,476	$754	$770	$82	$1,607	$1,747	£3,353	$980	$4,333	
Dr. B E Grote	$923	$1,100	$0	$2,023	$2,077	$4,100	$1,152	$5,252	$923	$1,100	$0	$2,023	$2,077	£4,100	$1,152	$5,252	Other Benefits

Components of 2005 Remuneration
Salary
Bonus 2005 Annual Performance Bonus
Other Benefi Non-Cash Benefits and Other Emoluments
Total Annual Total Annual Remuneration (Salary + Bonus + Non-Cash)
Long Term 2003-2005 Share Element of EDIP
Pensions Increase in Transfer Value of Pensions less Director Contributions
Total Total Compensation (Subtotal + Long Term + Pensions)

US$/GBP Exchange Rate used to convert GBP data to US$ = 1.75

Comments: This is the Executive Director compensation most readily available in the 20-F.
It does not consider other highly remunerated employees (e.g., traders).
It does not guard executive of share options.

Amounts in Thousands	2004 (Source: 2004 20-F) (in currency received by individual)								2004 (Converted to US$ at Year Average Exchange Rate)							
	Salary	Bonus	Other Benefits	Total Annual	Long Term	Total Direct	Pensions	Total Comp	Salary	Bonus	Other Benefits	Total Annual	Long Term	Total Direct	Pensions	Total Comp
Executive Directors																
Lord Browne of Madingly	£1,382	£2,280	£82	£3,744	£1,905	£5,649	£1,268	£6,917	$2,529	$4,172	$150	$6,852	$3,486	£10,338	$2,320	$12,658
Dr. A B Hayward	£410	£615	£36	£1,061	£294	£1,355	£288	£1,643	$750	$1,125	$66	$1,942	$538	£2,480	$527	$3,007
Dr. D C Allen	£410	£615	£11	£1,036	£320	£1,356	£175	£1,531	$750	$1,125	$20	$1,895	$586	£2,481	$320	$2,802
J A Manzoni	£410	£615	£46	£1,071	£320	£1,391	£200	£1,591	$750	$1,125	$84	$1,960	$586	£2,546	$366	$2,912
Dr. B E Grote	$841	$1,262	$0	$2,103	$1,381	$3,484	$715	$4,199	$841	$1,262	$0	$2,103	$1,381	£3,484	$715	$4,199
Director Leaving the Board in 2004																
R.L. Olver	£292	£438	£42	£772	£786	£1,558	£2,827	£4,385	$534	$802	$77	$1,413	$1,438	£2,851	$5,173	$8,025

Components of 2004 Remuneration
Salary
Bonus 2004 Annual Performance Bonus
Other Benefi Non-Cash Benefits and Other Emoluments
Total Annual Total Annual Remuneration (Salary + Bonus + Non-Cash)
Long Term 2002-2004 Share Element of EDIP
Pensions Increase in Transfer Value of Pensions less Director Contributions
Total Total Compensation (Subtotal + Long Term + Pensions)

US$/GBP Exchange Rate used to convert GBP data to US$ = 1.95

Comments: This is the Executive Director compensation most readily available in the 20-F.
It does not consider other highly remunerated employees (e.g., traders).

DRAFT 1
June 3, 2008

Executive Director Remuneration Data from Annual Report/20-F

Amounts in Thousands	2003 (Source: 2003 20-F) (in currency received by individual)								2003 (Converted to US$ at Year Average Exchange Rate)							
	Salary	Bonus	Other Benefits	Total Annual	Long Term	Total Direct	Pensions	Total Comp	Salary	Bonus	Other Benefits	Total Annual	Long Term	Total Direct	Pensions	Total Comp
Executive Directors																
Lord Browne of Madingly	£1,316	£1,882	£79	£3,277	£1,503	£4,780	£1,159	£5,939	$2,316	$3,312	$139	$5,768	$2,645	£8,413	$2,040	$10,453
Dr. A B Hayward	£367	£459	£3	£829	£234	£1,063	£665	£1,728	$646	$808	$5	$1,459	$412	£1,871	$1,170	$3,041
Dr. D C Allen	£367	£459	£2	£828	£256	£1,094	£567	£1,661	$646	$808	$4	$1,457	$468	£1,925	$998	$2,923
J A Manzoni	£367	£477	£24	£878	£218	£1,096	£388	£1,484	$646	$840	$60	$1,545	$384	£1,929	$683	$2,612
R.L. Olver	£570	£741	£43	£1,354	£616	£1,970	£798	£2,768	$1,003	$1,304	$76	$2,383	$1,084	£3,467	$1,404	$4,872
Dr. B E Grote	£770	$1,001	$179	$1,950	$1,063	$3,013	$1,321	$4,334	$770	$1,001	$179	$1,950	$1,063	£3,013	$1,321	$4,334
Director Leaving the Board in 2003																
R.F. Chase	£231	£295	£30	£556	£742	£1,298	£153	£1,451	$407	$519	$53	$979	$1,306	£2,284	$269	$2,554

Components of 2003 Remuneration
Salary
Bonus 2003 Annual Performance Bonus
Other Benefi Non-Cash Benefits and Other Emoluments
Total Annual Total Annual Remuneration (Salary + Bonus + Non-Cash)
Long Term 2001-2003 Share Element of EDIP
Pensions Increase in Transfer Value of Pensions less Director Contributions
Total Total Compensation (Subtotal + Long Term + Pensions)

US$/GBP Exchange Rate used to convert GBP data to US$ = [illegible]

Caveats: This is the Executive Director compensation most readily available in the 20-F. It does not consider other highly remunerated employees (e.g., traders). It does not include exercise of share options.

Amounts in Thousands	2002 (Source: 2002 20-F) (in currency received by individual)								2002 (Converted to US$ at Year Average Exchange Rate)							
	Salary	Bonus	Other Benefits	Total Annual	Long Term	Total Direct	Pensions	Total Comp	Salary	Bonus	Other Benefits	Total Annual	Long Term	Total Direct	Pensions	Total Comp
Executive Directors																
Lord Browne of Madingly	£1,284	£1,695	£52	£3,031	£883	£3,914	£2,808	£6,722	$1,926	$2,543	$78	$4,547	$1,325	£5,871	$4,212	$10,083
R.F. Chase	£640	£768	£32	£1,440	£548	£1,988	£1,016	£3,004	$960	$1,152	$48	$2,160	$822	£2,982	$1,524	$4,506
R.L. Olver	£530	£636	£37	£1,203	£463	£1,666	£1,255	£2,921	$795	$954	$56	$1,805	$695	£2,499	$1,883	$4,382
Dr. B E Grote	$713	$856	$302	$1,871	$402	$2,273	$2,424	$4,697	$713	$856	$302	$1,871	$402	£2,273	$2,424	$4,697
Director Leaving the Board in 2003																
Dr. J.G.S. Buchanan	£477	£572	£17	£1,066	£485	£1,551	£934	£2,485	$716	$858	$26	$1,599	$728	£2,327	$1,401	$3,728
W.D. Ford	$180	$180	$148	$508	$624	$1,132	$2,336	$3,468	$180	$180	$148	$508	$624	£1,132	$2,336	$3,468

Components of 2002 Remuneration
Salary
Bonus 2002 Annual Performance Bonus
Other Benefi Non-Cash Benefits and Other Emoluments
Total Annual Total Annual Remuneration (Salary + Bonus + Non-Cash)
Long Term 2000-2002 Share Element of EDIP
Pensions Increase in Transfer Value of Pensions less Director Contributions
Total Total Compensation (Subtotal + Long Term + Pensions)

US$/GBP Exchange Rate used to convert GBP data to US$ = [illegible]

Caveats: This is the Executive Director compensation most readily available in the 20-F. It does not consider other highly remunerated employees (e.g., traders).

DRAFT 1
June 3, 2008

Executive Director Remuneration Data from Annual Report/20-F

Excludes risk costs because of share options.

Amounts in Thousands	2001 (Source: 2001 20-F) (in currency received by individual)								2001 (Converted to US$ at Year Average Exchange Rate)							
	Salary	Bonus	Other Benefits	Total Annual	Long Term	Total Direct	Pensions	Total Comp	Salary	Bonus	Other Benefits	Total Annual	Long Term	Total Direct	Pensions	Total Comp
Executive Directors																
Lord Browne of Madingly	£1,200	£1,782	£55	£3,037	£2,575	£5,612	£4,806	£10,417	$1,728	$2,566	$79	$4,373	$3,708	£8,081	$6,920	$15,001
R.F. Chase	£590	£797	£31	£1,418	£1,717	£3,135	£861	£3,996	$850	$1,147	$45	$2,042	$2,472	£4,514	$1,240	$5,754
R.L. Olver	£492	£664	£37	£1,192	£1,374	£2,566	£944	£3,510	$708	$956	$53	$1,717	$1,978	£3,695	$1,360	$5,055
Dr. B E Grote	$665	$898	$301	$1,864	$1,373	$3,237	$182	$3,419	$665	$898	$301	$1,864	$1,373	£3,237	$182	$3,419
Dr. J.G.S. Buchanan	£480	£648	£22	£1,150	£1,526	£2,676	£403	£3,078	$691	$933	$32	$1,656	$2,197	£3,853	$580	$4,433
W.D. Ford	$720	$972	$496	$2,188	$1,373	$3,561	$1,664	$5,225	$720	$972	$496	$2,188	$1,373	£3,561	$1,664	$5,225
Director Leaving the Board in 2003																
Dr. C.S. Gibson-Smith	£345	£537	£308	£1,190	£1,374	£2,564	£14	£2,578	$497	$773	$444	$1,714	$1,978	£3,692	$20	$3,712

US$/GBP Exchange Rate used to convert GBP data to US$ = 1.44

Components of 2001 Remuneration
Salary
Bonus 2001 Annual Performance Bonus
Other Benefi Non-Cash Benefits and Other Emoluments
Total Annual Total Annual Remuneration (Salary + Bonus + Non-Cash)
Long Term 1999-2001 Share Element of EDIP
Pensions Estimated Increase in Transfer Value of Pensions less Director Contributions
Total Total Compensation (Subtotal + Long Term + Pensions)

Caveats: This is the Executive Director compensation most readily available in the 20-F.
It does not include other highly remunerated employees (e.g., traders).
It does not count exercise of share options.

Amounts in Thousands	2000 (Source: 2000 20-F) (in currency received by individual)								2000 (Converted to US$ at Year Average Exchange Rate)							
	Salary	Bonus	Other Benefits	Total Annual	Long Term	Total Direct	Pensions	Total Comp	Salary	Bonus	Other Benefits	Total Annual	Long Term	Total Direct	Pensions	Total Comp
Executive Directors																
Lord Browne of Madingly	£815	£925	£89	£1,629	£3,017	£4,646	£0	£4,646	$1,231	$1,396	$135	$2,762	$4,556	£7,316	£0	$7,318
R.F. Chase	£510	£578	£53	£1,141	£1,921	£3,062	£0	£3,062	$770	$873	$80	$1,723	$2,900	£4,623	£0	$4,623
R.L. Olver	£430	£487	£44	£961	£1,685	£2,646	£185	£2,831	$649	$736	$66	$1,451	$2,544	£3,995	$280	$4,275
Dr. J.G.S. Buchanan	£450	£511	£50	£1,011	£1,812	£2,823	£199	£3,022	$680	$771	$76	$1,527	$2,736	£4,263	$300	$4,563
W.D. Ford	$620	$703	$546	$1,869	$0	$1,869	$871	$2,740	$620	$703	$546	$1,869	$0	£1,869	$871	$2,740
Dr. C.S. Gibson-Smith	£410	£465	£72	£946	£1,685	£2,631	£185	£2,817	$619	$702	$108	$1,429	$2,544	£3,973	$280	$4,253
Director Leaving the Board in 2003																
B.K.Sanderson	£338	£383	£627	£1,348	£1,921	£3,268	£0	£3,268	$510	$578	$947	$2,035	$2,900	£4,935	£0	$4,935

US$/GBP Exchange Rate used to convert GBP data to US$ = 1.50

Components of 2000 Remuneration
Salary
Bonus 2001 Annual Performance Bonus
Other Benefi Non-Cash Benefits and Other Emoluments
Total Annual Total Annual Remuneration (Salary + Bonus + Non-Cash)
Long Term 1998-2000 Share Element of EDIP
Pensions Estimated Increase in Transfer Value of Pensions less Director Contributions
Total Total Compensation (Subtotal + Long Term + Pensions)

Caveats: This is the Executive Director compensation most readily available in the 20-F.

DRAFT 1
June 3, 2008

Questions of Senator Sheldon Whitehouse
Following the Senate Judiciary Committee Hearing
on
"Exploring the Skyrocketing Price of Oil"

Questions for Entire Panel:

Has your company, any subsidiary, or any entity acting under common ownership or control, financially contributed to any organizations that study global warming or climate change? If so, which are those organizations and how much in total has your company given to each one?

> *Yes, over the course of the period 2002 - 2007, BP has invested approximately $27 million dollars to organizations such as Princeton, Stanford, and MIT to climate change issues. BP believes that human activity is contributing to CO2 increases and global climate change. BP supports the Intergovernmental Panel on Climate Change (IPCC) peer reviewed science and conclusions. We also support the adoption of a mandatory, national, economy-wide climate policy to address future CO2 emissions.*

Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the American Legislative Exchange Council? If so, how much has it contributed? Does your company agree with the American Legislative Exchange Council's opinion that increasing levels of carbon dioxide are not causing glaciers to retreat?

> *BP America does not fund ALEC, however prior to company mergers individual companies that comprise BP today may have participated with this organization. BP believes that human activity is contributing to CO2 increases and global climate change. BP supports the Intergovernmental Panel on Climate Change (IPCC) peer reviewed science and conclusions. We also support the adoption of a mandatory, national, economy-wide climate policy to address future CO2 emissions.*

Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Cato Institute? If so, how much has it contributed? Either way, does your company agree with Cato Institute commentary that "science no longer provides justification for any rush to pass drastic global warming legislation."?

> *BP America does not fund the Cato Institute, however prior to company mergers individual companies that comprise BP today may have participated with this organization. BP believes that human activity is contributing to CO2 increases and global climate change. BP supports the Intergovernmental Panel on Climate Change (IPCC) peer reviewed science and conclusions. We also support the adoption of a mandatory, national, economy-wide climate policy to address future CO2 emissions.*

Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Committee for a Constructive Tomorrow? If so, how much has it contributed? Does your company agree with the Committee for a Constructive Tomorrow that "recent glacial retreats, sea-level rise and migrations of temperature sensitive species are all within the bounds of known natural variability."?

43354.109

BP America does not fund this organization, however prior to company mergers individual companies that comprise BP today may have participated with this organization. BP believes that human activity is contributing to CO2 increases and global climate change. BP supports the Intergovernmental Panel on Climate Change (IPCC) peer reviewed science and conclusions. We also support the adoption of a mandatory, national, economy-wide climate policy to address future CO2 emissions.

Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Annapolis Center for Science-Based Public Policy? If so, how much has it contributed? Does your company agree with an Annapolis Center for Science-Based Public Policy report that states "climate models may never be able to make greenhouse-warming predictions with certainty?"

BP America does not fund this organization, however prior to company mergers individual companies that comprise BP today may have participated with this organization. BP believes that human activity is contributing to CO2 increases and global climate change. BP supports the Intergovernmental Panel on Climate Change (IPCC) peer reviewed science and conclusions. We also support the adoption of a mandatory, national, economy-wide climate policy to address future CO2 emissions.

Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Acton Institute for the Study of Religion and Liberty? If so, how much has it contributed? Does your company agree with Acton Institute for the Study of Religion and Liberty commentary that it is a "myth that [global warming] is an emergency that demands a drastic cutback in CO-2 emissions" and that "making a case against CO-2 without making a case against nature is like making an omelet without breaking the proverbial egg. It is impossible."?

BP America does not fund this organization, however prior to company mergers individual companies that comprise BP today may have participated with this organization. BP believes that human activity is contributing to CO2 increases and global climate change. BP supports the Intergovernmental Panel on Climate Change (IPCC) peer reviewed science and conclusions. We also support the adoption of a mandatory, national, economy-wide climate policy to address future CO2 emissions.

Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Center for the Study of Carbon Dioxide and Global Change? If so, how much has it contributed? Does your company agree with the Center for the Study of Carbon Dioxide and Global Change that "there is no compelling reason to believe that the rise in temperature was caused by the rise in CO-2."?

BP America does not fund this organization, however prior to company mergers individual companies that comprise BP today may have participated with this organization. BP believes that human activity is contributing to CO2 increases and global climate change. BP supports the Intergovernmental Panel on Climate Change (IPCC) peer reviewed science and conclusions. We also support the adoption of a mandatory, national, economy-wide climate policy to address future CO2 emissions.

43354.110

Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Frontiers of Freedom Institute? If so, how much has it contributed? Does your company agree with the Frontiers of Freedom Institute that S.2191, America's Climate Security Act, is "a hyped-up rallying cry against a 'problem' that scientists can't even agree exists in the first place."?

BP America does not fund this organization, however prior to company mergers individual companies that comprise BP today may have participated with this organization. BP believes that human activity is contributing to CO2 increases and global climate change. BP supports the Intergovernmental Panel on Climate Change (IPCC) peer reviewed science and conclusions. We also support the adoption of a mandatory, national, economy-wide climate policy to address future CO2 emissions.

Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the George C. Marshall Institute? If so, how much has it contributed? Does your company agree with the George C. Marshall Institute that there is a "shattered consensus" on the state of global warming?

BP America does not fund this organization, however prior to company mergers individual companies that comprise BP today may have participated with this organization. BP believes that human activity is contributing to CO2 increases and global climate change. BP supports the Intergovernmental Panel on Climate Change (IPCC) peer reviewed science and conclusions. We also support the adoption of a mandatory, national, economy-wide climate policy to address future CO2 emissions.

Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Heartland Institute? If so, how much has it contributed? Does your company agree with the Heartland Institute that "there is no consensus about the causes, effects, or future rate of global warming," and that "most climate scientists doubt the reliability of computer models and the accuracy of land-based temperature records," and that "reports by the IPCC are unreliable due to political editing and rewriting of the reports' conclusions," and that "some of the key evidence cited in past IPCC reports has been shown to be fraudulent."?

BP America does not fund this organization, however prior to company mergers individual companies that comprise BP today may have participated with this organization. BP believes that human activity is contributing to CO2 increases and global climate change. BP supports the Intergovernmental Panel on Climate Change (IPCC) peer reviewed science and conclusions. We also support the adoption of a mandatory, national, economy-wide climate policy to address future CO2 emissions.

Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Institute for Energy Research? If so, how much has it contributed? Does your company agree with the Institute for Energy Research that global climate change is a "craze...fueled by alarmist rhetoric and trumped up scientific claims."?

BP America does not fund this organization, however prior to company mergers individual companies that comprise BP today may have participated with this organization. BP believes that human activity is contributing to CO2 increases and global climate change. BP supports the Intergovernmental Panel on Climate Change

43354.111

(IPCC) peer reviewed science and conclusions. We also support the adoption of a mandatory, national, economy-wide climate policy to address future CO2 emissions.

At a time when gasoline prices were near record highs, your five companies earned record-breaking profits last year: $116 billion. ExxonMobil made $40.6 billion last year, which is more than the all federal highway spending and about as much as the entire credit card industry earned that year. Since 2002, your five companies have consistently broken profit records. If you continue to profit this year at the pace you did in the first quarter, you are once again poised to smash profit records, not just for your industry, but for all industries. Please explain why what, in raw numbers, may be the most profitable industry in history needs the multi-billion dollar Section 199 domestic manufacturing tax breaks enacted in 2004. Why aren't those profits adequate to provide access to capital without those tax incentives?

The Section 199 domestic manufacturing deduction was included in the American Jobs Creation Act of 2004. Although it began as an effort to modify the Extraterritorial Income Exclusion (ETI) tax rules (successor to FSC rules) which were declared illegal by the World Trade Organization, Congress ultimately expanded that goal to include the creation of US jobs. Section 199 helps spur investment in the US, which in turn, helps create new US manufacturing and production jobs. Congress recognized the importance of the thousands of jobs in the domestic oil and natural gas industry and included petroleum extraction and refining with the US as qualifying activities.

Congress is constantly reevaluating the industry's tax incentives. We would urge you to treat all competitors equally and to maintain a level playing field for all companies in the energy industry. In addition, I would recommend that if you want to encourage domestic oil and gas production, you should recognize that punitive tax regimes will encourage capital to be invested outside of the US, which is contrary to your intent.

BP supports a balanced energy policy that encourages development of alternative energy sources but also allows us to continue to responsibly develop our investment in all forms of energy in the US.

The petroleum industry operates in an unusual fashion. Your five corporations are integrated oil giants that control all stages of production and distribution. From the exploration and mining to the refinement and transportation to the moment the customer swipes her Exxon or Shell charge card at the pump, you control everything. Are you aware of any other industries that operate in this fashion? How would you respond to the suggestion that it may be time to examine whether the vertically integrated ownership structure facilitates price gouging and harms consumers? Would you support a Congressionally-directed study to examine the effects of your ownership structure?

Vertical integration is common throughout the economy and can be found in varying degrees in industries including airlines, steel, movie production, retailing and technology.

In a recent publication, the American Petroleum Institute ("API") stated that:

> *The oil industry is becoming less vertically integrated. According to the FTC (2004), the share of U.S. refining capacity owned by independent refiners with no*

43354.112

production operations was eight percent in 1990. By 2007, the share was over 21 percent.[1]

The same publication also cited a 2006 FTC investigation in which the FTC found:

> *"no evidence indicating that refiners make product output decisions to affect the market price of gasoline. Instead, the evidence indicated the refiners responded to market prices by trying to produce as much higher-valued products as possible...The evidence collected in this investigation indicated that firms behave competitively."*[2]

Based on these findings, BP believes that the vertical integration structure is not harmful to consumers, but instead has resulted in benefits because of the efficient nature of the ownership structure.

As to whether BP would support a study to examine the effects of its ownership structure, in the past, BP has cooperated fully with numerous investigations. If the government elects to conduct another investigation or study, BP will cooperate.

The attached graph illustrates that the growth in profits of your five companies over the past six years has outpaced even the sharp increase in the price of gasoline. Why is your profit margin rising at a rate that is so much higher than the price of your product? How much has your company invested in research and development of coal to liquids technology for use as transportation fuel in each of the past five years? How much has your company invested in research and development of hydrogen technology for use as transportation fuel in each of the past five years? How much has your company invested in research and development of non-fossil fuel renewable energy sources for use as transportation fuel, excluding hydrogen technology, in each of the last five years?

An integrated oil company's worldwide profits are comprised of many points of information, not simply the price of one refined petroleum product – gasoline. BP has invested billions of dollars to explore and produce oil from around the world as well as to supply refined products, including gasoline, to the US and other countries. BP's profits reflect the investments made in all of these aspects of the company.

- *The oil and gas industry has been cyclical. The chart provided by Senator Whitehouse in essence shows only one side of an industry price cycle. The 6 year period from 2002 through 2007 starts at a cyclical low point in oil and gas prices, and covers a period in which tightening supply/demand fundamentals led to general increases in the market value of petroleum products. Due to the long-term nature of oil and gas industry investments, it may be more appropriate to show data over an entire cycle, or perhaps several cycles.*

- *"Gas Prices" presumably reflects gasoline prices a unit basis (e.g., dollars per gallon) while "Oil Industry Profits" are presumably on an absolute basis (e.g., total dollars).*

---

[1] "America's Oil and Natural Gas Industry: The Facts About Oil Industry Mergers, Market Power and Fuel Prices: An API Primer," May 12, 2008, page 5.
[2] Id.

43354.113

Companies who have succeeded in growing volumes over this period would show profits growing faster than gasoline prices, other factors being equal.

- *The attached chart was not presented with any information regarding the source of the information presented or how the aggregated amounts were obtained. In analyzing the information in the chart with regards to the "Gas Prices" line, it is impossible to determine whether the senator used wholesale prices in the price calculation; whether there was any consideration as to taxes paid by the company or the consumer; costs associated with refining and marketing the gasoline, etc. Similarly, with regards to the "Oil Company Profits" line, there was no indication of whether the senator's office included physical growth; whether the amounts are US only or worldwide; whether the time period was particularly selected because it was a time of a cyclical low in average industry oil and gas prices.*

The chart below details the research investment in energy alternatives for BP over the last 5 years.

R&D Spend ($m)

	2003	2004	2005	2006	2007	TOTAL
Solar	5.4	4.0	6.1	8.2	8.2	31.9
Renewables & Alternatives / AE Technology (Wind, Hydrogen power)			9.4	8.3	27.7	45.4
Biofuels			5.0	7.2	14.3	26.5
Energy Biosciences Institute (CA Berkeley, IL Urbana)				2.5	26.0	28.5
Hydrogen for Transport	10.0	10.0	10.0	10.0	10.0	50.0
TOTAL	15.4	14.0	30.5	36.1	86.2	182.2

How much has your company invested in research and development of wind, solar, and geothermal energy in each of the last five years? Compare the answer to each of the three above questions with the aggregate compensation of your top 10 executives and, separately, your budget for travel, entertainment, and other fringe benefits.

The chart below reflects the aggregate salary and benefits of the top executives of BP whose compensation is publicly available.

Compensation ($m)

	2003	2004	2005	2006	2007
Salary	$6,434	$6,155	$6,462	$7,198	$7,911
Bonus	$8,592	$9,612	$7,365	$4,021	$10,013
Benefits	$515	$397	$361	$397	$766
Deferred Compensation	$7,362	$8,015	$13,727	$8,783	$872
Pension	$7,886	$9,422	$10,529	$7,777	$15,917
Total	$30,789	$33,602	$38,443	$28,175	$35,479

43354.114

The table below reflects aggregate travel and entertainment expense for BP globally and in the US (rounded to the nearest $10m).

T&E ($m)

	2003	2004	2005	2006	2007
Global	390	640	610	700	840
US	150	210	230	250	290

43354.115

SENATOR KOHL'S FOLLOW-UP QUESTIONS FOR HEARING ON
"EXPLORING THE SKYROCKETING PRICE OF OIL"

For Robert A. Malone

1. We all recognize that the anti-competitive actions of the OPEC cartel have an important role to play in higher gas prices. In your estimation what would a gallon of gas cost if there was no supply limits imposed by the OPEC cartel?

OPEC's influences the market in two ways: Members collectively seek to manage production levels, and individually manage production capacity within their own countries. Last year, according to DOE/EIA data, OPEC members participating in production cuts (all members but Angola and Iraq) reduced crude oil output by 700,000 b/d. This was a substantial contributing factor behind the increase in oil prices over the past year and half: The exact dollar impact is impossible to calculate.

- *Currently, however, DOE/EIA data shows that most OPEC members are producing at full capacity, with only Saudi Arabia holding significant spare capacity...spare capacity which the Saudi government has stated is akin to the strategic petroleum reserve in that it is reserved for supply emergencies.*

Equally important is the control OPEC members—and many other countries, including the US—exercise in limiting access to oil resources and therefore production capacity. The BP Statistical Review of World Energy shows that global proved oil reserves are sufficient to support growing levels of production for decades to come—and in fact proved reserves have tended to rise over time. But constraints on economically rational investment have limited the ability of global oil supply to rise to meet growing demand, another key contributor to the increase in oil prices in recent years.

2. The FTC has testified to the Antitrust Subcommittee that 85 % of the variability in the cost of gasoline is caused by changes in the

We absolutely agree with the FTC's conclusion that the vast majority of the variability in gasoline costs—and prices—is due to changes in crude oil prices. Using official DOE annual data for the US from 1985 - 2007, our figure is even higher: 95%.

In other words, the price of crude oil is—by far—the most important factor driving changes in US gasoline prices.

3. In your opinion, how much of the price of crude oil is due to the speculation by oil traders?

BP agrees with the CFTC, which has concluded that "there is little evidence that changes in speculative positions are systematically driving up crude oil prices." In his April 3, 2008 testimony before the Senate Committee on Energy and Natural Resources, CFTC Chief Economist Jeffrey Harris stated:

> *Given the relative stability of the makeup of participants and their positions in the markets and the absence of evidence that speculation has caused oil price changes, it appears that fundamentals provide the best explanation for crude oil price increases. These fundamentals can*

43354.116

be either broad factors that affect many markets—like the value of the dollar or general inflation fears—or factors particular to a market—such as strong demand from China and India for crude oil and other commodities. In addition, geopolitical events, such as tensions involving Venezuela, Nigeria, Iran, Iraq, Turkey and the Kurds have affected commodity markets, especially the energy and precious metals markets.

The price of crude oil reflects the forces of supply and demand as they exist at any given time – it is not possible to say what the price of crude oil "should be" apart from those market forces of supply and demand.

4. Many experts believe that one important reason for excessive speculation in oil is low margin requirements in oil commodity trading. Unlike with respect to many other commodities and the stock market, a trader can speculate in this market with very small amounts of money, as margin requirements are as low as 8 percent. Do you agree with these experts that margin requirements should be increased in oil trading markets in order to reduce speculation?

If the margin requirements are increased substantially this will likely lead to fewer investors using energy as an asset class. However, investors, speculators, and large traders generally are less constrained by capital requirements than smaller producers or hedgers.

While most investors would look at the underlying volatility, momentum, and correlation to the other assets in their portfolio before choosing to invest in energy, it is also true that the carrying costs of their positions influence the viability of energy in their portfolio.

Therefore we expect that any increase in the margin requirements will decrease activity and therefore decrease liquidity - quite possibly increasing volatility in price movements.

But not only speculators would be affected by increased margin calls. Increased margin requirements (if applied across the board) will make it more expensive, perhaps prohibitively so, for some producers and end users to use futures as a hedge. This will again decrease participation, increase volatility, and jeopardize the smooth operation of physical delivery of energy contracts.

There could be a move away from the margined exchanges into the un-margined and less transparent OTC markets. If the exchanges outside the US did not raise their margin requirements, participants could be attracted offshore.

Clearer reporting requirements would be a more effective way to monitor and control activity.

5. Much of the crude oil U.S. oil companies refine into gasoline and other petroleum products comes from their own oil fields. Overall, the U.S. produces about 40% of the crude oil it consumes. The cost to produce this oil domestically should not be affected in any way by the rising worldwide price of crude oil. So why should the rising price of crude oil on the international markets lead to higher prices with respect to petroleum products refined from your own domestically produced oil? Are American oil companies just profiteering with respect to the oil that comes from the oil fields they own in the United States?

The price for crude oil is set by global forces of supply and demand, rather than the cost of production. In his April 3, 2008 testimony before the Senate Committee on Energy and Natural Resources, CFTC Chief Economist Jeffrey Harris stated:

43354.117

Given the relative stability of the makeup of participants and their positions in the markets and the absence of evidence that speculation has caused oil price changes, it appears that fundamentals provide the best explanation for crude oil price increases. These fundamentals can be either broad factors that affect many markets—like the value of the dollar or general inflation fears—or factors particular to a market—such as strong demand from China and India for crude oil and other commodities. In addition, geopolitical events, such as tensions involving Venezuela, Nigeria, Iran, Iraq, Turkey and the Kurds have affected commodity markets, especially the energy and precious metals markets.

BP's refining business in the U.S. purchases most of the crude oil it processes from third parties, and it must pay the prevailing market prices for that crude. Similarly BP's refining business pays the prevailing market price when it uses BP's equity crude production. For BP's exploration and production business to unilaterally lower its equity crude prices to its refineries would leave BP vulnerable to claims relating to royalty payments owed state and federal governments, severance taxes owed, below-cost pricing, unfair business competition, bad faith, and other reputational issues from governments, distributors, and competitors. Furthermore, BP does not and cannot set the retail price of gasoline at the vast majority of its branded outlets – the retail price is set by independent business persons such as jobbers and dealers who own those sites. If BP wholesaled the gasoline to those independent business persons at below market prices, there would be no assurance the retail price would be set below the market price in the trade area. It would most likely result as increased margin for the station owners.

6. In the last 15 years there has been a tremendous amount of consolidation in the oil industry – in its 2004 report, the GAO counted 2600 mergers and acquisitions in this industry since the 1990s alone. Indeed, almost all the companies represented here today are a product of these mergers. During this time, the FTC has approved most of the oil industry mergers it has reviewed, including the gigantic ones like Exxon/Mobil, Chevron/Texaco, and Conoco/Phillips. While each one of these mergers may not have seemed problematic when reviewed, taken as a whole these mergers have greatly increased concentration in the industry. And the GAO concluded that these mergers have raised gasoline prices. The GAO is currently updating its 2004 study at the request of me and some of my colleagues.

What is your view of the effects of these mergers on competition in your industry and the price of petroleum products? And please predict whether we are likely to see even more consolidation in the years ahead.

BP agrees with the Federal Trade Commission that the GAO report should not be relied upon in making policy. As stated by the FTC:

The GAO report still contains major methodological mistakes that make its quantitative analyses wholly unreliable. It relies on critical factual assumptions that are both unstated and unjustified, and it presents conclusions that lack a quantitative foundation. Simply stated, the GAO report is fundamentally flawed.[1]

[1]Prepared Statement of the Federal Trade Commission titled "Market Forces, Anticompetitive Activity, and Gasoline Prices: FTC Initiatives to Protect Competitive Markets, presented by William E. Kovacic, General Counsel, Before The Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs Committee on Government Reform United States House of Representatives (July 7, 2004) at 8.

43354.118

Even if you take the conclusions of the GAO Report at face value, the GAO concluded that two of the transactions studied led to decreases in wholesale prices and the results from one of the transactions was inconclusive. This suggests that in at least some cases, integration can lead to lower prices. In the absence of any clear metric as to which transactions will lead to lower prices and which will lead to higher prices, any disincentive for further integration has the potential to lead to economic inefficiencies and higher costs for consumers.

As to consolidation and concentration in the market place, consolidation has allowed BP to compete in this global environment. Even after mergers such as BP's, the FTC has determined that the U.S. domestic oil and natural gas industry remains highly competitive, highly regulated and unconcentrated because retail gasoline is sold largely through independent dealers who face stiff competition.

The price of gasoline is largely dependent on the price of crude oil. And, current sources of crude oil are expensive and challenging to obtain. In the last five years, BP has invested more than $30 billion dollars into energy investments in the United States. BP's size and scale allows the company to continue to increase both its crude oil production and long-term reserve base in the United States, while also investing in new alternative and renewable energy technologies.

BP's consolidation with Amoco and ARCO has allowed significant investment into its facilities and infrastructure at approximately $700 million a year. Finding and producing oil and gas today requires greater scale to meet the challenges posed by greater technical, logistical, financial and permitting hurdles. For example, BP is currently working with others to invest in a pipeline to bring Alaska natural gas to consumers in the US Midwest.

BP is also using investment to find new oil and gas reserves in the deep water Gulf of Mexico; this exploration would most likely have overwhelmed a smaller company. These projects are extreme in every way – extremely risky, extremely large, extremely deep and extremely costly – and present unprecedented technical challenges.

Finally, BP remains a small player in this global business. Foreign national oil companies control more than 50 percent of global oil and gas production and more than 80 percent of the world's oil and gas reserves. By comparison, BP represented roughly 3 percent of global oil and gas production, and less than one percent of global oil and gas reserves.

It is impossible for BP to predict whether any further consolidation is contemplated among its competitors.

43354.119

U.S. Senate Judiciary Committee
Hearing on "Exploring the Skyrocketing Price of Oil"
Written Questions from Senator Richard J. Durbin

1. Please provide a table displaying, for each year since 2000:

- **the names of the top five most highly compensated individuals in your company for that year (with compensation defined to include salary, bonuses, benefits, stock options, in-kind gifts, deferred compensation, and other remuneration); and**
- **the amount of compensation received by each of those individuals, broken down by amount and type of compensation.**

Answer: [See Attachment I] This is the executive compensation information reported in our annual proxy statements to shareholders and the SEC. These data cover the years from 2001 (the first consolidated reporting year following the Chevron/Texaco merger) to the most recent statement covering 2007.

2. Please provide a table displaying the following information for your company for each year since 2000:

- **revenue**
- **net income**
- **return on equity**
- **total capital investment**
- **oil development investment**
- **refinery investment**
- **alternative energy research and development**
- **cash holdings**
- **marketing expenses**

Answer: Following is a table delineating the information requested since 2001 for Chevron's worldwide operations. We exclude data from 2000 because the merger between Chevron and Texaco in 2001 distorted the comparative data in years prior to the merger.

Chevron Corporation (Millions of Dollars)	2007	2006	2005	2005	2003	2002	2001
Total Revenue and Other Income	$220,904	$210,118	$198,200	$155,300	$121,277	$98,537	$105,702
Net Income	$18,688	$17,138	$14,099	$13,328	$7,230	$1,132	$3,288
Return on Average Stockholders' Equity	25.6%	26.0%	26.1%	32.7%	21.3%	3.5%	9.8%
Cash and Cash Equivalents	$7,362	$10,493	$10,043	$9,291	$4,266	$2,957	$2,117
Capital and Exploratory Expenditures	$20,026	$16,611	$11,063	$8,315	$7,363	$9,255	$12,028
- Exploration and Production	$15,538	$12,189	$8,389	$6,321	$5,675	$6,283	$7,129
- Refining	$2,207	$1,980	$1,134	$643	$470	$599	$669
- Marketing	$598	$530	$463	$425	$349	$378	$836

As we have testified, globally Chevron has spent more than $2 billion since 2002 on a broad range of renewables and energy efficiency. Between 2007 and 2009, we have announced plans to spend an additional $2.5 billion on renewable technologies and energy efficiency solutions.

June 13, 2008

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00182 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.120

The annual totals or more detailed breakout of these expenditures is proprietary business information, which we need to keep confidential for competitive reasons.

We don't aggregate, report, or publicly divulge unaudited marketing expenses which require arbitrary assumptions and could disclose Chevron's business strategies.

3. Several weeks ago, the Wall Street Journal's *Market Watch* quoted an industry analyst as estimating that about $25 to $30 of the price per barrel of crude oil may be attributed solely to speculation.

a) Does your internal research support that analysis?
b) What in your view is the price per barrel that can be justified purely by the supply and demand in the market?
c) What steps do you think should be taken to protect consumers from the effects of excessive speculation in the trading markets for oil?

Answer: Many factors influence the price of oil, including supply and demand, perceptions of market trends, geopolitical instability, commodity investments, and the devaluation of the dollar. We don't have the ability to quantify the impact of these factors. While speculation can be a factor in any commodity market, including oil, we believe it is unlikely that speculative financial trading has a significant effect on crude prices over the long term.

Our view is that efficient and transparent markets work, and measures to increase transparency may be helpful.

4. In your testimony, you claim that consolidation in the oil industry has been necessary to enable your company to compete globally. However, a 2004 GAO study found that consolidation and mergers in the oil refinery industry, "generally led to higher wholesale gasoline prices in the United States." As a result of all the mergers, the largest five oil companies now control 55% of the refining market, and the largest 10 dominate 81%.

a) In your view, how has market concentration in the refinery industry affected the price of gasoline?
b) Do you see a link between market concentration and reduced refinery production?

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00183 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.121

c) How much would increased refinery production lower gasoline and diesel prices?

Answer: The oil and gas business in the U.S. remains extremely competitive. Chevron's U.S. production of approximately 410,000 barrels of crude oil per day represents about 8 percent of U.S. total. U.S. transportation fuel markets are not only well supplied but also highly competitive. We are the sixth largest U.S. refiner and operate five of the nation's roughly 150 refineries, with a market share of less than six percent. Marketing operations are similarly competitive. Chevron is the fourth largest U.S. branded marketer operating under the Chevron and Texaco brands. We have roughly 9,700 of the country's 168,000 branded stations. And it's important to note that 95 percent of our stations are operated by independent business people, who must compete aggressively against at least 40 other companies.

We believe that the referenced mergers as approved by the FTC with associated mandated divestitures were not injurious to competition. Industry structure varies greatly from industry to industry, and depends upon the costs of entry, capital intensity, technology, economies of scale, historical developments, the regulatory environment, and many other factors. The true level of competition in an industry often depends more upon these factors than on the number of mergers or on formal industry concentration measures. In fact, many industries, including automobile manufacturing, airline travel, and commercial banking, are far more concentrated than the petroleum industry. Finally, the refined products market in the U.S. is well supplied. Over the time frame of the mergers, refinery production has steadily increased. U.S. refinery capacity has increased by 20% over 1985 levels.

U.S. energy companies need the scale that is necessary to partner and compete with large national oil companies to gain access to critically needed energy resources that fuel America's cars, heat America's homes and power America's businesses.

Because of the many variables involved, including import availability, we can't predict the effect of increased refinery production on motor fuel prices. However, we note that the primary reason for the recent rise in gasoline and diesel prices is the global rise in crude oil prices.

5. In the last couple of weeks, we have seen the release of a handful of reports that claim that our use of ethanol has displaced a certain amount of gasoline from the nation's pool of transportation fuels, and that the displacement of more expensive gasoline with less expensive ethanol has resulted in lower consumer prices at the gas pump. These experts say that the savings have been between 15-20%, which would translate into about $400-$600 of savings per family or about $50 billion to $75 billion saved nationwide.

a) What is the effect on retail gasoline prices of cheaper ethanol being blended into gasoline?

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00184 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.122

Answer: Ethanol is only one of a number of factors in fuel costs, but to a much lesser extent than crude oil because of the relatively low ratio of ethanol in gasoline.

b) If the renewable fuels mandate were waived this year and nine billion gallons of ethanol were removed from the market, additional petroleum would need to be "found" to replace this fuel. Some economists say that prices would increase by as much as 50 cents to 80 cents per gallon based on standard calculations. Based on your historical observations, would you expect to see that large of an increase?

Answer: We can't predict how a hypothetical waiver of the renewable fuels mandate would impact gasoline prices. They are determined by supply, demand and competition.

c) One of the challenges to making production and the mandate sync up is associated with the infrastructure needed to develop the biofuels industry. What is your position regarding higher blend levels of ethanol and the deployment of pumps capable of dispensing E-85?

Answer: Chevron supports blending additional ethanol into gasoline up to 10 percent by volume (E10), the current amount allowed by law for use in conventional vehicles. Since compliance with the Renewable Fuel Standard will likely require fuel providers to blend more than this amount within in a few years, we support increased research and development into biofuels derived from non-food feedstocks (e.g., cellulosic renewables).

Consideration should be given to commissioning a national study of the feasibility of widespread use of ethanol-blended gasoline with levels of ethanol greater than 10% (i.e., between E11 and E85). The study should review the production and infrastructure constraints on increasing the content of ethanol in gasoline beyond 10%, including issues relating to the fungibility of gasoline supplies within and between markets, states, and regions, and laws that currently preclude blending ethanol greater than 10 %. It should also evaluate the economic, infrastructure, and transportation impacts on the gasoline refining, distribution, and retailing industries, and on consumers of gasoline in on-road, off-road, marine, and equipment uses. The study will also analyze the environmental impacts of ethanol blends higher than 10% on evaporative and exhaust emissions, as well as on other environmental media such as groundwater, surface waters, land and waste streams. Finally, it should consider other potential impacts of ethanol blends higher than 10%, such as their effects on the operation, durability, performance, and safety of engines that might be fueled with such blends.

It would be beneficial to convene all major industry stakeholders, as well as other significant parties such as academic institutions, environmental organizations, and States in an effort to obtain broad agreement on a single blend of gasoline above E10 (i.e., between E11 and E85) that would be suitable for adoption and implementation in the United States by ASTM International. The single blend would seek to optimize the environmental, fuel economy, and energy security benefits of blending biofuels into transportation fuels

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00185 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.123

Chevron's marketers and retailers are not prohibited from selling E-85 (or other non-Chevron products) at their Chevron or Texaco branded stations and some of our dealers do sell E-85. Chevron has developed guidelines for the sale of E85, should marketers and retailers chose to sell that product

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00186 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.124

SENATOR KOHL'S FOLLOW-UP QUESTIONS FOR HEARING ON "EXPLORING THE SKYROCKETING PRICE OF OIL"

1. We all recognize that the anti-competitive actions of the OPEC cartel have an important role to play in higher gas prices. In your estimation what would a gallon of gas cost if there was no supply limits imposed by the OPEC cartel?

Answer: If demand and other market factors were to stay constant, over time an increase in supply from OPEC or elsewhere including additional production from the United States would place downward pressure on crude prices, and eventually motor fuel prices. These factors are dynamic and therefore we can't estimate what a gallon of gasoline would cost in response to actions taken by OPEC.

2. The FTC has testified to the Antitrust Subcommittee that 85 % of the variability in the cost of gasoline is caused by changes in the price of crude oil. Do you agree?

Answer:

We understand that the FTC bases this estimate on various studies which we have not analyzed and therefore are not in a position to question or affirm the specific assertion.

Over time, there is a strong correlation between crude oil and gasoline price movement. As we demonstrated in our written testimony, the largest portion of the cost of gasoline is crude oil, and today's high gasoline prices are a direct result of the increased cost of crude oil.

However crude oil and gasoline are sold in different markets – crude oil is a global commodity, while gasoline can be affected by supply, demand, and competition in local markets. As the example in our testimony illustrated, these market forces have prevented gasoline prices from keeping pace with the rising prices of crude oil.

3. In your opinion, how much of the price of crude oil is due to the speculation by oil traders?

Answer: We believe it is unlikely that speculative financial trading has a significant effect on crude prices over the long term. Many factors influence the price of oil, including supply and demand, perceptions of market trends, geopolitical instability, commodity investments, and the devaluation of the dollar. Speculation can be a factor in any commodity market, including oil. Over the long term we don't see speculators dominating the market – it is too large. We don't have the ability to quantify the impact of various factors that influence the price of crude oil.

4. Many experts believe that one important reason for excessive speculation in oil is low margin requirements in oil commodity trading. Unlike with respect to many other commodities and the stock market, a trader can speculate in this market with very small

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00187 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.125

amounts of money, as margin requirements are as low as 8 percent. Do you agree with these experts that margin requirements should be increased in oil trading markets in order to reduce speculation?

Answer: Our view is that efficient and transparent markets work.

5. Much of the crude oil Chevron and the other U.S. oil companies refine into gasoline and other petroleum products comes from their own oil fields. For example, according to your annual report, in 2004 Chevron produced 505,000 barrels of oil per day in the United States, more than 55% of your domestic refining capacity. Overall, the U.S. produces about 40% of the crude oil it consumes. The cost to produce this oil domestically should not be affected in any way by the rising worldwide price of crude oil. So why should the rising price of crude oil on the international markets lead to higher prices with respect to petroleum products refined from your own domestically produced oil? Are the oil companies just profiteering with respect to the oil that comes from the oil fields they own in the United States?

Answer: Crude oil is a globally traded commodity which is efficiently moved around the world to minimize transportation expenses, and whose prices are determined by various factors in a world market. As your question points out, imported crude oil accounts for about 60% of the crude oil consumed in the U.S. A small portion of the crude Chevron produces is refined at Chevron facilities. It is not realistic to expect domestic crude oil producers to sell their production in the U.S. for less than it is worth on the world market.

The federal government imposed price controls on domestically produced oil during the 1970s with disastrous results. Production was discouraged, shortages developed, crude oil imports increased, and fuel prices rose to significantly higher levels than prevailed once the controls were finally lifted. Serious distortions also occurred because some refiners had greater access to price-controlled domestic oil than other refiners that had to pay the world price for imported oil.

6. In the last 15 years there has been a tremendous amount of consolidation in the oil industry – in its 2004 report, the GAO counted 2600 mergers and acquisitions in this industry since the 1990s alone. Indeed, almost all the companies represented here today are a product of these mergers. During this time, the FTC has approved most of the oil industry mergers it has reviewed, including the gigantic ones like Exxon/Mobil, Chevron/Texaco, and Conoco/Phillips. While each one of these mergers may not have seemed problematic when reviewed, taken as a whole these mergers have greatly increased concentration in the industry. And the GAO concluded that these mergers have raised gasoline prices. The GAO is currently updating its 2004 study at the request of me and some of my colleagues.

What is your view of the effects of these mergers on competition in your industry and the price of petroleum products? And please predict whether we are likely to see even more consolidation in the years ahead.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00188 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.126

Answer: We believe that the referenced mergers as approved by the FTC with associated mandated divestitures were not injurious to competition. Industry structure varies greatly from industry to industry, and depends upon the costs of entry, capital intensity, technology, economies of scale, historical developments, the regulatory environment, and many other factors. The true level of competition in an industry often depends more upon these factors than on the number of mergers or on formal industry concentration measures. In fact, many industries, including automobile manufacturing, airline travel, and commercial banking, are far more concentrated than the petroleum industry.

The petroleum industry is very capital intensive and the leading companies operate globally; hence, they are very large in size, but their shares of market within regional and local distributive areas in the U.S. are well within competitive norms.

The market price of petroleum products derives from the price of crude oil and other inputs to the refining process and the supply of and demand for petroleum products. Chevron mergers have resulted in operating expense reductions, optimization of capital and exploratory expenditures, and having greater technical, financial and other resources available to most efficiently pursue large project development to bring new energy supplies to market in a manner that benefits both stockholders and consumers.

It is impossible to predict whether we will see more consolidation. Many capital intensive industries have tended to consolidate over time, but technological developments, changing economics and divestitures have created new competitors. We are now in a period of great change in the energy sector. With significant investment needed to provide new energy supplies and to develop new technologies and alternative fuels, it is likely the industry will continue to evolve, which may include additional merger activity.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00189 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.127

Questions of Chairman Patrick Leahy
Following the Senate Judiciary Committee Hearing
"Exploring the Skyrocketing Price of Oil"

1. Mr. Hofmeister testified last week that the price of crude oil should be in the range of $35 to $65 a barrel. If the price of crude oil on the world market returned to that competitive level, what could your company charge for a gallon of gas and remain profitable?

Answer: As we testified, the price of crude is affected by various factors. A reduction of raw material costs will place downward pressure on motor fuel prices. We can't predict with any precision what will happen to gasoline prices if crude oil costs decline because gasoline prices are determined by the marketplace forces of supply, demand, and competition.

2. Each of your companies is vertically integrated from oil exploration and production through refining and retail gasoline sales. I understand that the price of crude oil is set on the world market, and that your companies, for the most part, sell the crude oil they produce on the market and then buy back the crude oil that they refine. I further understand that each of your companies refines more oil than it produces. The efficiencies that come from vertical integration, however, should include the ability to refine the oil that you produce in a manner that is less expensive than if purchased in the commodities market.

(a) What is your company doing to make vertical integration work for consumers?

(b) If your company refined only the oil that it actually produced, rather than buying and selling on the world market, what price could it charge for a gallon of gas today and remain profitable?

Answer:
Today's energy reality is global, vast, complex, and brings with it significant challenges. Integrated companies are meeting these challenges which require scale, specialized expertise, advanced technology, financial strength, and human energy to search for the next source of energy and deliver it to consumers in markets on six continents. Increasing energy supplies and improving efficiencies in getting those supplies to market will result in fueling vehicles, heating homes and powering businesses.

Crude oil is a globally traded commodity which is efficiently moved around the world to minimize transportation expenses, and whose prices are determined by various factors in a world market. A small portion of the crude Chevron produces is refined at Chevron facilities. It is not realistic to expect domestic crude oil producers to sell their production for less than it is worth on the world market. Trading oil produced in one area and buying it back in another is simply a way to reduce transportation expenses or more simply stated preventing different crude oils from passing one another in opposite directions. It

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00190 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.128

would be wasteful, more costly to consumers, and in fact impossible in the existing infrastructure to only refine one's own proprietary crude oil in every refinery.

We can't predict what would happen to gasoline prices if we were able to refine only our own crude oil, particularly considering that we refine in the U.S. roughly twice the amount we produce. It is apparent that doing so would take away transportation and trading efficiencies that characterize the current market. Added operating costs on industry participants would most likely put upward pressure on prices.

3. How much has each of your companies spent, directly or indirectly, on studies and reports on climate change? Please specify the studies and reports produced with your companies direct or indirect support.

Answer: Chevron contributes to the funding of academic research programs on climate science, engineering, and economics policy research at the Massachusetts Institute of Technology (MIT) Joint Program on the Science and Policy of Global Change; MIT Carbon Sequestration Initiative; International Energy Agency's Greenhouse Gas R&D Programme; Global Energy Technology Strategy Program of the University of Maryland; and the Pacific Northwest National Laboratory, for a total of approximately $233,000 annually. In addition, Chevron also provides approximately $50,000 annually to the non-profit organization Resources for the Future which conducts independent research on environmental and energy issues. Climate change is addressed as part of their research portfolio.

A list of publications from the MIT programs can be found here.
http://web.mit.edu/globalchange/www/reports.html

A list of the publications from the IEA GHG R&D Programme can be requested here.
http://www.ieagreen.org.uk/publications.html

A list of the publications from the Global Energy Technology Strategy Program of the University of Maryland and the Pacific Northwest National Laboratory can be found here.
http://www.pnl.gov/gtsp/publications/

Chevron provides general support to a broad range of organizations active in public policy dialogue. These organizations include the Brookings Institute, the Center for Strategic and International Studies, the Council on Foreign Relations, the Heritage Foundation, the Bipartisan Policy Center, and the American Enterprise Institute. Our general support is not earmarked for climate change policy research but given the prominence of the issue these organization are all engaged in work around climate change policy.

Chevron's experts have also actively participated in the fourth assessment process (2004-2007) of the Intergovernmental Panel on Climate Change and have been recognized individually by the IPCC in the form of a certificate presented to these Chevron staff

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00191 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.129

experts, signed by R. K. Pachauri, chairman of the IPCC and Renate Christ, secretary of the IPCC, in relation to "...contributing to the award of the Nobel Peace Prize for 2007."

Chevron was also actively involved developing the core recommendations of the National Petroleum Council study, which recognized that reducing carbon emissions and enhancing energy security are dual, interdependent challenges.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00192 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.130

Questions of Senator Sheldon Whitehouse
Following the Senate Judiciary Committee Hearing
on
"Exploring the Skyrocketing Price of Oil"

1) **Has your company, any subsidiary, or any entity acting under common ownership or control, financially contributed to any organizations that study global warming or climate change? If so, which are those organizations and how much in total has your company given to each one?**

Answer: Chevron recognizes and shares the concerns of governments and the public about climate change and we are actively participating in the development of climate change policy and regulations in the U.S. and abroad. Chevron contributes to the funding of academic research programs on climate science, engineering, and economics policy research at the Massachusetts Institute of Technology (MIT) Joint Program on the Science and Policy of Global Change; MIT Carbon Sequestration Initiative; International Energy Agency's Greenhouse Gas R&D Programme; Global Energy Technology Strategy Program of the University of Maryland; and the Pacific Northwest National Laboratory, for a total of approximately $233,000 annually. In addition, Chevron also provides approximately $50,000 annually to the non-profit organization Resources for the Future which conducts independent research on environmental and energy issues. Climate change is addressed as part of their research portfolio.

A list of publications from the MIT programs can be found here.
http://web.mit.edu/globalchange/www/reports.html

A list of the publications from the IEA GHG R&D Programme can be requested here.
http://www.ieagreen.org.uk/publications.html

A list of the publications from the Global Energy Technology Strategy Program of the University of Maryland and the Pacific Northwest National Laboratory can be found here.
http://www.pnl.gov/gtsp/publications/

Chevron provides general support to a broad range of organizations active in public policy dialogue. These organizations include the Brookings Institute, the Center for Strategic and International Studies, the Council on Foreign Relations, the Heritage Foundation, the Bipartisan Policy Center, and the American Enterprise Institute. Our general support is not earmarked for climate change policy research but given the prominence of the issue these organization are all engaged in work around climate change policy.

Chevron's experts have also actively participated in the fourth assessment process (2004-2007) of the Intergovernmental Panel on Climate Change and have been recognized individually by the IPCC in the form of a certificate presented to these Chevron staff

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00193 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.131

experts, signed by R. K. Pachauri, chairman of the IPCC and Renate Christ, secretary of the IPCC, in relation to "...contributing to the award of the Nobel Peace Prize for 2007."

Chevron was also actively involved developing the core recommendations of the National Petroleum Council study, which recognized that reducing carbon emissions and enhancing energy security are dual, interdependent challenges.

Response to questions 2 - 11 regarding contributions to specific organizations:

These data reflect cumulative contributions to the subject organizations between 2001 and the present. 2001 is the first year with consolidated operations following the Chevron Texaco merger.

Organization	Cumulative amount contributed	Years contributed
American Legislative Exchange Council	$136,440	2001 to present
Cato Institute	$30,000	2001 to 2003
Committee for a Constructive Tomorrow	$50,000	2001 to 2005
Annapolis Center for Science-Based Public Policy	None	
Acton Institute for the Study of Religion and Liberty	None	
Center for the Study of Carbon Dioxide and Global Change	None	
Frontiers of Freedom Institute	$5,000	2001
George C. Marshall Institute	$5,000	2006
Heartland Institute	None	
Institute for Energy Research	None	

These contributions are for general support for the organizations in question. Regarding the statements on climate change attributed to each organization in the questions below, we have not reviewed or approved these statements.

2) **Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the American Legislative Exchange Council? If so, how much has it contributed? Does your company agree with the American Legislative Exchange Council's opinion that increasing levels of carbon dioxide are not causing glaciers to retreat?**

3) **Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Cato Institute? If so, how much has it contributed? Either way, does your company agree with Cato Institute**

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00194 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.132

commentary that "science no longer provides justification for any rush to pass drastic global warming legislation."?

4) Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Committee for a Constructive Tomorrow? If so, how much has it contributed? Does your company agree with the Committee for a Constructive Tomorrow that "recent glacial retreats, sea-level rise and migrations of temperature sensitive species are all within the bounds of known natural variability."?

5) Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Annapolis Center for Science-Based Public Policy? If so, how much has it contributed? Does your company agree with an Annapolis Center for Science-Based Public Policy report that states "climate models may never be able to make greenhouse-warming predictions with certainty?"

6) Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Acton Institute for the Study of Religion and Liberty? If so, how much has it contributed? Does your company agree with Acton Institute for the Study of Religion and Liberty commentary that it is a "myth that [global warming] is an emergency that demands a drastic cutback in CO-2 emissions" and that "making a case against CO-2 without making a case against nature is like making an omelet without breaking the proverbial egg. It is impossible."?

7) Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Center for the Study of Carbon Dioxide and Global Change? If so, how much has it contributed? Does your company agree with the Center for the Study of Carbon Dioxide and Global Change that "there is no compelling reason to believe that the rise in temperature was caused by the rise in CO-2."?

8) Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Frontiers of Freedom Institute? If so, how much has it contributed? Does your company agree with the Frontiers of Freedom Institute that S.2191, America's Climate Security Act, is "a hyped-up rallying cry against a 'problem' that scientists can't even agree exists in the first place."?

9) Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the George C. Marshall Institute? If so, how much has it contributed? Does your company agree with the George C. Marshall Institute that there is a "shattered consensus" on the state of global warming?

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00195 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.133

10) Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Heartland Institute? If so, how much has it contributed? Does your company agree with the Heartland Institute that "there is no consensus about the causes, effects, or future rate of global warming," and that "most climate scientists doubt the reliability of computer models and the accuracy of land-based temperature records," and that "reports by the IPCC are unreliable due to political editing and rewriting of the reports' conclusions," and that "some of the key evidence cited in past IPCC reports has been shown to be fraudulent."?

11) Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Institute for Energy Research? If so, how much has it contributed? Does your company agree with the Institute for Energy Research that global climate change is a "craze...fueled by alarmist rhetoric and trumped up scientific claims."?

12) At a time when gasoline prices were near record highs, your five companies earned record-breaking profits last year: $116 billion. ExxonMobil made $40.6 billion last year, which is more than the all federal highway spending and about as much as the entire credit card industry earned that year. Since 2002, your five companies have consistently broken profit records. If you continue to profit this year at the pace you did in the first quarter, you are once again poised to smash profit records, not just for your industry, but for all industries. Please explain why what, in raw numbers, may be the most profitable industry in history needs the multi-billion dollar Section 199 domestic manufacturing tax breaks enacted in 2004. Why aren't those profits adequate to provide access to capital without those tax incentives?

Answer: Any increase in taxes on the industry will result in less capital available for new investments in energy projects, at a time when we need more investment.

Formatted: Bullets and Numbering

The Section 199 provision was designed to encourage domestic jobs in various industries. Including Section 199's tax benefits encourages new U.S. oil and natural gas production and investments in new petroleum refining capacity. Comparatively costly domestic energy projects become more economically competitive with alternative foreign investments. High-paying U.S. oil industry jobs with excellent health care and other benefits are preserved, and development of domestic energy supplies is encouraged. We believe that the recent punitive proposal to deny this provision to 5 companies is neither good energy policy nor good tax policy.

Formatted: Bullets and Numbering

13) The petroleum industry operates in an unusual fashion. Your five corporations are integrated oil giants that control all stages of production and distribution. From the exploration and mining to the refinement and transportation to the moment the customer swipes her Exxon or Shell charge card at the pump, you control everything. Are you aware of any other industries that operate in this fashion? How would you respond to the suggestion that it may be time to

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00196 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.134

examine whether the vertically integrated ownership structure facilitates price gouging and harms consumers? Would you support a Congressionally-directed study to examine the effects of your ownership structure?

Answer: Industry structure varies greatly from industry to industry, and depends upon the costs of entry, capital intensity, technologies, economies of scale, historical developments, the regulatory environment, and many other factors. There is no single company in the U.S. petroleum industry that has sufficient market power to control the market. Repeated investigations of the oil industry by federal and state agencies have found no evidence of price gouging or anti-competitive behavior by vertically integrated companies.

About 95% of the Chevron and Texaco branded stations in the U.S. are privately owned and operated by independent retailers. The FTC has determined that state bans on refiners operating retail service stations (so-called "divorcement" laws) have resulted in consumers paying higher gasoline prices.

In the oil industry, vertical integration drives expertise and efficiencies that are needed to compete globally within the industry with much larger national oil companies competing to develop new energy sources. Today's global resources are increasingly nationalized, and single crude oil and natural gas development projects run in the billions of dollars. The search for the next source of energy and delivering it to markets on six continents—whether oil or next-generation fuels from renewable sources—takes enormous capital, specialized expertise, advanced technology and human energy that characterizes Chevron. U.S. energy companies need the scale that is necessary to partner and compete with these large national oil companies to gain access to critically needed energy resources that fuel America's cars, heat America's homes and power America's businesses.

14) The attached graph illustrates that the growth in profits of your five companies over the past six years has outpaced even the sharp increase in the price of gasoline. Why is your profit margin rising at a rate that is so much higher than the price of your product?

Answer: In general, the upstream (exploration and production) portion of our business has benefited from the recent increase in worldwide crude prices but our downstream (refining and marketing) business has not been able to fully recover the increased cost of crude oil in the prices received for refined products. While overall our profits have increased over the last six years, Chevron has also increased its capital and exploratory spending a similar amount to find and develop new energy and invest in critical energy infrastructure.

Response to questions 15-18 regarding Chevron spending:

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00197 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.135

As we have testified, globally Chevron has spent more than $2 billion since 2002 on a broad range of renewables and energy efficiency. Between 2007 and 2009, we have announced plans to spend an additional $2.5 billion on renewable technologies and energy efficiency solutions.

The annual totals or more detailed breakout of these expenditures is proprietary business information, which we need to keep confidential for competitive reasons.

15) How much has your company invested in research and development of coal to liquids technology for use as transportation fuel in each of the past five years?

16) How much has your company invested in research and development of hydrogen technology for use as transportation fuel in each of the past five years?

17) How much has your company invested in research and development of non-fossil fuel renewable energy sources for use as transportation fuel, excluding hydrogen technology, in each of the last five years?

18) How much has your company invested in research and development of wind, solar, and geothermal energy in each of the last five years?

19) Compare the answer to each of the three above questions with the aggregate compensation of your top 10 executives and, separately, your budget for travel, entertainment, and other fringe benefits.

Answer: Please review attachment 1 for publicly available executive compensation information for our five named executive officers. The requested information on the other executives is not disclosed due to privacy considerations. Corporate travel and entertainment expense detail is not publicly available.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00198 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.136

Hearing of the Senate Committee on the Judiciary
"Exploring the Skyrocketing Price of Oil"
May 21, 2008
Questions for the Record
Senator Dianne Feinstein

1. According to the May 15th Congressional testimony of the CFTC's Chief Economist and the CFTC's Director of Market Surveillance, oil companies are driving up the price of oil. These experts stated: "Our studies consistently find that when new information comes to the market and prices respond, it is the commercial traders (such as oil companies, utilities, airlines) who react first by adjusting their futures positions. When these commercial traders adjust their futures positions, it is speculators who are most often on the other side of the trade. Price changes that prompt hedgers to alter their futures positions attract speculators who change their positions in response. Simply stated, there is no evidence that position changes by speculators precede price changes for crude oil futures contracts." CFTC believes that oil companies are driving up prices in futures markets, not speculators. Yet, during the Judiciary Committee hearing on May 21, Mr. Stephen Smith of Exxon Mobil asserted that his firm "does not speculate." Does your firm buy or sell positions in crude oil futures markets? If your firm participates in futures markets, can you refute CFTC's assertion that your firms are driving up oil prices?

Answer: Generally, we do not use the crude oil futures market to sell forward our crude oil production. In our U.S. refining system, we hedge some of our shorter term exposure on physical crude purchases using the futures market to manage our exposure on crude oil price changes. Hedges are not altered or changed in our physical crude business due to price changes. Once hedges are in place, they are normally left in place until the physical exposure is no longer present and the crude has been fully priced.

Many factors influence the price of oil, including worldwide supply and demand, perceptions of market trends, geopolitical instability, commodity investments, and the devaluation of the dollar. While speculation can be a factor in any commodity market, including oil, we believe it is unlikely that speculative financial trading has a significant effect on crude prices over the long term.

2. Your firms vehemently oppose legislation – such as the 2007 energy bill tax amendment and Senator Reid's recent legislation to tax windfall oil company profits – that would increase the tax burden on oil and gas companies, arguing that increased taxation will lead to higher gas prices for consumers. However, you argued before the Judiciary Committee that your companies are unable to lower the price of oil. You say that you simply take the price in this global marketplace, instead of offering oil for sale at a set price and set mark-up. These two positions seem inconsistent. Do the economics of your firms influence oil prices, and will oil prices go up if your taxes go up? Or do the economics of your firms stand independent of oil prices, and will oil prices be set by demand regardless of the enormous size of your profits? It can't possibly be both.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00199 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.137

Answer: Many factors influence the price of oil, including supply and demand, perceptions of market trends, geopolitical instability, commodity investments, and the devaluation of the dollar. We don't have the ability to control or quantify the impact of various factors that influence the price of crude oil.

Taxing oil industry profits discourages long term investment strategies, which could negatively impact supplies and create upward pressure on prices. While overall our profits have increased over the last six years, Chevron has also increased its capital and exploratory spending a similar amount to find and develop new energy and invest in critical energy infrastructure.

Oil and gas industry profits are not excessive, compared to other industries. In 2007, the oil and natural gas industry earned 8.3 cents for every dollar of sales compared to an average of 7.8 cents for Dow Jones Industrial Average companies. More specifically, oil and natural gas profit margins, or earnings per dollar of sales, are typically in line with the average of other major U.S. manufacturing industries.

3. The expense and technical challenge of developing new oil resources in harsh environments such as the Arctic is a frequently heard rationale for large oil industry mergers. Are these projects working out as planned? Can we expect to see large new petroleum resources coming on line in the next few years as a result of mergers?

Answer: Mergers have been driven by the need to operate more efficiently, and to deploy capital more effectively. Mergers have allowed international oil companies – such as Chevron – to increase investments in key energy basins around the world, which has led to more energy production. As noted in our testimony, Chevron currently has a queue of 40 projects to bring more energy on line where our share of investment is $1 billion or more.

Chevron mergers have resulted in operating expense reductions, optimization of capital and exploratory expenditures and greater technical and other resources to pursue opportunities that benefits both stockholders and consumers.

For example, we are working on several deepwater crude oil and natural gas projects in the U.S. Gulf of Mexico. One of these, known as Tahiti, offers a typical case study in the risks facing this business today in terms of timing, scale and cost. In 2002, we used leading-edge technology to drill in 4,000 feet of water and found an estimated 400 million to 500 million barrels of recoverable resources. It will have taken seven years to build the infrastructure required to produce the oil and gas more than 100 miles offshore. When Tahiti finally comes online next year, we will have invested $4.7 billion—and dedicated personnel and resources for over a decade to manage exploration, permitting, engineering and development —before realizing $1 of return on our investment. Once in production, Tahiti is expected to produce for up to 30 years. Tahiti is expected to add 125,000 barrels of oil and 70 million cubic feet of gas per day to the U.S. domestic supply.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00200 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.138

4. To what extent are your refineries able to defer planned maintenance if and when refined product markets are tight? Has your company ever deferred refinery maintenance to meet a tight marketplace? If so, how frequently has your firm deferred maintenance? At what refineries and on what dates?

Answer: Planned refinery maintenance or turnarounds are scheduled years in advance. We have not deferred planned refinery maintenance or turnarounds to meet a tight marketplace.

The safety and reliability of our operations is our highest priority. We are dedicated to being a reliable supplier of products to our customers and plan accordingly. Therefore, we work hard to increase utilization by improving refinery reliability. It allows us to access more of the capacity that already exists within our system to increase supplies to the market.

We plan turnarounds of our refineries with these guiding principles in mind. Scheduled turnarounds are important to allow maintenance and ongoing safe operations. These projects are complex and require a significant amount of detailed planning and long-lead time to procure materials, equipment and skilled contract labor resources. Turnarounds are planned 1-6 years in advance, allowing time to rigorously plan, contract for skilled resources and delivery of new equipment, coordinate contractor schedules and develop supply contingencies for these complex projects – as well as build inventories and arrange alternative supplies to provide uninterrupted supplies of our products to our customers.

5. With constraints on the expansion of refinery capacity in California, how do you foresee meeting demand for gasoline and diesel in the future?

Answer: We are investing in our refineries and marketing business to continue to improve our ability to supply the products U.S. consumers need. We are investing $2.3 billion in 2008 in our U.S. refining and marketing assets. Since 2002, we have invested $5.2 billion and we have developed additional gasoline production capacity of more than 1 million gallons of transportation fuel production per day. At present, we are working on major projects at each of our big three U.S. refineries. In California, we are advancing through the permitting process for projects at our El Segundo and Richmond refineries. We are also investing in refineries outside the United States, such as Pembroke, Wales, which can produce gasoline to meet U.S. and California specifications.

Further we all need to moderate the growing demand for energy by increasing efficiency of transportation, residential, commercial and industrial uses. Energy efficiency is the most immediate and important action that each of us can take to contribute to rising energy prices. Increased energy efficiency and conservation will help reduce demand for energy and will reduce pressures on the system.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00201 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.139

6. According to initial research by the Government Accountability Office conducted at my request, the San Francisco Bay area has a significant degree of refinery market concentration. San Francisco also consistently has some of the highest gasoline prices in the United States – higher than other regions of California that must use the same reformulated gasoline. Do you believe that the high degree of market concentration among refineries in the San Francisco Bay Area is causing higher gasoline prices in this area?

Answer: We don't believe refinery concentration is contributing to higher gasoline prices in the San Francisco Bay Area. It is impossible to know exactly why gasoline prices in particular areas move as they do because of a myriad of complex factors. These factors include the number and location of gasoline stations in the area, land and building costs, labor costs, commute patterns, zoning laws, taxes, business strategies, demographics, and so on, which together create a distinct market.

7. How do pipeline and port constraints affect your ability to provide adequate supplies of fuel to consumers?

Answer: The safe and reliable delivery of quality products to our customers is critical. Existing pipeline infrastructure is closer to full capacity now than it has been over the past 10-15 years and additional tankage at ports is unavailable. Lack of pipeline and port distribution capacity will limit flexibility in meeting short term shifts in demand, impacting product availability and price. Therefore, Chevron and other companies have projects underway or planned to help debottleneck, upgrade or expand distribution infrastructure.

8. Given the importance of free market competition to the energy sector, what is your view of the current 54 cent a gallon tariff on ethanol imports into the United States? Do you believe Congress should reduce the tariff, at least to the $0.45 per gallon level that blenders receive for using ethanol in the United States? Would you endorse legislation to do this?

Answer: We believe that free and open markets for transportation fuels, where all fuels must compete on their own merits, are the best way to deliver the greatest value to our customers. Mandates, subsidies, and tariffs can distort those market forces by picking winners and reducing the incentive for innovation. With the recent passage of the Renewable Fuels Standard (RFS) and significant growth in the mature domestic ethanol industry, we believe it makes sense to reevaluate the costs and benefits to taxpayers of both of these policies.

9. It would appear that Russia is currently working to lay claim to the North Pole and its natural resources. How would you like to see the situation resolved? What role should the U.S. government play?

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00202 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.140

Answer: This is clearly an issue that will require a multilateral consensus among stakeholder nations. As such, we think this is an excellent opportunity for U.S. leadership toward a cooperative multilateral resolution.

10. Over half, and in some cases, roughly 75% of the proven reserves of a number of American oil companies are located abroad. Looking at, say, Venezuela as an example, it seems possible that we are beginning to see a new wave of energy resource nationalizations. How is your company working to protect shareholders from the adverse consequences of such actions?

Answer: We operate in a complex global environment, facing a variety of economic, geologic and political risks. We have been successful in this challenging environment through our technical skill, collaborative approach and commitment to lasting partnerships, and in the example cited we continue to return shareholder value from our Venezuelan operations. We also strive to maintain a diverse portfolio of assets in numerous countries around the world to help minimize and spread the various risks to our company. Our current operations span the globe and we currently have 40 major capital oil and natural gas projects in the planning, engineering or development stage, each with a net Chevron share of the investment over $1 billion. Eight of these projects are in the United States—we would welcome the opportunity to invest even more in the U.S., through expanded access to promising off-limits areas.

We take a long term view of the world's energy challenges, and know we can't solve them alone. The U.S. Government can help. While we know geopolitical challenges cannot be resolved overnight, we strongly support and advocate greater international engagement among producing and consuming nations, such as that called for by the G8+3 Energy Ministers in Japan in June. Dialog to identify both differences and common interests, and government to government measures—such as investment treaties and free trade agreements—can help promote a more stable international investment environment and greater energy cooperation.

Chevron is working with a broad range of stakeholders to promote these principles. We helped develop the core recommendations in the recent National Petroleum Council study. The study highlighted the importance of integrated energy, foreign, economic and trade policies as well as the need for international engagement and cooperation on energy and investment issues. We have worked for years to ensure that energy and energy investment remain on the action agenda of the Asia Pacific Economic Cooperation (APEC). Our Chairman participates regularly in international fora such as APEC participating with thought leaders from around the globe seeking to identify and promote areas of common interest and cooperation. Finally, we are participating as a stakeholder in the ongoing development of the U.S. trade and investment agenda, reinforcing the importance of strong investor protections to enhanced energy security, and advocating the inclusion of strong investment protection provisions in trade agreements and investment treaties—so that the energy industry can continue to make investments of the size and scope necessary to deliver the energy resources that are requisite to drive our economic growth.

ATTACHMENT I

Executive compensation information extracted from Chevron proxy statements.

(Also available at: http://www.chevron.com/investors/financialinformation/)

43354.142

EXECUTIVE COMPENSATION (2001, 2002)

SUMMARY COMPENSATION TABLE

		Annual Compensation		Long-Term Compensation			
				Awards	Payouts		
Name and Principal Position	Year	Salary ($)	Bonus($) (Year Earned) (2)	Securities Underlying Options (#)	Vested Performance Units ($)	Non-Stock Award ($)	All Other Compensation(1) ($)
D. J. O'Reilly	2002	$ 1,075,000	$ 700,000	200,000	$ 2,154,240	—	$ 81,209
Chairman	2001	$ 970,833	$ 5,000,000	150,000	$ 1,143,581	—	$ 141,853
P. J. Robertson	2002	$ 615,000	$ 425,000	80,000	$ 471,240	—	$ 46,112
Vice Chairman	2001	$ 519,167	$ 1,150,000	60,000	$ 640,406	—	$ 73,914
P. A. Woertz	2002	$ 543,750	$ 275,000	45,500	$ 471,240	—	$ 41,072
Executive Vice President	2001	$ 487,292	$ 1,128,000	45,500	$ 640,406	—	$ 67,896
G. L. Kirkland	2002	$ 418,750	$ 264,000	33,000	$ 418,750	—	$ 31,261
Vice President	2001	$ 345,000	$ 836,000	33,000	$ 155,527	—	$ 54,480
J. S. Watson	2002	$ 450,000	$ 350,000	45,500	$ 175,032	—	$ 32,524
Vice President	2001	$ 405,417	$ 2,000,000	33,000	$ 237,865	—	$ 54,480

(1) Includes ChevronTexaco's contributions to the Employee Savings Investment Plan and allocations under the Excess Benefit Plan for the Employee Savings Investment Plan. For 2002, contributions under the Employee Savings Investment Plan for the named individuals were as follows: D. J. O'Reilly, $12,649; P. J. Robertson, $13,379; P. A. Woertz, $13,655; G. L. Kirkland, $14,261; and J. S. Watson, $14,124 and contributions under the Excess Benefit Plan for the named individuals were as follows: D. J. O'Reilly, $68,560; P. J. Robertson, $32,733; P. A. Woertz $27,417; G. L. Kirkland, $17,000; and J. S. Watson, $18,400.

(2) 2001 amounts include regular annual bonus amounts as follows: D. J. O'Reilly, $1,800,000; P. J. Robertson, $650,000; P. A. Woertz, $628,000; G. L. Kirkland $336,000; and J. S. Watson, $500,000. In addition, the ChevronTexaco Management Compensation Committee of the Board of Directors recognized exemplary performance related to the successful merger of Chevron and Texaco. They granted special one-time supplemental cash awards in 2001 that will not be benefits bearing for retirement plan purposes as follows: D. J. O'Reilly, $3,200,000; P. J. Robertson, $500,000; P. A. Woertz, $500,000; G. L. Kirkland, $500,000; and J. S. Watson, $1,500,000.

Source: CHEVRON CORP, DEF 14A, April 14, 2003

43354.143

Executive Compensation (2003-2005)

SUMMARY COMPENSATION TABLE

		Annual Compensation			Long-Term Compensation			
					Awards		Payouts	
Name and Principal Position	Year	Salary ($)	Bonus (Year Earned) ($)	Other Compensation ($)	Restricted Stock Unit Awards(2) ($)	Securities Underlying Options(3) (#)	Vested Performance Units ($)	All Other Compensation(4) ($)
D.J. O'Reilly	2005	$ 1,550,000	$ 3,500,000	$ 51,083	—	425,000	$ 3,575,250	$ 124,000
Chairman	2004	$ 1,506,250	$ 3,950,000	$ 84,714	—	460,000	$ 841,120	$ 120,500
	2003	$ 1,312,500	$ 3,150,000	—	—	460,000	$ 3,255,200	$ 105,000
P.J. Robertson	2005	$ 879,583	$ 1,500,000	—	—	180,000	$ 1,532,250	$ 70,367
Vice-Chairman	2004	$ 806,667	$ 1,575,000	—	—	200,000	$ 328,563	$ 64,533
	2003	$ 723,750	$ 1,365,000	—	$ 1,137,700	200,000	$ 712,075	$ 57,900
P.A. Woertz	2005	$ 685,417	$ 850,000	—	—	115,000	$ 825,713	$ 54,833
Executive Vice	2004	$ 635,417	$ 1,210,000	—	—	120,000	$ 254,965	$ 50,833
President	2003	$ 585,417	$ 945,000	—	$ 380,800	120,000	$ 712,075	$ 46,833
J.S. Watson	2005	$ 635,417	$ 1,000,000	—	—	115,000	$ 825,713	$ 50,833
Vice President	2004	$ 576,667	$ 1,155,000	—	—	120,000	$ 183,995	$ 46,133
	2003	$ 502,500	$ 945,000	—	$ 380,800	120,000	$ 712,075	$ 40,200
G.L. Kirkland	2005	$ 618,750	$ 1,000,000	—	—	115,000	$ 595,875	$ 49,500
Executive Vice	2004	$ 519,583	$ 945,000	—	—	90,000	$ 183,995	$ 41,567
President	2003	$ 456,875	$ 787,500	—	$ 477,100	90,000	$ 528,970	$ 36,550

(1) For security reasons, D.J. O'Reilly uses company aircraft for both business and personal travel when judged appropriate. Included for D.J. O'Reilly is $27,551 for 2005 and $61,716 for 2004 for his personal use of company aircraft based on estimated incremental costs to the Company. Also included for D.J. O'Reilly is $20,700 for 2005 for financial counseling services.

(2) As of December 31, 2005, the aggregate number of restricted stock units held by the named officers are as follows: P.J. Robertson, 33,592 with an aggregate market value of $1,907,036; P.A. Woertz, 26,007 with an aggregate market value of $1,476,415; J.S. Watson, 26,007 with an aggregate market value of $1,476,415; G.L. Kirkland, 14,087 with an aggregate market value of $799,725.

On June 25, 2003, the named officers received the following restricted stock unit awards (adjusted for the September 10, 2004 two-for-one stock split); P.J. Robertson, 31,000 units; P.A. Woertz, 24,000 units; J.S. Watson, 24,000 units and G.L. Kirkland, 13,000 units. Fifty percent of the units subject to the award will be vested on the fourth anniversary of the grant date and 50 percent will be vested on the eighth anniversary of the grant date.

Dividend equivalents are paid on the restricted stock units and are converted into additional restricted stock units as of the dividend payment date.

(3) The number of securities underlying stock options has been adjusted for the Company's September 10, 2004 two-for-one stock split.

(4) Includes Chevron's contributions to the Employee Savings Investment Plan and allocations under the Employee Savings Investment Plan Restoration Plan. For 2005, contributions under the Employee Savings Investment Plan were $16,800 for each of the named individuals. Contributions under the ESIP Restoration Plan for the named individuals were as follows: D.J. O'Reilly, $107,200; P.J. Robertson, $53,567; P.A. Woertz, $38,033; J.S. Watson, $34,033; G.L. Kirkland, $32,700.

Source: CHEVRON CORP, DEF 14A, March 20, 2006

Executive Compensation (2006-2007)

SUMMARY COMPENSATION TABLE

The following table sets forth the compensation of our named executive officers, or "NEOs," for the fiscal years ending December 31, 2007, and December 31, 2006. None of our NEOs has an employment contract with the Company. The primary components of each NEO's compensation are also described in our Compensation Discussion and Analysis, above.

Name and Principal Position	Year	Salary ($)(1)	Stock Awards ($)(2)	Option Awards ($)(3)	Non-Equity Incentive Plan Compensation(4)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)(5)	All Other Compensation ($)(6)	Total ($)
D.J. O'Reilly, Chairman and CEO	2007	$ 1,650,000	$ 19,387,350	$ 6,650,584	$ 3,600,000	$ 0	$ 255,251	$ 31,543,185
	2006	$ 1,620,833	$ 13,008,715	$ 6,922,146	$ 3,500,000	$ 6,322,578	$ 228,617	$ 31,602,889
S.J. Crowe, Chief Financial Officer	2007	$ 628,125	$ 4,204,525	$ 1,865,439	$ 875,000	$ 1,384,104	$ 66,522	$ 9,023,715
	2006	$ 553,125	$ 1,931,712	$ 1,224,583	$ 750,000	$ 1,514,768	$ 61,986	$ 6,036,174
P.J. Robertson, Vice Chairman	2007	$ 985,417	$ 8,476,531	$ 2,950,296	$ 1,500,000	$ 119,935	$ 136,143	$ 14,168,322
	2006	$ 935,417	$ 5,544,890	$ 2,946,302	$ 1,500,000	$ 3,215,273	$ 118,723	$ 14,260,605
G.L. Kirkland, Executive Vice President	2007	$ 746,042	$ 4,287,145	$ 1,539,819	$ 1,050,000	$ 662,309	$ 76,303	$ 8,361,618
	2006	$ 679,583	$ 2,303,245	$ 1,158,095	$ 1,000,000	$ 1,688,917	$ 72,428	$ 6,902,268
J.S. Watson, Executive Vice President	2007	$ 746,042	$ 4,675,957	$ 1,306,593	$ 1,050,000	$ 0	$ 100,260	$ 7,878,852
	2006	$ 685,417	$ 2,844,431	$ 1,206,416	$ 1,000,000	$ 834,565	$ 70,756	$ 6,641,585

(1)
Compensation is reviewed after the end of each year, and salary increases, if any, are effective April 1 of the following year. The table below reflects the salary effective April 1, 2006 and 2007, for each of the NEOs and the amounts earned and deferred under the Deferred Compensation Plan for Management Employees (DCP).

Name	Year	Salary Effective April 1	Salary Deferred Under the DCP
D.J. O'Reilly	2007	$ 1,650,000	$ 660,000
	2006	$ 1,650,000	$ 630,250
S.J. Crowe	2007	$ 650,000	$ 251,250
	2006	$ 575,000	$ 221,250
P.J. Robertson	2007	$ 1,000,000	$ 15,208
	2006	$ 950,000	$ 14,308
G.L. Kirkland	2007	$ 765,000	$ 10,421
	2006	$ 700,000	$ 9,192
J.S. Watson	2007	$ 765,000	$ 10,421
	2006	$ 700,000	$ 9,308

(2)
2007 amounts include the aggregate proportionate fair value for (a) performance shares granted under the Corporation's Long-Term Incentive Plan in four grant years (2007, 2006, 2005 and 2004) and (b) restricted stock units granted under the LTIP on June 25, 2003, that have been recognized as compensation costs in our financial statements for the fiscal year ended December 31, 2007 under Financial Accounting Standards Board Statement of Financial Accounting Standards (FAS) No. 123 (revised 2004), Share-Based Payment (FAS 123R).

Source: CHEVRON CORP, DEF 14A, April 1, 2008

43354.145

Executive Compensation*(Continued)*

The amounts do not represent the grant date fair value of performance shares granted in 2007. The grant date fair value of performance shares granted in 2007 reported in the "Grants of Plan-Based Awards in Fiscal Year 2007" table below, for each of the NEOs is as follows:

Name	Grant Date Fair Value of Performance Shares Granted in 2007
D.J. O'Reilly	$4,511,240
S.J. Crowe	$1,555,600
P.J. Robertson	$2,100,060
G.L. Kirkland	$1,555,600
J.S. Watson	$1,555,600

2007 amounts relating to performance shares reflect the compensation costs recognized in our 2007 financial statements under FAS 123R. As such, this includes amounts for the following number of performance shares granted from 2004 through 2007 as follows:

Name	2007 Grant	2006 Grant	2005 Grant	2004 Grant
D.J. O'Reilly	58,000	64,000	66,000	106,000
S.J. Crowe	20,000	12,000	13,000	9,000
P.J. Robertson	27,000	27,000	28,000	40,000
G.L. Kirkland	20,000	20,000	18,000	18,000
J.S. Watson	20,000	20,000	18,000	27,000

Under the provisions of FAS 123R, performance shares are classified as liability awards. Accordingly, total per-share compensation cost equals the payout amount measured as of the settlement date at the end of the three-year performance period. Until settlement, compensation costs recorded in our financial statements recognize changes in estimated fair value as of the end of each quarterly reporting period. We use a Monte Carlo approach to calculate estimated fair value of performance shares. To derive estimated fair value per share, this valuation technique simulates TSR for the Company and the peer group using market data for a period equal to the term of the performance period, correlates the simulated returns within the peer group to estimate a probable payout value, and discounts the probable payout value using a risk-free rate for Treasury bonds having a term equal to the performance period. As of December 31, 2007, this technique generated estimated fair values per share of $118.34, $147.10, and $162.74 for the outstanding 2007, 2006 and 2005 grants, respectively. The settlement value for the 2004 grant was $82.36 per share. Since the performance period for the 2004 grant ended in 2007, each performance share under the 2004 grant was further adjusted by the actual performance modifier of 125 percent.

2007 amounts in the "Stock Awards" column also include the proportionate amount of fair value of the restricted stock units granted under the LTIP on June 25, 2003, that have been recognized as compensation costs in our 2007 financial statements and the aggregate dividend accrual in 2007 paid and to be paid at vesting. The value of each restricted stock unit is $36.70, which is based on the closing price of Chevron common stock on the date of the grant. The number of restricted stock units granted in 2003 were: Mr. Robertson, 31,000; Mr. Kirkland, 13,000; and Mr. Watson, 24,000. Fifty percent vested on June 25, 2007, and the remaining 50 percent will vest on June 25, 2011. Total restricted stock unit dividends accrued in 2007 (including a portion paid upon the vesting in June 2007) were: Mr. Robertson, $58,827; Mr. Kirkland, $24,669; and Mr. Watson, $45,543.

Source: CHEVRON CORP, DEF 14A, April 1, 2008

43354.146

Executive Compensation *(Continued)*

(3)
2007 amounts include the aggregate proportionate fair value for stock option grants made under the LTIP in four grant years (2007, 2006, 2005 and 2004) that have been recognized as compensation costs in our financial statements for the fiscal year ended December 31, 2007 under FAS 123R. The actual value of stock options granted in 2007, as reported in the "Grants of Plan-Based Awards in Fiscal Year 2007" table, below for each of the NEOs was:

Name	Grant Date Fair Value of Stock Options Granted in 2007
D.J. O'Reilly	$5,726,250
S.J. Crowe	$1,908,750
P.J. Robertson	$2,595,900
G.L. Kirkland	$1,908,750
J.S. Watson	$1,908,750

The number of stock options granted to each of the NEOs was:

Name	2007 Grant	2006 Grant	2005 Grant	2004 Grant
D.J. O'Reilly	375,000	400,000	425,000	460,000
S.J. Crowe	125,000	75,000	80,000	42,000
P.J. Robertson	170,000	170,000	180,000	200,000
G.L. Kirkland	125,000	125,000	115,000	90,000
J.S. Watson	125,000	125,000	115,000	120,000

One-third of the stock options vest on each anniversary of the date of grant and expire after 10 years.

The grant date fair value was determined under FAS 123R for financial reporting purposes. For a discussion of the determination of fair value under FAS 123R for the 2007, 2006 and 2005 grants, see Note 21, "Stock Options and Other Share-Based Compensation," to the Consolidated Financial Statements contained in our Annual Report on Form 10-K/A for the year ended December 31, 2007 and for 2004 grants, see Note 22, "Stock Options and Other Share-Based Compensation," to the Consolidated Financial Statements contained in our Annual Report on Form 10-K for the year ended December 31, 2006.

(4)
2007 amounts reflect Management Incentive Plan awards for the 2007 performance year that will be paid in April 2008. See "Compensation Discussion and Analysis—Annual Cash Incentive (Management Incentive Plan)" above for a detailed description of MIP awards.

(5)
2007 amounts represent the change in pension value for the Chevron Retirement Plan (CRP) and the Chevron Retirement Restoration Plan (RRP) from January 1, 2007, through December 31, 2007, expressed as a lump sum. (The Deferred Compensation Plan (DCP) and ESIP Restoration Plan (ESIP-RP) do not pay preferential earnings and are not represented in this table.) Mr. O'Reilly's theoretical pension value is $220,592 less, generally because he did not receive a salary increase in 2007 and because a higher interest rate was used to calculate the present value of his benefit. When a higher interest rate is used, a lower lump sum results. Mr. Crowe's theoretical pension value has increased to a greater degree than the other NEOs' because he has reached age 60 and his pension is no longer discounted. In addition, his salary increases and MIP awards have increased due to his promotion to CFO in January 2005.
Mr. Robertson's theoretical pension value has not changed to the same degree because his benefit is already undiscounted with no increase in the amount of his MIP award. Mr. Kirkland's theoretical pension value has not changed to the same degree because he received no increase in the amount of his MIP award and a higher interest rate was used to calculate the present value of his benefit in his age group. Mr. Watson's theoretical pension value is $14,584 less, generally due to a higher interest rate being used to calculate the present value of his benefit in his age group.

Source: CHEVRON CORP, DEF 14A, April 1, 2008

43354.147

Executive Compensation *(Continued)*

(6)
All Other Compensation for 2007 includes the following:

Name	ESIP Company Contributions(a)	ESIP-RP Company Contributions(a)	Company-Paid Life Insurance Premiums(b)	Perquisites(c)				Total All Other Compensation
				Financial Counseling	Aircraft/ Other(d)	Motor Vehicles	Home Security	
D.J. O'Reilly	$ 18,000	$ 114,000	$ 15,923	$ 21,075	$ 82,456	$ 2,057	$ 1,740	$ 255,251
S.J. Crowe	$ 18,000	$ 32,250	$ 4,272	$ 12,000	$ —	$ —	$	$ 66,522
P.J. Robertson	$ 18,000	$ 60,833	$ 9,650	$ 16,335	$ 28,299	$ 2,745	$ 281	$ 136,143
G.L. Kirkland	$ 18,000	$ 41,683	$ 4,620	$ 12,000	$ —	$ —	$	$ 76,303
J.S. Watson	$ 18,000	$ 41,683	$ 2,464	$ 12,000	$ 25,626	$ —	$ 487	$ 100,260

(a)
The Employee Savings Investment Plan for executives is common in design and purpose to those for the broad base of employees in the United States. When an employee contributes 2 percent of earnings to the ESIP, the Company provides an 8 percent match. Employees may choose to contribute 1 percent and receive a 4 percent match. They may also choose to contribute an amount above 2 percent, but none of the amount above 2 percent is matched. The Company match up to IRS limits ($225,000 of income in 2007) is made to the qualified ESIP account. For amounts above the IRS limit, the executive can elect to have 2 percent of base pay directed into the Deferred Compensation Plan and the Company will match those funds in the nonqualified ESIP Restoration Plan. Management Incentive Plan awards were not eligible for an ESIP or ESIP Restoration Plan company match in 2007.

(b)
This column includes basic life insurance and on-the-job accident insurance. Generally, all U.S. employees have basic company-paid life insurance, which would remit a benefit to the beneficiary in the amount of two times the employee's base salary in the event of death.

(c)
Perquisites within Chevron are very limited and consist of only financial counseling fees, home security, and the incremental cost to the Company for personal use of Company motor vehicles and Company aircraft. We do not provide tax gross-ups to our NEOs for any perquisites.

(d)
Amounts include the aggregate incremental cost for the NEOs' spouses accompanying the NEO on the international Board trip, which is described in the narrative preceding the Directors' Compensation Table below and footnote 8 to the Directors' Compensation Table. Amounts attributable to aircraft are as follows: Mr. O'Reilly—$21,218; Mr. Robertson—$21,374; and Mr. Watson—$19,187. For Mr. O'Reilly, an additional $54,408 of incremental cost to Chevron is also included for other personal use of aircraft in 2007. Generally, executives are not allowed to use the Company planes for personal use. For security reasons, the CEO has been requested to use the Company plane in most instances, and on a very limited basis, the CEO has authorized the personal use of Company aircraft for other key executives if it is in relation to and part of a trip that is business related. Incremental cost was determined by multiplying the operating hours attributable to personal use by the average estimated direct operating costs and the addition of crew costs for overnight lodging and meals and airport landing fees, as applicable, divided by the number of passengers.

Source: CHEVRON CORP, DEF 14A, April 1, 2008

43354.148

Daniel Nelson
Vice President
Washington Office

June 26, 2008

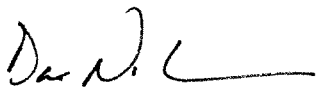
The Honorable Patrick J. Leahy
Chairman
Senate Committee on the Judiciary
224 Dirksen Senate Office Building
Washington, DC 20510

Dear Senator Leahy:

Enclosed please find our company's responses to questions posed by respective committee members following the May 21, 2008 Senate Judiciary Committee hearing. On Monday of this week, we received additional questions from Senator Feingold, along with his request that our responses be included in this response. Unfortunately, the data gathering aspects of preparing our responses to his new questions require additional time, and we are working expeditiously in that regard.

Thank you for the opportunity to participate in the hearing and provide you with our views.

Sincerely,



Enclosures

Exxon Mobil Corporation 2000 K Street, NW, Suite 710 Washington, DC 20006

43354.149

Following the Senate Judiciary Committee Hearing on "Exploring the Skyrocketing Price of Oil"

During the Committee hearing on May 21, Senator Schumer pursued a line of questions concerning the witnesses' companies' investments in alternative energy and steps to improve fuel efficiency. In the interest of limited time, he requested additional information to be submitted in writing to the committee.

Answer: ExxonMobil shares the same goal as policymakers — to meet the world's growing energy demand while lowering the projected growth in greenhouse gas emissions. We approach this by:

a. improving energy efficiency and reducing GHG emissions in our own operations;

b. improving the efficiency of consumers' use of energy; and

c. conducting or sponsoring research that could lead to breakthroughs in alternative energy.

We are taking significant actions to assist.

a. improving energy efficiency and reducing emissions in our own operations

As an industry leader in the use of cogeneration applications, we have interests in about 100 cogeneration facilities in more than 30 locations worldwide. We have invested more than $1 billion in cogeneration projects since 2004, bringing the combined power generation capacity at facilities in which we have an interest to more than 4.5 gigawatts in 2007. With new facilities under construction around the world, we expect to increase this capacity to more than 5 gigawatts in the next three years.

Additionally, we are investing more than $4 billion in gas utilization and commercialization projects to eliminate routine gas flaring in Nigeria.

ExxonMobil launched its proprietary Global Energy Management System (GEMS) in 2000, through which we have identified opportunities to improve energy efficiency at our refineries and chemical plants by 15 to 20 percent. We have implemented about 60 percent of these opportunities. Our refining and chemical operations achieved best-ever energy efficiency in 2007. Over the past several years, we have been improving the energy efficiency of our refining and chemical businesses at a rate two to three times faster than the industry.

Through efficiency actions taken in 2006 and 2007, we reduced GHG emissions by about 5 million metric tons in 2007, equivalent to removing about one million cars from roads in the United States. We are also on track to meet our target of improving energy efficiency across our worldwide refining and chemical operations by at least 10 percent between 2002 and 2012.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00212 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.150

b. improving the efficiency of consumers' use of energy.

We are actively involved in improving energy efficiency of consumers' use of our products, promoting low-emissions technologies that are ***deployable today***, such as tire inner liners that keep tires inflated longer; advanced fuel economy engine oil; and light weight automobile plastics. Utilization of these technologies in one-third of U.S. vehicles would translate to a savings of about 5 billion gallons of gasoline annually and yield greenhouse gas emissions savings equal to taking about 8 million cars off the road.

In addition, we are working on other technologies both for the mid- and longer-term that address the need for both improved fuel economy and reduced emissions. This includes separator films for lithium ion batteries that could accelerate the adoption of hybrid vehicles, and our collaborative research with auto and engine makers on technologies that may enhance fuel economy by up to 30 percent. ExxonMobil is also conducting research into hydrogen generation on board vehicles to power fuel cells which could improve fuel economy by 80 percent and reduce emissions by as much as 45 percent. Recently, we also announced a more than $100 million investment in a new technology for separating CO2 from natural gas, which could help commercialize some applications of carbon capture and storage.

c. conducting or sponsoring research that could lead to breakthroughs in alternative energy

A primary value we also bring is through financial and technical ***support of breakthrough research*** to overcome the economic and technological barriers inhibiting these sources from being applied on a broader scale. On the research side, we are spending approximately $100 million in 2008 on alternative energy and efficiency improvement technologies, and technology for separating CO2 from natural gas, which could have a significant longer term impact on reducing emissions. We agree with the view that in order to meet future energy demand, we are going to need a wide range of energy sources — including wind, solar, nuclear, coal, biofuels, oil and natural gas.

Five years ago, ExxonMobil initiated the Global Climate and Energy Project (GCEP) at Stanford University to identify future step-out advanced energy technologies. ExxonMobil has committed $100 million to this project over ten years. GCEP now funds research programs in the United States, Europe, Australia and Japan.

Our investment in groundbreaking research at GCEP represents our commitment to work to meet future energy needs with significantly lower greenhouse gas emissions. GCEP is the largest privately funded low-greenhouse-gas-energy research effort in history. This project aims to undertake fundamental and pre-commercial research on a wide range of technologies that offer the potential to supply and use energy with significantly reduced greenhouse gas emissions. Emphasis is on breakthrough research that can enable widespread, commercial solutions in a broad portfolio of areas including:

- How hydrogen and solar energy can be made economically;
- How engine and fuel systems can be made significantly more efficient;
- How carbon dioxide capture and storage can be made more effective; and
- How biofuels can be made with greater yield and lower emissions.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00213 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.151

With these efforts underway, however, ExxonMobil remains focused on meeting the growing energy demand projections in the next few decades and the realities of various investment options to meet those demands. Increased energy supplies will serve as the foundation of a growing global economy and the tremendous expansion of living standards throughout the developing world. We therefore assess pragmatically the role that alternative energy sources can play in meeting these future needs. Even as wind and solar energy are likely to grow at about 10 percent per year on average, supported by government subsidies and mandates, they will account for about 1 percent of global energy demand in 2030. Costs and intermittency remain challenges to expanding use. We have particular reservations about mandates and subsidies that distort markets by picking "winners and losers", penalize selected taxpayers, raise investment risks, and increase fuel costs for consumers.

The advantages of oil and natural gas across a broad array of applications provide economic value unmatched by any currently available alternative. On any assessment, oil and gas will continue to play a significant role in meeting energy demand for many years to come. And that is where ExxonMobil's strengths lie — to use our technology, the expertise of our people and our global scale to safely and reliably supply the oil and gas that is, and will continue to be, needed to power the American economy, and to improve the environmental performance of our products and operations.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00214 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.152

Questions of Senator Sheldon Whitehouse

Questions for Entire Panel:

1. Has your company, any subsidiary, or any entity acting under common ownership or control, financially contributed to any organizations that study global warming or climate change? If so, which are those organizations and how much in total has your company given to each one?

   Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the American Legislative Exchange Council? If so, how much has it contributed? Does your company agree with the American Legislative Exchange Council's opinion that increasing levels of carbon dioxide are not causing glaciers to retreat?

   Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Cato Institute? If so, how much has it contributed? Either way, does your company agree with Cato Institute commentary that "science no longer provides justification for any rush to pass drastic global warming legislation."?

   Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Committee for a Constructive Tomorrow? If so, how much has it contributed? Does your company agree with the Committee for a Constructive Tomorrow that "recent glacial retreats, sea-level rise and migrations of temperature sensitive species are all within the bounds of known natural variability."?

   Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Annapolis Center for Science-Based Public Policy? If so, how much has it contributed? Does your company agree with an Annapolis Center for Science-Based Public Policy report that states "climate models may never be able to make greenhouse-warming predictions with certainty?"

   Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Acton Institute for the Study of Religion and Liberty? If so, how much has it contributed? Does your company agree with Acton Institute for the Study of Religion and Liberty commentary that it is a "myth that [global warming] is an emergency that demands a drastic cutback in CO-2 emissions" and that "making a case against CO-2 without making a case against nature is like making an omelet without breaking the proverbial egg. It is impossible."?

   Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Center for the Study of Carbon Dioxide and Global Change? If so, how much has it contributed? Does your company agree with the Center for the Study of Carbon Dioxide and Global Change that "there is no compelling reason to believe that the rise in temperature was caused by the rise in CO-2."?

   Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Frontiers of Freedom Institute? If so, how much has it contributed? Does your company agree with the Frontiers of Freedom Institute that S.2191, America's Climate Security Act, is "a hyped-up rallying cry against a 'problem' that scientists can't even agree exists in the first place."?

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00215 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.153

Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the George C. Marshall Institute? If so, how much has it contributed? Does your company agree with the George C. Marshall Institute that there is a "shattered consensus" on the state of global warming?

Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Heartland Institute? If so, how much has it contributed? Does your company agree with the Heartland Institute that "there is no consensus about the causes, effects, or future rate of global warming," and that "most climate scientists doubt the reliability of computer models and the accuracy of land-based temperature records," and that "reports by the IPCC are unreliable due to political editing and rewriting of the reports' conclusions," and that "some of the key evidence cited in past IPCC reports has been shown to be fraudulent."?

Has your company, any subsidiary, or any entity acting under common ownership or control ever contributed to the Institute for Energy Research? If so, how much has it contributed? Does your company agree with the Institute for Energy Research that global climate change is a "craze...fueled by alarmist rhetoric and trumped up scientific claims."?

A. ExxonMobil promotes public discussion on issues of direct relevance to the company. We, like many U.S. based corporations, contribute to a wide range of academic and policy organizations that research and promote dialogue on significant domestic and foreign policy issues, such as climate change, including the Brookings Institution, the American Enterprise Institute, the Council on Foreign Relations, the Center for Strategic and International Studies, and Resources for the Future. Corporate contributions to these organizations should not be confused with management of their policy recommendations or statements. There is value, however, in the debate they prompt if it leads to more optimal public policy decisions. We annually review our support of tax-exempt organizations and make appropriate adjustments. In addition, we publish a list of the 501(c)(3) organizations we support on our web site and update the list once per year. We also specifically disclose our support for organizations in the documents referenced below.

With regard to our position on climate change, ExxonMobil has the same concerns as people everywhere – and that is how to provide the world with the energy it needs while reducing greenhouse gas emissions. We take the issue of climate change seriously and the risks warrant action. ExxonMobil is taking action by reducing greenhouse gas emissions in our operations, helping consumers reduce their emissions, supporting research into technology breakthroughs and participating in constructive dialogue on policy options with NGOs, industry and policy makers. Our strategy is to reduce emissions and improve efficiency. We are already seeing results. Through efficiency actions taken in 2006 and 2007, we reduced our greenhouse gas emissions by about 5 million metric tons in 2007, equivalent to removing about one million cars from roads in the United States.

Responding to your question concerning ExxonMobil funding of certain organizations that may study climate change, attached as Appendices 1 and 2 are the "ExxonMobil Corporation 2007 Worldwide Contributions and Community Investments Report" and the "2007 Corporate Citizenship Report." The first addresses comprehensively and specifically, by institution and organization, our

43354.154

company's financial and other support. At page 41, the review of support for "Public Information and Policy Research" is provided and at page 51, our support for environmental organizations and research is provided. The second report addresses a range of activities in which we are engaged to manage the risks posed by increases in global greenhouse gas emissions and, particularly, to reduce emissions in our operations. It also elaborates on our view that the long term objective of a climate change policy should be to reduce the risk of serious impacts on society and ecosystems, while considering the importance of energy to global economic development.

2. At a time when gasoline prices were near record highs, your five companies earned record-breaking profits last year: $116 billion. ExxonMobil made $40.6 billion last year, which is more than the all federal highway spending and about as much as the entire credit card industry earned that year. Since 2002, your five companies have consistently broken profit records. If you continue to profit this year at the pace you did in the first quarter, you are once again poised to smash profit records, not just for your industry, but for all industries. Please explain why what, in raw numbers, may be the most profitable industry in history needs the multi-billion dollar Section 199 domestic manufacturing tax breaks enacted in 2004. Why aren't those profits adequate to provide access to capital without those tax incentives?

   A. First, we appreciate the opportunity to address the facts behind the Domestic Manufacturing deduction (found under §199 of the Tax Code) because there have been so many mischaracterizations of this issue.

   As background, The American Jobs Creation Act of 2004 provided new tax rules for **all** US manufacturers and producers. While this legislation began as an effort to modify the Extraterritorial Income Exclusion (ETI) tax rules declared illegal by the World Trade Organization, Congress expanded that goal to include the creation and retention of U.S. jobs throughout the critical domestic manufacturing and production sector, including, of course, jobs in the U.S. oil and natural gas industry.

   Congress had not reduced the U.S. corporate income tax rate since 1986, despite rate cuts enacted by many other nations. Section 199 addressed this for U.S. manufacturers and producers since, when fully phased in, the §199 deduction will be approximately the equivalent of a three percentage point reduction in the corporate income tax rate for all qualified domestic manufacturing and production income.[1]

   The §199 provision applies to **all** manufacturing activities in the U.S., i.e., it is not a provision designed solely for the oil and gas industry, or only for large companies in the oil and gas industry. Characterizing this general provision as an "oil company subsidy" or as a "tax break for big oil", is highly misleading to the public. Repealing this provision only for U.S. oil and natural gas producers and refiners, or worse, only for five companies operating in that business, while

[1] The provision was "phased in" over several years, starting with the approximate equivalent of a 1% rate reduction for 2005 and 2006, a 2% rate reduction for 2007-2009, and finally the 3% reduction beginning in 2010.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00217 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.155

maintaining it for all other manufacturers and producers, would simply single out one industry, or worse, five companies within an industry, for unjust, punitive and arbitrary treatment. That is highly discriminatory and unsound tax policy.[2] And the result would be to discourage critical new oil and gas investments here in the U.S., by making those already costly domestic energy investments even more costly[3] and thus less competitive with foreign opportunities. In the refining sector, U.S. industry margins in the first quarter of 2008 fell dramatically from the first quarter of 2007. Given these current conditions for the U.S. refining business, and the call of many in Congress for increased refinery capacity, it is perplexing that some members of Congress would continue to propose increasing taxes on such investments.

Investments in oil and gas exploration and development projects require a long term commitment of massive amounts of capital. As we all have seen, the oil and gas business is a highly cyclical one, and the fact that prices are high at the current time is no guarantee that they will stay that way throughout the 20-30 years of the project life. One need only look back over the last 20-30 years, and the predictions made during that period, to see the volatility of prices and the inaccuracy of predictions based on such prices.

The issue, then, is not whether sufficient capital exists to invest in such projects. It does, within our company, within our industry, and within the capital markets that oil and gas companies may access. But the question is whether the investor has a reasonable prospect, taking into account the huge uncertainties associated with such investments, to realize an acceptable return over the project life for undertaking such risks. Adverse changes to tax laws, which when originally enacted were intended to encourage certain investments, not only reduce the returns on such investments after the fact but inject even more uncertainties and risks for potential investors considering future projects. And increasing taxes on U.S. oil and gas investments will result in less domestic investment, and ironically, even greater reliance on foreign imports.[4]

According to a recent study by PricewaterhouseCoopers, the oil and natural gas industry employed 1.86 million wage and salary workers in the United States in 2004.[5] In addition, the industry's purchase of goods and services from other industries supported nearly 4.1 million indirect and induced jobs across the

---

[2] Interestingly, out of 78 oil and gas companies operating worldwide, the five companies singled out by the Senate for such treatment were ranked 42, 53, 57, 60, and 63 in terms of profitability based upon profit margin. See Energy Intelligence Research: The Energy Intelligence Top 100: Ranking the World's Oil Companies, 2008, p. 85.

[3] In the U.S., the most promising exploration and development projects are increasingly found offshore. According to the Energy Information Administration, it costs U.S.-based oil and gas companies about 20 percent more to explore for and produce a barrel of oil or equivalent natural gas in the United States than abroad.

[4] See the Congressional Research Service's *CRS Report for Congress: Energy Tax Policy: History and Current Issues, Updated April 1, 2008*, which, in addressing the effect of the Section 199 repeal, states: "Domestic oil and gas output would be lower, and imports would be higher than they otherwise would be without the tax increase." Page 20.

[5] *The Economic Contributions to the U.S. National and State Economies by the Oil and Natural Gas Industry*, PricewaterhouseCoopers, January 15, 2007, Table 4, p. 9.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00218 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.156

country, resulting in nearly 6 million jobs as the total employment contribution of the oil and natural gas industry to the U.S. economy. Oil and gas extraction activities are found in 42 states. These are high-paying jobs for middle-class Americans, paying more than three times the current minimum wage for non-supervisory workers. Encouraging greater investment in domestic oil and gas operations in exactly the same way as for all other domestic manufacturers and producers helps keep more Americans working in these valued occupations.

U.S. energy security is clearly enhanced by greater investment in domestic oil and gas activities. According to projections by the Energy Information Administration (EIA) in its *Annual Energy Outlook 2008*, domestic crude oil production is expected to rise slightly through 2020 before declining in the 2020–2030 timeframe. Increased access to available resources and a reliable fiscal and regulatory investment framework will be critical to sustain domestic production over the long term and reduce U.S. reliance on imported oil.

In order to provide adequate supplies of energy for American consumers, U.S. oil and natural gas companies must seek out the most cost-competitive sources of oil and natural gas available to them. Retaining §199 for the domestic oil and gas industry, and keeping those investments on a par with all other domestic manufacturing and production activities, will maximize domestic oil and gas investment and jobs, and reduce foreign imports.

3. The petroleum industry operates in an unusual fashion. Your five corporations are integrated oil giants that control all stages of production and distribution. From the exploration and mining to the refinement and transportation to the moment the customer swipes her Exxon or Shell charge card at the pump, you control everything. Are you aware of any other industries that operate in this fashion? How would you respond to the suggestion that it may be time to examine whether the vertically integrated ownership structure facilitates price gouging and harms consumers? Would you support a Congressionally-directed study to examine the effects of your ownership structure?

   A. Economists and other academics have studied vertical integration extensively in recent decades, and vertically-integrated ownership structures are ubiquitous in the U.S. economy. Economists recognize that there are significant efficiencies associated with vertical integration in the petroleum industry and elsewhere.[6]

   Vertical integration simply substitutes ownership for contractual relationships when it is less expensive and more efficient to do so. In the past two decades, as spot and futures markets for crude oil and refined product have become more developed, the petroleum industry has become less vertically integrated, and firms have been able to enter successfully and produce at only one level of the industry. A number of major U.S. refining companies have no crude oil production, but simply purchase crude oil supplies on the open market. Similarly, a number of crude oil producers own no refineries and simply sell crude oil. In addition, the increasing ability to procure a steady supply of

[6] *See e.g.*. Martin Perry, Vertical Integration: Determinants and Effects, in 1 HANDBOOK OF INDUSTRIAL ORGANIZATION 185 (edited by Richard Schmalensee and Robert Willig, 1989).

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00219 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.157

gasoline has led to the growth of gasoline retailers — such as WaWa, QuickTrip, and Costco — that sell large volumes of gasoline without owning any upstream assets. Because vertical integration has been studied so often and the evidence of its benefits is so strong, we do not believe that it facilitates price gouging or that a congressionally-directed study is needed.

4. The attached graph illustrates that the growth in profits of your five companies over the past six years has outpaced even the sharp increase in the price of gasoline. Why is your profit margin rising at a rate that is so much higher than the price of your product?

   A. ExxonMobil's profit margins have risen at a slower rate than the price of gasoline. Profit margins have changed as follows:

   2002: 6%
   2007: 10%
   1Q'08: 9%

   ExxonMobil's earnings have risen less than "Oil Company Profits" as indicated on the chart, increasing 254% from 2002 to 2007.

   Generally, integrated oil and gas companies produce and sell a very broad and diverse range of petroleum and petrochemical products, with motor gasoline representing only a portion of total sales. Industry earnings represent this broad range of products. The graph appears to indicate that U.S. motor gasoline prices have doubled from 2002 to 2007. Over the same time period, however, global crude prices have almost tripled, which resulted in a significant ramp-up in earnings in the Upstream segments within the industry.

5. How much has your company invested in research and development of coal to liquids technology for use as transportation fuel in each of the past five years?

   A. ExxonMobil has many commercial technologies today, and continues to invest in R&D for processes that could be used to convert coal to fuels, lubricants, and chemicals. In the area of fuels and lubricants, the processes include gasification of coal to synthesis gas, conversion of synthesis gas to fuels and lubricants, and carbon capture and storage processes.

   From 2003-2007, ExxonMobil invested more than $150M in R&D that could be used to advance economic conversion of coal to transportation fuels and lubricants.

   In addition to R&D, ExxonMobil licenses its commercial Methanol to Gasoline (MTG) technology to third parties. In the MTG process, methanol is typically coal or gas based. ExxonMobil has two licensees for the MTG process, one in the U.S. and one in China, to convert coal-based methanol to gasoline. We are under discussions with several other potential customers in the U.S. and foreign countries for additional MTG licenses.

43354.158

Since ExxonMobil R&D expenditures on technologies are related to ExxonMobil business strategies, public disclosure of annual R&D expenditures could impact ExxonMobil competitiveness; therefore, we have provided aggregated R&D expenditures for this question and the three following questions.

6. How much has your company invested in research and development of hydrogen technology for use as transportation fuel in each of the past five years?

   A. ExxonMobil considers hydrogen as one of the potential long-term fuels for transportation because hydrogen when used in a fuel cell vehicle could be more efficient and could emit lower greenhouse gases than current vehicles. However, use of hydrogen fuels faces production, delivery and storage challenges. In order to overcome these challenges, ExxonMobil has invested more than $30M over the 2003-2007 timeframe for use of hydrogen as a transportation fuel.

7. How much has your company invested in research and development of non-fossil fuel renewable energy sources for use as transportation fuel, excluding hydrogen technology, in each of the last five years?

   A. Excluding hydrogen, ExxonMobil is working on breakthroughs for biofuels via the Global Climate and Energy Project, and also on improving components for batteries that could be used for hybrid and electric cars. Over 2003-2007, ExxonMobil invested more than $20M in R&D in technologies that could be used for non-fossil fuel energy sources for transportation fuel.

8. How much has your company invested in research and development of wind, solar, and geothermal energy in each of the last five years?

   A. ExxonMobil has spent about $10M in research on wind, solar, and geothermal energies over the 2003-2007 timeframe.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00221 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.159

9. Compare the answer to each of the three above questions with the aggregate compensation of your top 10 executives and, separately, your budget for travel, entertainment, and other fringe benefits.

A.

ExxonMobil - Selected Financial Data

($M)

	'03 - '07
Hydrogen technology R&D	*30*
Renewable Energy R&D	*20*
Wind, solar & geothermal R&D	*10*
Aggregate Executive Comp	*504*

Data Sources:
ExxonMobil Proxy Statement
ExxonMobil Internal Data

Data from the Summary Compensation Tables contained in the 2004 through 2008 Proxy Statements filed with the Securities and Exchange Commission (SEC) were used as the basis for calculating the compensation for the executives disclosed in the statement. These disclosures complied with SEC requirements at the time of submission. However, due to changes in disclosure requirements since 2003, meaningful data comparisons (on a like basis) across the years are not possible.

ExxonMobil tracks compensation for executives as required for SEC disclosure purposes. We have made an estimate to calculate the compensation for the additional executives required for this response, since they are outside the scope of our tracking efforts. The compensation is based on the SEC disclosure rules for each respective year.

Expenditures for travel, entertainment and other benefits are internally stewarded by individual ExxonMobil business functions. These costs are imbedded in the 'Production and Manufacturing Expenses' and 'Selling, General and Administrative Expenses' categories of the income statement contained in our Form 10-K filed with the SEC, and are not aggregated at a corporate level.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00222 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.160

Questions from Senator Richard J. Durbin

Questions for all witnesses

1. Please provide a table displaying, for each year since 2000:
   - the names of the top five most highly compensated individuals in your company for that year (with compensation defined to include salary, bonuses, benefits, stock options, in-kind gifts, deferred compensation, and other remuneration); and
   - the amount of compensation received by each of those individuals, broken down by amount and type of compensation.

   A. Please see Appendix 3 for copies of the Summary Compensation Tables contained in the 2001 through 2008 Proxy Statements filed with the Securities and Exchange Commission (SEC).

   These disclosures complied with SEC requirements at the time of submission. However, due to changes in disclosure requirements since 2000, meaningful data comparisons (on a like basis) across the years are not possible.

2. Please provide a table displaying the following information for your company for each year since 2000:
   - revenue
   - net income
   - return on equity
   - total capital investment
   - oil development investment
   - refinery investment
   - alternative energy research and development
   - cash holdings
   - marketing expenses

   A.

ExxonMobil - Selected Financial Data

($M - unless otherwise noted)

	2000	2001	2002	2003	2004	2005	2006	2007
Sales and Other Operating Revenue	227,596	208,715	200,949	237,054	291,252	358,955	365,467	390,328
Net Income	17,720	15,320	11,460	21,510	25,330	36,130	39,500	40,610
Return on Shareholder's Equity (%)	26.4	21.3	15.5	26.2	26.4	33.9	35.1	34.5
Total Capital Expenditures	11,168	12,311	13,955	15,525	14,885	17,699	19,855	20,853
Upstream Capital Expenditures	6,899	8,816	10,394	11,988	11,715	14,470	16,231	15,724
Refining Capital Expenditures	1,335	1,038	1,355	1,766	1,324	1,368	1,610	2,173
Cash and cash equivalents (year-end)	7,080	6,547	7,229	10,626	18,531	28,671	28,244	33,981

Alternative Energy R & D Expenditures [1]	ExxonMobil has spent more than $235 million on alternative energy initiatives since 2000
Marketing Expenses	Expenditures for marketing expenses are internally stewarded by individual ExxonMobil business functions. These costs are embedded in the "Selling, General and Administrative Expenses category of the income statement contained in our Form 10-K filed with the SEC and are not aggregated at a corporate level.

Data Sources:
ExxonMobil Form 10-K
ExxonMobil Financial and Operating Review
ExxonMobil Internal Data

[1] Not separately disclosed

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00223 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.161

3. Several weeks ago, the Wall Street Journal's *Market Watch* quoted an industry analyst as estimating that about $25 to $30 of the price per barrel of crude oil may be attributed solely to speculation.

   a) Does your internal research support that analysis?

   A. We are unable to quantify the effect on crude oil price that may be attributable solely to speculation.

   b) What in your view is the price per barrel that can be justified purely by the supply and demand in the market?

   A. Crude oil prices are influenced by a multitude of factors. These include physical and fundamental factors such as, for example, supply, demand, inventory, and spare capacity, as well as expectations of the market participants on such matters as potential weather-related effects and outlooks on the growth of supply, demand, and capacity. In addition, crude oil prices can be affected by currency exchange rates, geopolitical risks, and actions of speculators and financial institutions such as hedge funds. It is not possible to identify definitively the impact of individual factors on crude prices because many of the factors may be correlated to each other. Thus, it is not possible to identify a price per barrel that can be justified purely by the supply and demand in the market.

   c) What steps do you think should be taken to protect consumers from the effects of excessive speculation in the trading markets for oil?

   A. ExxonMobil does not speculate in the oil or petroleum products markets.

   Markets must operate freely and not be subject to manipulation. Speculation and/or financial investment in futures contracts for commodities (such as oil), however, can add to market liquidity and thus the efficiency of the market for such commodities. While speculation in the commodities market does not increase supply or demand in the physical market for such commodities because there is a buyer for every position seller, it does provide an assessment of the expectations of forward price levels by market participants. Any proposals to limit speculation should be carefully considered to avoid unintended consequences such as reducing liquidity in the market.

4. In your testimony, you claim that consolidation in the oil industry has been necessary to enable your company to compete globally. However, a 2004 GAO study found that consolidation and mergers in the oil refinery industry, "generally led to higher wholesale gasoline prices in the United S tates." As a result of all the mergers, the largest five oil companies now control 55% of the refining market, and the largest 10 dominate 81%.

   a) In your view, how has market concentration in the refinery industry affected the price of gasoline? [see answer immediately below, under (b)]

43354.162

b) Do you see a link between market concentration and reduced refinery production?

A. We believe that consolidations in the U.S. refining sector have improved the efficiency and capacity of U.S. refining, thus benefiting consumers. In the last decade, refinery capacity has grown significantly, as has the production of refined products.[7] U.S. refineries add the equivalent of one new refinery each year through expansion of existing facilities.[8] After significant restructuring in the industry, concentration of refining capacity is not at a level that gives rise to market power concerns — regional and national concentration levels are generally low to moderate.

c) How much would increased refinery production lower gasoline and diesel prices?

A. The price of gasoline and diesel is determined by market forces, of which increased production by U.S. refineries is only one factor. Directionally, if the supply of domestic products to the market could be increased at a cost less than imported product, this would be expected to have the effect of mitigating potential price increases. However, it is difficult to predict the precise impact on fuel prices because a number of other factors also affect prices including, for example, crude prices, the cost and level of imports/exports, demand, quality, inventory levels, refinery operations, government regulations, and market perceptions.

5. In the last couple of weeks, we have seen the release of a handful of reports that claim that our use of ethanol has displaced a certain amount of gasoline from the nation's pool of transportation fuels, and that the displacement of more expensive gasoline with less expensive ethanol has resulted in lower consumer prices at the gas pump. These experts say that the savings have been between 15-20%, which would translate into about $400-$600 of savings per family or about $50 billion to $75 billion saved nationwide.

a) What is the effect on retail gasoline prices of cheaper ethanol being blended into gasoline?

A. Ethanol prices have been both higher and lower than gasoline prices. Retail gasoline prices are set by the market, based on supply and demand. At any specific point in time, the underlying costs of the product or its component parts, which may include ethanol, are factors in the retail price. Ethanol prices are also set by the market, based on supply and demand, and bear a similar relationship to costs of feedstock (e.g., corn), processing, and other factors of production.

b) If the renewable fuels mandate were waived this year and nine billion gallons of ethanol were removed from the market, additional petroleum would need to be

---

[7] *See* Energy Information Administration, ANNUAL ENERGY REVIEW 2006, at page 141, Table 5.9 (Refinery Capacity and Utilization, Selected Years 1949-2006); Timothy J. Muris and Richard Parker, A DOZEN FACTS YOU SHOULD KNOW ABOUT ANTITRUST AND THE OIL INDUSTRY 44.

[8] Muris and Parker, *supra* note 2, at 26.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00225 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.163

"found" to replace this fuel. Some economists say that prices would increase by as much as 50 cents to 80 cents per gallon based on standard calculations. Based on your historical observations, would you expect to see that large of an increase?

A. Ethanol prices have been both highe r and lower than gasoline prices, so it is not clear that there would be a significant change in product prices if ethanol were removed from gasoline. We believe the lowest price to consumers (and cost to taxpayers) would be achieved through free market competition, without the distorting effects of subsidies or mandates. Finally, if the mandate were waived, ethanol could still compete for a share of the market.

c) One of the challenges to making production and the mandate sync up is associated with the infrastructure needed to develop the biofuels industry. What is your position regarding higher blend levels of ethanol and the deployment of pumps capable of dispensing E-85?

A. The most cost-effective use of ethanol is to maximize use of low level blends such as E-10 (10% ethanol in gasoline). E-85 can only be used by Flexible Fuel Vehicles, which according to EIA make up about 3% of the vehicle fleet. E-85 also requires special equipment that may include tanks, pumps, underground piping and dispensers that are certified to handle this product. We believe intermediate blends (E-15 or E-20, for example) should be explored before widespread deployment of E-85 is considered.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00226 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.164

Senator Kohl's Follow-Up Questions

For J. Stephen Simon

1. We all recognize that the anti-competitive actions of the OPEC cartel have an important role to play in higher gas prices. In your estimation what would a gallon of gas cost if there was no supply limits imposed by the OPEC cartel?

   A. ExxonMobil is not able to speculate on an answer, due to the multiple factors that influence such prices, which we cannot foresee and over which we have no control.

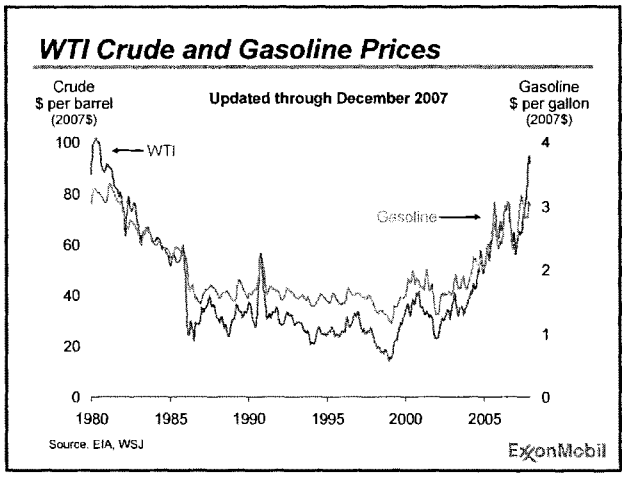
   The question refers to actions of the OPEC cartel in withholding oil supplies from the global marketplace, but does not recognize the cumulative impacts of decades of our own national policies that have discouraged — and, by force of law blocked — the development of domestic energy supplies from an array of sources, including oil and natural gas. Ironically, proposed NOPEC legislation sanctioning limitations by other nations on "the production and distribution of oil, natural gas, or any other petroleum product" could be asserted against the United States itself if it were enacted by other nations. Longstanding doctrines of "sovereign immunity" between nations and "the act of state" doctrine have been established to avoid the predictable and counterproductive chain of retaliations that can unfold when one nation unilaterally asserts unbounded legal authority over the sovereign affairs of another. Over 25 years ago, U.S. federal courts relied upon these principles in rejecting antitrust litigation against OPEC.

   The development of domestic energy resources here in the U.S. should be a leading policy option for meeting our economy's growing energy needs, *as it is actually within the power of our elected officials to authorize.* According to the American Petroleum Institute (API), federal land and coastal waters hold an estimated 650 trillion cubic feet (Tcf) of recoverable natural gas — enough to heat 60 million homes for 160 years — and an estimated 118 billion barrels of recoverable oil — enough to power over 65 million cars for 60 years. Yet today the federal government prohibits any development activities for an estimated 30 billion barrels of recoverable oil and 125 Tcf of natural gas. The American oil and gas industry's exploration and production methods have advanced substantially in recent decades to minimize the environmental impact of operations, and are being utilized all over the world to meet growing global energy demand.

2. The FTC has testified to the Antitrust Subcommittee that 85 % of the variability in the cost of gasoline is caused by changes in the price of crude oil. Do you agree?

   A. Numerous FTC and other state and federal studies have concluded that there is a high correlation between changes in the price of crude oil and changes in the price of motor gasoline. The graphic below reinforces the point:

43354.165



3. In your opinion, how much of the price of crude oil is due to the speculation by oil traders?

   A. We are unable to quantify the effect on crude oil price attributable solely to speculation.

4. Many experts believe that one important reason for excessive speculation in oil is low margin requirements in oil commodity trading. Unlike with respect to many other commodities and the stock market, a trader can speculate in this market with very small amounts of money, as margin requirements are as low as 8 percent. Do you agree with these experts that margin requirements should be increased in oil trading markets in order to reduce speculation?

   A. ExxonMobil does not speculate in the oil or petroleum products markets. Therefore, we are not in a position to provide an opinion on margin requirements for commodity trading.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00228 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.166

5. Much of the crude oil the U.S. oil companies refine into gasoline and other petroleum products comes from their own oil fields. In 2005, ExxonMobil produced 477,000 barrels of oil per day in the United States, over 26% of your domestic refining capacity. Overall, the U.S. produces about 40% of the crude oil it consumes. The cost to produce this oil domestically should not be affected in any way by the rising worldwide price of crude oil, a price largely determined by the OPEC oil nations. Indeed, we've heard estimates that it costs only about $ 12 to produce each barrel of oil from a U.S. oil field, a far cry from the more than $ 130 per barrel price of crude oil on the world market. So why should the rising price of crude oil on the international markets lead to higher prices with respect to petroleum products refined from your own domestically produced oil? Are the oil companies just profiteering with respect to the oil that comes from the oil fields they own?

A. U.S. consumers are faced with the prices on international petroleum markets because the U.S. imports the majority of its petroleum supply. Worldwide prices for petroleum products reflect physical and fundamental factors such as, for example, the current supply, demand, inventory, and spare capacity fundamentals, as well as expectations of the market participants on future supply, demand, inventory, and spare capacity fundamentals, as well as potential weather-related effects, geopolitical developments, currency relationships, interest rates, and storage cost expectations, and the actions of other market participants such as speculators, commodity investors, and hedge funds. The current cost of extracting oil from any particular field would be only a factor in the current price of petroleum. Clearly, in a highly competitive and transparent energy marketplace where thousands of transactions occur each day, prices move to levels where potential buyers and sellers enter mutually-beneficial transactions that efficiently balance supply and demand.

The crude oil used to manufacture the fuel Americans consume may have been produced in the United States or in any one of more than 35 countries. Of the nearly 2 million barrels per day of crude oil that ExxonMobil refined in 2007 in the United States, about 90 percent were purchased from others. ExxonMobil is a substantial net buyer of crude oil and we pay the prevailing market price for the crude oil needed to supply our refineries.

43354.167

6. In the last 15 years there has been a tremendous amount of consolidation in the oil industry – in its 2004 report, the GAO counted 2600 mergers and acquisitions in this industry since the 1990s alone. Indeed, almost all the companies represented here today are a product of these mergers. During this time, the FTC has approved most of the oil industry mergers it has reviewed, including the gigantic ones like Exxon/Mobil, Chevron/Texaco, and Conoco/Phillips. While each one of these mergers may not have seemed problematic when reviewed, taken as a whole these mergers have greatly increased concentration in the industry. And the GAO concluded that these mergers have raised gasoline prices. The GAO is currently updating its 2004 study at the request of me and some of my colleagues.

   What is your view of the effects of these mergers on competition in your industry and the price of petroleum products? And please predict whether we are likely to see even more consolidation in the years ahead.

   A. We believe that recent consolidations in the US refining sector have improved the efficiency of U.S. refining, placing it in a stronger position to compete in the worldwide petroleum marketplace. In our own merger, we have seen improvements from sharing the best practices of each of the parent companies with the refineries of the other. Several refineries have been sold to independent/smaller refiners as part of FTC conditions for allowing mergers to proceed. For example, independent refiner Valero is now the largest U.S. refiner.

   ExxonMobil does not know whether more consolidation of firms will occur in the future.

43354.168

Questions of Chairman Patrick Leahy

1. Mr. Hofmeister testified last week that the price of crude oil should be in the range of $35 to $65 a barrel. If the price of crude oil on the world market returned to that competitive level, what could your company charge for a gallon of gas and remain profitable?

   A. ExxonMobil does not set the price for gasoline in the marketplace, and we are not able to speculate on an answer, due to the multiple factors that influence such prices, which we cannot foresee and over which we have no control. Gasoline prices are driven primarily by crude oil prices over the long-term, but are also impacted in the short-term by many regional as well as local factors. For example, gasoline prices can be affected in the short term by factors such as planned or unplanned refinery turnarounds, weather, pipeline outages, variations in the level of petroleum product imports, or a real or perceived supply-demand imbalance associated with changes in specifications or seasonal grade changes.

   Also, "profitability" is an imprecise term. During the 1980s and 90s, the U.S. oil industry earned relatively poor rates of return on its investments, especially for the refining sector that needed to meet various environmental requirements, including for cleaner-burning fuels. According to the American Petroleum Institute, from 1990–2006, the average return on investment for the U.S. oil and natural gas industry was ~10.0% compared to ~13.1% for the Standard and Poor's Industrials.

2. Each of your companies is vertically integrated from oil exploration and production through refining and retail gasoline sales. I understand that the price of crude oil is set on the world market, and that your companies, for the most part, sell the crude oil they produce on the market and then buy back the crude oil that they refine. I further understand that each of your companies refines more oil than it produces.

   The efficiencies that come from vertical integration, however, should include the ability to refine the oil that you produce in a manner that is less expensive than if purchased in the commodities market.

   a) What is your company doing to make vertical integration work for consumers?

   A. Vertical integration is common throughout the U.S. economy and occurs in many industries. This structure simply substitutes ownership for contractual relations when it is less expensive and more efficient to do so. Vertical integration is generally pro-consumer. There are numerous efficiency-enhancing benefits that flow from vertical integration, including, for example, (i) reducing transaction costs, (ii) preventing contractual opportunism, e.g., where one party to a contract "holds up" another party after that party has made significant investments in

43354.169

support of the contract, and (iii) eliminating distortions in input choices when firms can substitute between inputs.[9]

b) If your company refined only the oil that it actually produced, rather than buying and selling on the world market, what price could it charge for a gallon of gas today and remain profitable?

A. ExxonMobil produces less oil than it refines and is a net buyer of crude oil. Worldwide, we refine nearly two and a half times as much crude as we produce, and we must pay the prevailing market price for crude to meet our refining needs.

ExxonMobil optimizes the crude slate for its refinery operations while adhering to the highest safety, health, and environmental standards and reliably meeting our customer commitments. If the preferred crude is different than ExxonMobil's own equity production based on timing, market values, quality and logistical considerations, it may sell its own production and buy another crude from the market. Such steps ultimately lead to lower overall costs to the consumer due to increasing efficiency in the very competitive refining sector.

3. How much has each of your companies spent, directly or indirectly, on studies and reports on climate change? Please specify the studies and reports produced with your companies direct or indirect support.

A. ExxonMobil has contributed approximately $1.8 million over the last five years for studies at universities and other institutions pursuing work on climate change (see chart).

As we do not keep an accounting of the number of papers and reports these programs produce, we suggest the Committee contact these organizations if the Committee wishes to have additional information.

Organization Name	Support over 5 year period
Battelle – Pacific Northwest National Laboratory	$250,000
Bermuda Institute of Ocean Science	$250,000
IEA Greenhouse Gas R&D Programme	$157,000
MIT Global Climate Change Program	$1,000,000
Stanford University (Climate Change Impact & Assessment Workshop; Energy Modeling Forum)	$120,000
Yale University (Climate Science Forum)	$70,000

[9] *See* Federal Trade Commission, THE PETROLEUM INDUSTRY: MERGERS, STRUCTURAL CHANGE, AND ANTITRUST ENFORCEMENT 229 at note 23, *available at* http://www.ftc.gov/os/2004/08/040813mergersinpetrolberpt.pdf; John Gewecke, Empirical Evidence on the Competitive Effects of Mergers in the Gasoline Industry (Public Comment, FTC Conference on Factors that Affect Prices of Refined Petroleum Products II, July 16, 2003), *available at* http://www.ftc.gov/bc/gasconf/comments2/gewecke1.pdf; Martin Perry, Vertical Integration: Determinants and Effects, in 1 HANDBOOK OF INDUSTRIAL ORGANIZATION 185 (edited by Richard Schmalensee and Robert Willig, 1989).

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00232 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.170

In addition, ExxonMobil scientists have undertaken climate change research and related policy analysis for more than 25 years and their work has produced more than 40 papers in peer-reviewed literature. Following is a list of ExxonMobil contributed papers and reports as well as published work our scientists have conducted with colleagues. Our scientists also participate in the United Nations Intergovernmental Panel on Climate Change (IPCC) and numerous related scientific bodies. See Appendix 4, also available at http://www.exxonmobil.com/Corporate/investor_issues_contributedpapers.aspx

ExxonMobil is also advancing emerging energy technologies and carbon capture and sequestration approaches, which obviously are related to responsibly addressing the challenge of climate change, but are not "studies and reports on climate change" per se. In addition, our company has ongoing work at our research centers, which involve collaboration with universities and other research organizations, but these are not addressed as they do not relate to completed "studies and reports."

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00233 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.171

Questions for Mr. Simon:

1. In April, you testified that Exxon Mobil planned to spend $100 million over the next ten years on research into renewable fuels. In response to a question from Senator Schumer last week, you indicated that Exxon Mobil spends over $100 million in research and development of alternative fuels, but did not specify a time frame. Please provide the Committee with the number that accurately reflects the amount of money Exxon Mobil is investing in research and development of alternative fuels in 2008, and the total that accurately reflects the amount Exxon Mobil is planning to invest in research and development of alternative fuels over the next 10 years.

   A. ExxonMobil plans to invest more than $100M in research and development on energy efficiency and alternative energy in 2008. Due to the competitive nature of R&D investments, Exxon Mobil is not in a position to share future planned spending in this area over the next ten years.

2. A May 25, 2008 article in the New York Times, "Peeved at Prices? Don't Blame the Dealer," implies that Exxon increases the wholesale price that it charges its franchisees for refined gasoline based on what the retailer is charging the end user – not based on an increase in the price of crude oil or other costs to the company. As a result, small business owners are squeezed even as the price of a gallon of gas for consumers continues to rise. Is this accurate and, if not, on what basis does Exxon determine the wholesale prices it charges franchisees?

   A. No. ExxonMobil sets its wholesale price to its dealers based on a number of market factors, including competitive retail prices, enabling ExxonMobil dealers to compete effectively in their local trade areas. Dealer wholesale prices are determined not with reference to an individual dealer, but are based on these local market factors that may vary significantly from area to area. The cost of crude and commodity gasoline prices do have an overall impact on the level of pump prices, but in the short term, the key factor is the local market.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00234 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.172

Senator Dianne Feinstein Questions for the Record

1. According to the May 15th Congressional testimony of the CFTC's Chief Economist and the CFTC's Director of Market Surveillance, oil companies are driving up the price of oil. These experts stated: "Our studies consistently find that when new information comes to the market and prices respond, it is the commercial traders (such as oil companies, utilities, airlines) who react first by adjusting their futures positions. When these commercial traders adjust their futures positions, it is speculators who are most often on the other side of the trade. Price changes that prompt hedgers to alter their futures positions attract speculators who change their positions in response. Simply stated, there is no evidence that position changes by speculators precede price changes for crude oil futures contracts." CFTC believes that oil companies are driving up prices in futures markets, not speculators. Yet, during the Judiciary Committee hearing on May 21, Mr. Stephen Smith of Exxon Mobil asserted that his firm "does not speculate." Does your firm buy or sell positions in crude oil futures markets? If your firm participates in futures markets, can you refute CFTC's assertion that your firms are driving up oil prices?

   A. ExxonMobil does not speculate in the oil or petroleum products markets. ExxonMobil's use of derivatives to hedge physical volumes is *de-minimus*. For example, during 2007 ExxonMobil's use of derivatives to hedge physical volumes was less than 2% of physical volumes. All of ExxonMobil's derivative positions are directly linked to physical volume movements and are not considered to be speculative under CFTC or NYMEX definitions.

2. Your firms vehemently oppose legislation – such as the 2007 energy bill tax amendment and Senator Reid's recent legislation to tax windfall oil company profits – that would increase the tax burden on oil and gas companies, arguing that increased taxation will lead to higher gas prices for consumers. However, you argued before the Judiciary Committee that your companies are unable to lower the price of oil. You say that you simply take the price in this global marketplace, instead of offering oil for sale at a set price and set mark-up. These two positions seem inconsistent. Do the economics of your firms influence oil prices, and will oil prices go up if your taxes go up? Or do the economics of your firms stand independent of oil prices, and will oil prices be set by demand regardless of the enormous size of your profits? It can't possibly be both.

   A. Crude oil prices, which are the largest component of fuel prices, are set on globally traded markets which consider supply, demand, geopolitical risk, dollar value and other factors in determining those prices. Each day, ExxonMobil buys about 4 million barrels of crude, at those market prices, to supply its refineries. In addition, ExxonMobil uses part of its global crude production of about 2.4 million barrels a day to supply its refineries.

   Because supply of product is critical in meeting the demands of a growing global economy, any legislation that would include provisions to single out an industry, such as the oil industry, for additional windfall profit or other taxes, would

43354.173

negatively effect investor confidence and directly reduce available funds for investment in exploration and production of energy sources. As such, by reducing investment in resource development along with already limited access to domestic development, growth of crude supplies would be reduced, and ultimately, upward pressure on prices should be expected as a consequence.

3. The expense and technical challenge of developing new oil resources in harsh environments such as the Arctic is a frequently heard rationale for large oil industry mergers. Are these projects working out as planned? Can we expect to see large new petroleum resources coming on line in the next few years as a result of mergers?

   A. We are not able to speculate on any direct correlation between oil industry mergers and future "large new petroleum resources." We are able, however, to speak to our major project start ups in the next few years. As project scale and complexity increase across the industry, the challenge to bring new energy supplies to market grows. Below are examples of the major project start-ups we now are planning, as provided in ExxonMobil's 2007 Financial and Operating Review:

MAJOR PROJECT START-UPS

		Target Peak Production (Gross) Liquids (KBD)	Gas (MCFD)	ExxonMobil Working Interest (%)	
2007 (Actual)					
Angola	Marimba North	40	–	40	■
	Rosa	140	–	20	●
Kazakhstan	Tengiz Phase 1	285	350	25	●
Netherlands	Wadenzee	–	185	40	●
Norway	Ormen Lange	35	2365	7	●
	Statfjord Late Life	90	315	21	●
Qatar	RasGas Train 5	45	740	30	▲
2008 (Projected)					
Angola	Kizomba C – Mondo	100	–	40	■
	Kizomba C – Saxi/Batuque	100	–	40	■
Azerbaijan	ACG Phase 3	260	–	8	●
Italy	Adriatic LNG Terminal		–	45	▲
Malaysia	Jerneh B	–	150	100	■
Norway	Volve	50	50	90	●
Nigeria	East Area Natural Gas Liquids II	40	–	51	■
Qatar	Qatargas II Train 4	80	1250	30	▲
	RasGas Train 6	75	1250	30	▲
U.K.	South Hook LNG Terminal	–	–	24	▲
	Sterling	5	110	75	●
U.S.	Thunder Horse	210	185	25	●
2009-2010 (Projected)					
Canada	Hibernia Southern Expansion	80	–	22	■
Norway	Tyrihans	80	335	12	●
Qatar	Al Khaleej Gas Phase 2	70	1250	30*	■
	RasGas Train 7	75	1250	30	▲
	Qatargas II Train 5	80	1250	16	▲
U.S.	Golden Pass LNG Terminal	–	–	18	▲
	Piceance Phase 1	2	200	100	■
2011+ (Projected)					
Angola	Cravo-Lirio-Orquidea-Violeta	150	–	20	●
	Girassol-Canela-Gerbera	120	–	15	●
	Kizomba Satellites	125	–	40	■
	Palas-Astrea-Juno	150	–	25	●
	Pazflor	200	–	20	●
	Plutao-Saturno-Venus-Marte	150	–	25	●
2011+ (Projected) (continued)					
Australia	Gorgon Gas/Condensate				
	Initial Development	15	2250	25	●
	Kipper / Tuna	15	175	41	■
	Scarborough	–	965	50	■
	Turum	10	245	50	■
Canada	Cold Lake Expansion	35	–	100	■
	Cold Lake LASER Future Phases	20	–	100	■
	Hebron	140	–	38	●
	Kearl Phase 1	100	–	100	■
	Kearl Future Phases	200	–	100	■
	Mackenzie Gas	10	830	58	■
Indonesia	Banyu Urip	165	–	45	■
	Natuna	–	1100	76	■
Italy	Tempa Rossa	50	5	25	●
Kazakhstan	Kashagan Phase 1	350		17*	●
	Kashagan Future Phases	1100	–	17*	●
	Tengiz Expansion	250	–	25	●
Nigeria	Bonga North	100	60	20	●
	Bonga SW	140	105	16	●
	Bosi Oil	120	–	56	■
	Erha North Phase 2	60	–	68	■
	LNG FPP Upstream	–	700	49	■
	Satellite Field Development	125	–	40	■
	Usan	180	–	30	●
	Usan Pressure Maintenance	50	–	40	■
Norway	Trestakk	55	50	23	●
Papua New Guinea					
	PNG LNG Project	40	940	34	■
Qatar	Barzan	120	1200	10*	▲
Russia	Sakhalin-1 Odoptu	35	–	30	■
	Sakhalin-1 Arkutun-Dagi	75	–	30	■
	Sakhalin-1 Future Phases	–	300	30	■
U.K.	Tiern	5	45	72	●
U.S.	Alaska Gas/Point Thomson	70	4500	36	*
	Piceance Future Phases	10	825	100	■
	Prudhoe Bay Western Region	50	–	30	●

Operatorship:

■ = ExxonMobil Operated ▲ = Joint Operation ● = Co-Venturer Operated * Pending Final Agreements Not Applicable

The merger of Exxon and Mobil was finalized in November 1999. The merger was an opportunity for both companies to significantly enhance shareholder value, including improved capital productivity which has allowed the combined company increased range and scope to select the best projects to advance.

While ExxonMobil is the largest U.S. oil and natural gas company, we account for only two percent of global energy production. With respect to oil reserves, we rank 14th. Government-owned national oil companies dominate the top spots. In order for American energy companies to compete successfully in the global energy market, it is vital that we have sufficient scale and financial strength to develop multi-billion dollar projects around the world. The merger of Exxon and Mobil nearly a decade ago enhanced the scale and competitiveness of our company.

The international market for energy is enormous. Providing the world the growing energy it will need will require massive investments, by strong

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00237 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.175

competitors, in coming decades. In fact, the International Energy Agency recently estimated that an estimated total investment of $22 trillion will be needed for the period 2006 through 2030 to meet the world's growing demand for energy of all types — or roughly eight times the size of the estimated 2007 U.S. federal budget.

4. To what extent are your refineries able to defer planned maintenance if and when refined product markets are tight? Has your company ever deferred refinery maintenance to meet a tight marketplace? If so, how frequently has your firm deferred maintenance? At what refineries and on what dates?

A. ExxonMobil takes seriously its responsibility to providing reliable supplies of energy at competitive prices to U.S. consumers. In order to operate safely and efficiently, refineries must conduct maintenance. ExxonMobil tries to maximize planned maintenance to achieve manufacturing cost efficiencies. Planned maintenance includes both routine maintenance and major maintenance. Major maintenance on refinery units is commonly referred to as turnarounds and typically occurs every three to seven years and reduces refinery output for a longer time than does routine maintenance. In order to minimize the impact of major maintenance on refinery output, ExxonMobil typically schedules major maintenance during lower seasonal demand periods.

Major maintenance activities are complex endeavors that are usually planned up to 3–4 years in advance of the event and often involve hundreds or even thousands of contractors. Schedules are affected by requirements to procure long-lead time materials and equipment, and by regulatory actions such as mandated environmental controls and newly required transportation fuel quality specifications. Planning for major maintenance includes developing product supply alternatives, for example, by sequencing of major maintenance across ExxonMobil's multiple refineries and/or by procuring supplies from other sources. Late changes to schedules can lead to costly inefficiencies, increased downtime durations and consequent overall reductions in refinery output, and jeopardizes predictability in executing and delivering on our plans.

Because of these factors, ExxonMobil generally does not defer scheduled refinery maintenance based on tightness of refined product markets. Exceptions are rare and reflect extraordinary events that disrupt our planning and execution strategies. For example, planned maintenance was safely deferred on a gasoline producing unit at our Baytown Refinery and a crude oil distillation unit at our Baton Rouge Refinery in order to maximize gasoline production capability in response to the extraordinary supply disruptions caused by Hurricanes Katrina and Rita.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00238 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.176

5. With constraints on the expansion of refinery capacity in California, how do you foresee meeting demand for gasoline and diesel in the future?

   A. ExxonMobil anticipates meeting customer demand for its products.

   According to data from the Energy Information Administration, ExxonMobil has expanded the capacity of its refinery in California (in Torrance) more than the average of other California refiners and more than the average for the US as a whole.

	EIA Distillation Capacity, kBD		
	1997	2007	Increase
Torrance	130	149.5	15%
California ex Torrance	1781	1888	6%
US	15,452	17,443	12%

kBD = thousands of barrels per day

6. According to initial research by the Government Accountability Office conducted at my request, the San Francisco Bay area has a significant degree of refinery market concentration. San Francisco also consistently has some of the highest gasoline prices in the United States – higher than other regions of California that must use the same reformulated gasoline. Do you believe that the high degree of market concentration among refineries in the San Francisco Bay Area is causing higher gasoline prices in this area?

   A. Prices are set by the market forces of supply and demand. It is difficult to quantify the impact of any one sub-factor on prices. This is because a number of them affect prices, including, for example, the level of imports and exports, demand, quality specification, inventory levels, refinery operations, government regulations, and market perceptions.

   Exxon sold its Benicia refinery, which is near San Francisco, at the time of the Exxon-Mobil merger. ExxonMobil does not own a refinery in the San Francisco area.

7. How do pipeline and port constraints affect your ability to provide adequate supplies of fuel to consumers?

   A. We are not aware of an infrastructure (port, terminal or pipeline) constraint that currently limits or restricts ExxonMobil's ability to provide adequate fuel supply to our customers in markets where we do business. However, there are areas in which the streamlining of government regulatory and permitting processes could improve our ability to respond efficiently to meeting the challenges and constraints in logistics infrastructure that are evolving as a result of growing demands, changing fuel specifications/composition and new supply sources.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00239 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.177

8. Given the importance of free market competition to the energy sector, what is your view of the current 54 cent a gallon tariff on ethanol imports into the United States? Do you believe Congress should reduce the tariff, at least to the $0.45 per gallon level that blenders receive for using ethanol in the United States? Would you endorse legislation to do this?

   A. ExxonMobil does not support subsidies, mandates or tariffs, or legislation that would result in any of these mechanisms, which distort the market and add cost.

9. It would appear that Russia is currently working to lay claim to the North Pole and its natural resources. How would you like to see the situation resolved? What role should the U.S. government play?

   A. It is the role of governments, and not of industry, to agree on national boundaries. If a boundary is agreed by treaty or otherwise among governments, ExxonMobil respects the sovereignty of the nations who are parties to that treaty or agreement, as would any law abiding citizen or organization.

10. Over half, and in some cases, roughly 75% of the proven reserves of a number of American oil companies are located abroad. Looking at, say, Venezuela as an example, it seems possible that we are beginning to see a new wave of energy resource nationalizations. How is your company working to protect shareholders from the adverse consequences of such actions?

    A. Unfortunately, current conditions and emerging challenges have led some to pursue isolationist or protectionist energy policies which could have severe consequences for the global economy and for global energy security over the longer term. The key to addressing global energy challenges lies in free markets and strong international partnerships, with the "rule of law" as an essential foundation. It continues to be very important that industry, policymakers and civic leaders work together to support these important principles.

    In addition, ExxonMobil is confident that its ability to complement partnerships with National Oil Companies, and other partners, will assure its future competitiveness. In these partnerships, we are able to align interests to maximize the value of a given resource. We provide: (i) proprietary technologies and financial capability; (ii) proven operations and project management capabilities; and (iii) a proven ability to bring people together. With technology, we can overcome the challenges associated with geography and geology, i.e., much of the Earth's remaining recoverable oil resources are found in complex geologic formations, in remote locations, and under harsh conditions. With project execution excellence, we have demonstrated our ability to deliver on project completion timelines, consistent with integrated contracts, and within budgets. This capacity is critical in today's relatively high price environment, where inefficiencies and mistakes are easily magnified.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00240 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.178

Questions for Exxon Mobil:

1. Many in the oil industry attribute the increasing cost of oil to the increasing cost of oil production. However, according to Exxon Mobil's first quarter 2008 financial statement, operating costs increased $200 million compared to the year before, but Exxon Mobil's upstream earnings were $8.8 billion, up $2.7 billion from the year before. If operating expenses are only $200 million more than last year, why are you selling your product for $2.7 billion more?

   A. Our Upstream earnings in the first quarter of 2008 were up $2.7 billion, reflecting the increased prices of crude oil and natural gas in the global marketplace. Crude oil and natural gas are global commodities that are traded freely on commodity markets. ExxonMobil is a price taker in this global marketplace, and our earnings are affected by the price the market sets for our products. Upstream costs in the first quarter were $250 million higher than last year, while taxes were $300 million higher.

2. According to Exxon Mobil's first quarter report, your liquid oil production is down 6 percent from last year. The quarterly report states: "Excluding the Venezuela expropriation, divestments, OPEC quota effects, and price and spend impacts on volumes, liquids production was down 6 percent. Increased production from projects in west Africa and the North Sea was more than offset by mature field decline, PSC net interest reductions and maintenance activities.") What accounts for this decline? Is Exxon Mobil hoarding oil in anticipation of the price going up further? Is your firm running out of available oil?

   A. ExxonMobil is neither "hoarding" nor "running out" of oil.

   The primary reason for the overall decline in liquids production is driven by the natural decline of the fields on production. After a period of production at plateau rates, it is the nature of oil and gas fields eventually to produce at declining rates for the remainder of their economic life. Decline rates can vary widely by individual field due to a number of factors, including, but not limited to, the type of reservoir, fluid properties, recovery mechanisms, and age of the field. Furthermore, ExxonMobil's net interest in production for individual fields can vary with price and contractual terms. Over the long term, ExxonMobil has been successful at offsetting the effects of natural field decline through disciplined investments in new opportunities to provide additional production volumes and anticipates similar results in the future.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00241 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.179

SUBMISSIONS FOR THE RECORD

Statement

of

John Hofmeister
Shell Oil Company

Before the

Senate Judiciary Committee

Wednesday, May 21, 2008

43354.180

Chairman Leahy, Senator Specter and members of the Committee, I am John Hofmeister, Retiring President of Shell Oil Company.

Shell Oil Company is an affiliate of the Shell Group, a global group of energy and petrochemical companies, employing approximately 104,000 people and operating in more than 110 countries and territories. Shell Oil Company, including its consolidated companies and its share in equity companies, is one of America's leading oil and natural gas producers, natural gas marketers, gasoline marketers and petrochemical manufacturers. Shell, a leading oil and gas producer in the deepwater Gulf of Mexico, is a recognized pioneer in oil and gas exploration and production technology.

I welcome the opportunity to testify today. It is, in fact, very timely because it comes at the end of an 18-month Shell journey called "A National Dialogue on Energy Security." We traveled to 50 cities and visited with more than 15,000 Americans to engage in meaningful dialogue on energy security.

I heard what you are hearing.

Americans are very worried about the rising price of energy – the cost to fill their cars, as well as the cost to heat, cool and light their homes and businesses. These cost increases are hitting consumers hard, particularly the poor and those on fixed incomes.

Let's look at historical data on the price of a barrel of crude and the average price of regular gasoline. Since April 2004, the price of a barrel of U.S. light sweet crude has gone up by more than $70, which is more than a 300 percent increase. In this same period, the average U.S. nationwide price of regular gasoline at the pump went up 100 percent. Looking just at the last 12 months, the price of a barrel has increased $60, or more than 100 percent. The price of regular gasoline has gone up 20 percent.

There is no single reason or simple explanation for the recent run-up in crude oil prices. Rather, a combination of circumstances, some short-term and some long-term in nature, is playing a role.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00243 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.181

Let me highlight some of these factors.

- The rate of growth in global demand for oil has accelerated in recent years. This is largely the result of rapid economic growth and industrialization in countries like China and India and also sustained subsidies on oil products in oil exporting countries.
- Geopolitical events, such as the disturbances in the Niger Delta, have reduced supplies available to the international market.
- The cost of materials, labor and engineering services has skyrocketed. This in turn drives up the cost of new energy projects and the cost of developing new energy supplies.
- There is a shortage of capacity in energy services and materials. This shortage is in some instances leading to project delays and lengthening the time it takes for new projects and new supplies to come on line to meet increased demand.
- Access to oil and gas resources is becoming more difficult around the world. This, coupled with more stringent fiscal conditions governing investment in several major oil and gas-producing countries, adversely affects the economics of new energy projects. It may lead to reductions or delays of new investment in oil and gas supply capacity.
- The oil and gas resources that are available for development are increasingly found in extremely difficult or hostile areas – areas that are more technically challenging, more remote from markets, require more infrastructure, carry greater technical risk, have longer development lead times and are more costly to develop than has been the case during the past 30 years.

In addition, developments in the financial market have also contributed to the rise in prices.

- The fall in the value of the U.S. dollar, relative to other currencies, has reduced the equivalent revenue available to oil exporting countries and also partially shielded other oil importing countries from the impact of rising dollar-denominated oil prices.
- Global investment funds are rebalancing their portfolios to include a higher portion of commodities, including oil and natural gas, and this trend has accelerated with recent weakness in equity markets.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00244 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.182

Along with the above factors, some observers have questioned whether speculative trading has also contributed to increased crude oil prices. We have observed that there are more participants buying and selling oil commodities than previously, and that these participants are made up of commercial users, such as ourselves, and non-commercial entities, such as pension funds, university endowment funds and hedge funds. Yet, it is unclear what effect this activity has had on prices. For example, the Commodities Futures Trading Commission recently testified before Congress that there was an absence of evidence that speculation had driven up oil prices. What is clear, however, is that the combined oil commodities trading community is telling us that we need to produce more oil.

Despite the apparent size of the major investor-owned energy companies, this remains a highly competitive industry. Consider the structure of our retail gasoline business, where the Shell brand has an 11.3 percent market share nationwide. Roughly 95 percent of Shell branded stations are owned by independent retailers and "jobbers." We are seeing healthy new retail competition emerging with brands such as WaWa, Sheetz and Turkey Hill.

From the perspective of the transactions experience at Shell, in markets of concern to both federal and state antitrust law enforcement agencies, mandatory divestitures were designed to prevent declines in the number of competitors or increases in concentration. And we have fully complied with such divestitures.

Most of these factors are not controlled by or even much influenced by the actions of oil companies. However, our business is developing energy and delivering it to consumers in the most efficient and cost-effective manner we can. We will continue to strive to contain cost pressures and to deliver these energy products to consumers at competitive prices in a secure and reliable manner.

Today I will talk about three issues related to the energy future of America. First, the global demand for energy and the supply outlook. Second, the investments that Shell is making to increase energy supply. Third, actions that policymakers can take to address the energy challenge.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00245 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.183

Energy Demand and Supply

The world will demand an additional 35 million barrels of oil per day by 2030, which is a 42 percent increase over today's demand. It will demand 64 percent more natural gas than we are producing now.

The United States accounts for 25 percent of the world's energy demand. Americans use 10,000 gallons of oil – enough to fill a backyard swimming pool – every second of every day. We use 20 railcars of coal every minute.

These are sobering facts. How will this demand be met? Alternative and renewable energy sources will play a role and grow substantially. Energy efficiencies will improve as new technologies are developed and implemented. But leading experts forecast that oil and natural gas will continue to meet more than half of the world's energy needs in 2030.

There is no shortage of molecules of oil and gas in the ground. However, there are multiple influences that will affect the pace at which this oil can, and will, be developed.

On the demand side, we are seeing a step-change in the growth of demand for energy, particularly as emerging economies, such as China and India, enter into more energy-intensive phases in their economic development. It will be vital to become more efficient in how we use energy and to develop unconventional sources of oil and gas (such as oil sands), biofuels and vehicle electrification to meet this surge in demand. All energy sources added together will struggle to match demand – we will need all of the energy we can get.

On the supply side, many existing reservoirs are facing a natural decline in production. This means that high levels of continuous investment are required just to maintain status quo or to invest in enhanced oil recovery (EOR) techniques. In addition, ever-increasing levels of investment are required as smaller fields are developed and more complex frontier environments become the targets for hydrocarbon exploration and production, alongside the development of unconventional oil and gas supply. There are also uncertainties about the pace of investment in sensitive regions such as the Middle East and Latin America. Naturally, major resource-holding governments seek also to develop their sovereign reserves at a pace that matches their own economic goals.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00246 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.184

The significant economic point comes when tensions arise between the growth of global demand for energy and the pace of investment, production and supply. We believe we are entering such a period and will face this increasingly for some time to come.

U.S. production has fallen steadily for the last 35 years. Oil production in this country peaked in the 1970s. As U.S. consumption of oil has doubled, domestic oil production has fallen off nearly 40 percent. Why? In large part, this is the result of government policies that placed important oil and gas resources off limits.

We still have a significant resource base in this country, both offshore and onshore. The U.S. Government estimates that there are about 300 trillion cubic feet of natural gas and more than 50 billion barrels of oil yet to be discovered on the Outer Continental Shelf surrounding the Lower 48. When you then add in the Alaska OCS resource, you add the potential for another 122 trillion cubic feet of natural gas and 25 billion barrels of oil. Unfortunately, 85 percent of the Lower 48 resource base is off-limits because of Congressional moratoria.

The U.S. has enormous oil shale resources, too, that, when the technology to extract it is mature, may provide a very significant boost to domestic energy supply. According to Rand Corporation, the oil resource in place within the Green River Formation, which covers portions of Colorado, Utah and Wyoming, ranges from 1.5 to 1.8 trillion barrels, of which between 500 billion and 1.1 trillion barrels are recoverable. According to Rand, "the midpoint in our estimate range, 800 billion barrels, is more than triple the proven oil reserves of Saudi Arabia." The U.S. has more oil locked in shale than any other country on Earth but impediments exist to accessing and developing this resource.

For the past 30 years, federal policies have restricted the availability of domestic oil and gas resources to U.S. consumers. Such as:

- Outer Continental Shelf Moratorium Atlantic Ocean
- Outer Continental Shelf Moratorium Pacific Ocean
- Outer Continental Shelf Moratorium Eastern Gulf of Mexico

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00247 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.185

- Congressional bans on onshore oil and gas activities in specific areas of the Rockies and Alaska
- And even a Congressional ban on doing an analysis of the resource potential for oil and gas in the Atlantic, Pacific and Eastern Gulf of Mexico

According to the Department of the Interior, 62 percent of all onshore federal lands are off-limits to oil and gas development with restrictions applying to 92 percent of all federal lands.

The Argonne National Laboratory did a report in 2004 that identified 40 specific federal policy areas that halt, limit, delay or restrict natural gas projects. I urge you to review it – it is a long list. If I may, I offer it today, if you would like to include it in the record.

Hundreds of lawsuits result in significant delays or eventually derail energy projects. A 2004 report by the General Accounting Office identified 10 opportunities during the leasing and permitting process where outside parties can sue to hold up or stop oil and gas projects on federal lands. And we are now seeing increased litigation on offshore activities as well. The combined weight of litigation and restrictive and uncertain policies is placing a heavy toll on America's ability to produce its own energy resources.

As we have increased imports to meet our domestic energy needs, a new concept of "resource nationalism" is emerging in resource-rich nations around the world. This concept has changed the dynamics of global energy development. Thirty years ago, national oil companies owned by or affiliated with governments were either non-existent or small players. Today, these national oil companies own as much as 90 percent of the proven oil reserves in the world, while investor-owned oil companies – some of which are here today – hold just six percent of proven reserves.

In 2006, the U.S. imported 3.7 billion barrels of oil to meet domestic demand, which is more than seven times the amount imported in 1970. The United States is the only country in the world that restricts the use of its own energy resources while transferring trillions of dollars of wealth to other countries in order to import energy.

So what is Shell doing? We are making significant capital investment to produce more energy – and more kinds of energy – to meet global demand.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00248 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.186

Enormous amounts of capital are required to fund our huge-scale projects and our cutting-edge research.

Let me share with you some statistics:

- Today, we have double the number of new projects under construction that we had in 2004.
- Last year, we spent some $25 billion on capital investment worldwide developing energy projects.
- This year, Shell will spend $28 billion to $29 billion – the largest capital expenditure program in the oil and gas industry.
- Over the last 3 years that I have been in office, Shell has spent over $10 billion on capital investments just here in the U.S.

Shell has invested in alternative and renewable technologies, as well as additional conventional and new unconventional energy sources.

Wind
Shell is becoming a significant wind energy producer. We are involved in 11 wind projects spread across the U.S. and Europe. The total capacity of these projects is around 1,100 megawatts (Shell share is about 550 megawatts) with 845 megawatts in operation and more than 260 megawatts under construction. Out of the total capacity, almost 900 megawatts are in the United States where we have wind farms in Texas, Colorado, Wyoming, California, Iowa and West Virginia. More wind farms are under development. Our activities focus on the development and operation of commercial-scale wind developments that can add significant power and capacity to the grid.

Solar
Shell is an international developer of thin-film solar technology. We believe thin-film technology – although in the early phases of development – could prove to be the most commercially viable form of photovoltaic solar technology to generate electricity from the sun's energy.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00249 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.187

Biofuels
Shell is making a major commitment to the use of biofuels in transport fuels. Shell is the world's largest blender of biofuels by volume and one of the world's largest distributors of transport biofuels, at around 800 million gallons a year. Shell buys and sells 400 million gallons of ethanol a year in the United States, about 11 percent of the total U.S. ethanol production.

And our commitment will increase to meet the new Renewable Fuel Standard (RFS) mandates passed by Congress last year, including the significant increase in the supply and distribution infrastructure necessary to move the five-fold increase in the RFS to markets all over the U.S.

Shell is a leader in the development of advanced biofuels technologies. We are quadrupling our rate of investment in transport biofuels, particularly in those using more sustainable second-generation technologies.

Shell believes that cellulosic ethanol holds particular promise. In the last six months, we have announced three new or expanded partnerships in advanced biofuels research and development projects in the United States, including fuel from algae and a promising new technology that could convert cellulose-derived sugars directly to biogasoline, rather than ethanol. This technology could potentially eliminate the need for special infrastructure and the low blend rates now required for standard vehicles.

Hydrogen
Shell is a leader developing transportation solutions with hydrogen. We are building hydrogen infrastructure in the United States, Europe and Asia. Right here in Washington, D.C., approximately three miles from Capitol Hill, is the nation's first integrated gasoline/hydrogen station at our Shell station on Benning Road.

Gasification and Gas-to-Liquids Fuel
The Shell proprietary gasification technology is being used to convert coal and biomass into a cleaner fuel for power generation and other applications. We also have a leading position in Gas-to-Liquids (GTL) technology for the production of cleaner transportation fuels. Our Pearl GTL project under construction in Qatar will be the world's largest plant converting natural gas into transportation fuel. GTL from our plant in Malaysia is mixed with diesel and sold at 5,000 Shell stations in 11 countries.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00250 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.188

Liquefied Natural Gas
Shell is an industry leader in the production of liquefied natural gas (LNG). When projects under construction in Australia, Sakhalin and Qatar are completed, our LNG production will have increased 80 percent above 2005 levels. In the United States, we have significant regasification capacity at two existing LNG terminals and plans for development of a new terminal in the Northeast.

It is important that we put these energy sources into proper perspective. As I mentioned earlier, alternative and renewable energy sources will not make a significant contribution to the energy mix for many decades to come. Therefore, Shell continues to make substantial investment in producing and refining conventional oil and gas.

Oil and Gas
Exploration and Production: The Shell Exploration & Production (E&P) North American business is dedicated to growing the North American energy supply, a commitment underpinned by a history of investing billions each year, developing future domestic energy sources and defining new frontiers.

In the Gulf of Mexico, our exploration strategy is to drill prospects with large potential volumes and pioneer new plays. We are involved in a number of material prospects. Shell will continue to be an industry leader in the deepwater Gulf of Mexico, a frontier we pioneered more than a decade ago. In the past five years, we have produced nearly one billion barrels of oil there. The costs of deepwater exploration and production are immense and rising – from buying leases to bringing product to market. In November 2005, I told the combined panel of the Senate Energy & Natural Resources and Commerce Committees that the industry average cost of renting a deepwater oilrig was approximately $200,000 a day. Twenty-two months later, rigs were in such scarce supply that the cost of chartering one had climbed to more than half a million dollars a day. That was just the rig rental. The *total* daily costs of drilling a deepwater well – with the costs of pipe, support and all the rest – are even higher. In 2007, the average daily cost for a deepwater exploration well in the Gulf of Mexico was $759,000.

Shell is also pursuing natural gas prospects in a number of onshore North American basins. It is our goal to build new supply positions by developing

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00251 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.189

both conventional and unconventional gas resources. Today Shell is drilling for new natural gas supplies in the Gulf of Mexico, Texas and the U.S. Canadian Rockies.

Downstream: Shell has a world-class manufacturing organization. By running our facilities safely, reliably and efficiently, we achieve consistently high levels of operational excellence that help us better meet customer demand. In the U.S., refineries operated by Shell and our joint venture, Motiva, currently have a refining capacity of nearly 1.4 million barrels per day. Motiva is spending around $7 billion to double the capacity of its refinery in Port Arthur, Texas. This project, when finished, will be one of the largest refineries in the United States and in the world. By adding 325,000 barrels-per-day capacity, the expansion is equivalent to building a new refinery.

Oil Sands and Oil Shale: Shell is investing in the technology and infrastructure to develop vast oil sands in Canada and oil shale in the United States. The Canadian resources can benefit the United States fuels market. Shell has a 25-year research and development program to access oil locked in shale rock in Colorado, Wyoming and Utah. Congress should pursue policies that ensure that these critical energy resources can be responsibly developed to help meet our nation's energy challenge.

This brings me to my closing point.

What policymakers can do to address the energy challenge.

I invite you to read the attached report, "A National Dialogue on Energy Security: The Shell Final Report," which highlights the findings of our tour across America. It lays out a 12-point plan to address future energy needs.

For today, however, let me highlight six points for you to consider.

First, I urge policymakers to look at the facts. Energy demand is rising to fuel economic growth. Oil and natural gas will be the major energy sources for decades, even as we grow new technologies. We cannot rationally decide among the hard choices ahead of us without understanding the basic issues of energy security.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00252 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.190

This brings me to the second point. In general, the United States tends to resist the need to develop new domestic energy sources. Can we afford to continue this approach while energy demand and costs are rising? Oil and gas development can and should occur in an environmentally responsible way. In 2006, Congress took a significant step in opening some new oil and gas prospects in the Gulf of Mexico to exploration and development while, at the same time, providing those energy-producing states and local coastal communities in the region with a revenue stream to help ensure economic and environmental stability. Congress should extend Outer Continental Shelf revenue sharing for all coastal areas adjacent to offshore development and should make more areas available for offshore leasing.

Third, we need more than oil and gas to meet demand. We need all forms of energy – plus conservation and energy efficiency. I commend Congress for passing the Energy Independence and Security Act of 2007 with more stringent CAFE standards. These standards and the other provisions in EISA will do more to increase energy efficiency than any other piece of legislation in recent memory. Congress should continue to adopt policies that encourage conservation, and companies like ours must continue to think more creatively about products and services we can develop to help customers use less energy. Consumers – and that means all of us – must think more about our own energy footprints: when and how we drive, what we buy, how we work and the kind of world we want to create for coming generations.

Fourth, government agencies must have the staff and the resources needed to do the environmental analyses and other scientific studies that must underpin energy projects of all kinds. This data is critical and must be completed in a thorough and timely manner. Therefore, Congress should consistently authorize and appropriate funding for these key federal agencies to hire, retain or contract the expertise needed.

Fifth, Shell supports the adoption of a federal law to reduce greenhouse gases. Specifically, we support a cap-and-trade program coupled with sector approaches. Such a program must include policies that lead to commercialization of carbon capture and storage (CCS) technology. Congress should ensure that we address CO2 emissions as we make the transition away from fossil fuels to new energy sources.

Finally, we need individuals skilled in math, science, technology and engineering to build the workforce of the future that will bring new energy

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00253 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.191

sources to America. School curricula should include more study of energy – where it comes from, how it is used and the impact of the energy choices we make. And these lessons should begin at an early age, to shape consumer behavior and encourage curious young minds to become our next generation of energy engineers. We welcome Congressional initiatives that will help secure a future energy workforce.

I thank the committee for its time. I am hopeful that policymakers, the private sector and the American people will come together on this important topic. We need to commit resources to all existing and potential energy sources, as well as innovations to address supply, demand and our carbon footprint.

Thank you. I am happy to answer any questions you may have.

Attachments:

"Environmental Policy and Regulatory Constraints to Natural Gas Production", by Deborah Elcock, ANL/EAD/04-1, Environmental Assessment Division, Argonne National Laboratory, December 2004

"A National Dialogue on Energy Security: The Shell Final Report", Shell Oil Company, 2008

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00254 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.192

Statement of Patrick Leahy
Chairman, Senate Judiciary Committee
Hearing on "Exploring the Skyrocketing Price of Oil"
May 21, 2008

The price of a gallon of gas at the pump today in Vermont reached a record $3.77. Nationwide, the average price has more than doubled since President Bush took office.

The President once boasted that with his pals in the oil industry, he would be able to keep prices low and consumers would benefit. Instead, it is his pals in the oil industry who have benefited. American consumers, and the American economy, have suffered immensely.

Today's witnesses represent the major, vertically integrated oil companies that, collectively, made more than $36 billion in profits in just the first quarter of this year--$36 billion in the first three months of the year.

I want these witnesses to hear about Warren Hill, whose family settled in Greensboro, Vermont, more than 200 years ago. Warren runs a logging and trucking company that he dreams of passing on to his son. But the increase in fuel prices has led him to question whether his business, which has been successful for over 30 years, can survive.

I say to our panel today: Mr. Hill wants to know how you can justify exorbitant profits on the backs of middle class, hard-working families. He deserves answers. Every member of this Committee, and of this Congress, has constituents with similar stories and similar questions.

We hear from the oil industry that the price of gas at the pump is directly related to the price of crude oil. One of our witnesses today has said that normal supply and demand indicates that the price should be somewhere around $50-$55 a barrel. As he said: "There is a disconnect." I would like to know, and I am sure American families and small businesses would like to know why prices are so disconnected from what normal supply and demand would indicate. Why has the price of oil increased 400 percent since President Bush took office? Why has it nearly doubled in the last year? Prices should not skyrocket like this in a properly functioning, competitive market.

Certainly the cost of oil to these companies has not doubled or quadrupled. Certainly our witnesses today would not contend that it is service station operators who are gouging consumers for windfall profits.

I expect that none of our witnesses would dispute that a protracted war in Iraq has caused the price of oil to rise. I expect that none of our witnesses would dispute that Bush administration economic policies, which have crippled the value of the dollar, have contributed to the rising price of oil.

43354.193

I want to hear directly from these oil companies about causes of the rising price of oil on which Congress can act. This Committee unanimously approved Senator Kohl's NOPEC legislation, which would put an end to artificial limits on supply by ensuring that the U.S. Government has the authority to prosecute OPEC members for collusive behavior. Seventy members of the Senate have voted for this legislation, as have 345 Members of the House. Yet this President threatened to veto it.

I would like to know what these oil executives think about applying principles of competition from our antitrust laws to the commercial activity of the oil producing states. The members of OPEC meet regularly to agree on limits on the amount of oil they will produce. That is wrong, and it hurts Americans. If such a meeting took place in almost any other context, the participants would likely be arrested for an illegal conspiracy in restraint of trade.

Do they agree that we need to crack down on speculation and manipulation in the oil commodities market? Numerous experts have testified before this Committee and others that oil prices are moving higher as a result of speculators. Investors are betting up the price of oil, and consumers are paying the bill. Increasingly, this speculation takes place in over-the-counter trading, which avoids the oversight of the Commodity Futures Trading Commission, thanks to the Enron loophole.

That is an unjustified loophole, which Senator Feinstein and I, among others, have been actively trying to close. Keeping the CFTC blind to speculation and manipulation in the oil futures market is inexcusable. Last week, Congress passed the Farm Bill that would close this loophole. The President threatened to veto the legislation. I would like to know what these oil executives think about that.

Finally, last week we were able to pass legislation calling for the Government to stop artificially inflating demand by diverting fuel to the strategic petroleum reserve. The President opposed it. Filing the SPR may have made sense when oil was $25 a barrel. At $125 a barrel, it is simply hurting consumers.

This Committee and the Congress need answers so that we can act in a way the administration will not – for the benefit of consumers, for American families and small businesses. We need to get prices under control and back to competitive levels, and we need to do it now. Warren Hill and his family in Vermont, and all Americans, deserve a government that will stand up for them. Small businesses should not be forced to close their doors because oil prices are skyrocketing out of control.

I thank the witnesses for being here today and look forward to hearing from them.

# # # # #

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00256 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.194

Closing Remarks Of Sen. Patrick Leahy (D-Vt.),
Chairman, Senate Judiciary Committee,
Hearing On "Exploring The Skyrocketing Price Of Oil"
May 21, 2008

I thank the witnesses for being here today. And some of you, to your credit, were more forthcoming than others in answering the questions on both sides of the aisle. Of course, the bottom line is very simple: People we represent are hurting. Your companies, the foreign oil interests, are profiting. And we need to get this somehow into balance.

I think the price of oil has to reflect market fundamentals. If oil returns to $35 to $65 a barrel, as some of you have said, then we could bring gas prices back to competitive levels. We look at the past profits of oil companies and what they're making on previously discovered oil; oil that was very profitable for them at $55 to $65 a barrel is obviously making them windfall profits at $130 a barrel.

And I think for any of the oil companies to come here, and, as your ads suggest and in some of the testimony today, to play the victim is extraordinary. The American people are the victims.

Billions of dollars are paid by Americans to oil companies every year to put gasoline in their cars, to heat their homes, to run their businesses. And skyrocketing oil prices hurt these consumers, but it's also hurting our nation's economy and, thus, its security.

And despite your opposition, the administration should support the NOPEC bill, as the majority of Republicans and Democrats in the Congress have.

When OPEC countries commercially set the limit of output of oil, this government, on behalf of all Americans, ought to be able to go after them as it could any other cartel. The president vetoed the bill to close the Enron loophole. I hope that that will be overridden.

The $36 billion that your companies reported in the first three months of this year were drawn directly from the exorbitant amounts of money Americans are paying at the pump. It's wrong. As we heard from other senators here today, it just doesn't seem fair.

I thank Senator Durbin. For some of you who were not able to remember how much you make, I'm glad that Senator Durbin reminded you.

But I thank you for your testimony. You've been here on Capitol Hill a lot. It is probably not the thing you enjoy the most. I thank you for being here.

We stand in recess.

# # # # #

43354.195

Testimony of John E. Lowe

Executive Vice President, Exploration and Production

ConocoPhillips

Before the

Committee on the Judiciary

U.S. Senate

Hearing on

"Exploring the Skyrocketing Cost of Oil"

On

Wednesday, May 21, 2008

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00258 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.196

Introduction

Good morning, Mr. Chairman and Members of the Committee on the Judiciary. My name is John Lowe, and I am executive vice president of Exploration and Production for ConocoPhillips. In that capacity, I am responsible for our worldwide oil and natural gas exploration, development and production for the company.

ConocoPhillips shares your and the American public's concern about high consumer energy prices and we appreciate the invitation to provide our views on the factors that led to today's situation and to dispel some common misperceptions. We also welcome the opportunity to discuss our own efforts to expand U.S. energy supplies and thus improve the nation's energy security, as well as offer suggestions on what we believe the government should do to facilitate the process.

Let me begin by briefly describing ConocoPhillips. We are an international, integrated energy company, headquartered in Houston, Texas and active in nearly 40 countries. Among U.S.-based companies, we are the third-largest integrated energy company based on market capitalization, the second-largest domestic refiner, and a leading natural gas producer. We had annualized revenues of $220 billion, assets of $183 billion and approximately 32,800 employees as of March 31, 2008.

As you requested, my testimony here today will address the following subjects:

- Perspective and drivers of higher gasoline prices,
- The impact of mergers on energy markets,
- Misperceptions about oil industry profitability,
- ConocoPhillips' activities to increase U.S. conventional oil and gas supply and alternatives, and
- The path to a sound energy policy, including policies that should be avoided.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00259 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.197

Perspective on Gasoline Prices

I want to start by giving you my perspective on gasoline prices and discuss what is driving those prices. This section of my testimony makes the following points:

- Gasoline prices have not increased as quickly as crude oil prices this year. This stems from the fact that the U.S. gasoline supply and demand balance is loosening due to a combination of flat-to-declining gasoline demand, increased gasoline production capability, higher imports in recent months, and greater use of ethanol in fuel supplies. As a result, refining profit margins are shrinking and consumers – although they have been severely impacted – are not paying the full cost of crude oil price increases. Refiners and other market participants are absorbing the difference – and are thus impacted along with consumers.

- Higher world crude oil prices continue to be the primary driver of increased domestic retail gasoline prices.

- In contrast with the global gasoline balance, the global diesel fuel balance is tightening due to a long-term trend of higher demand growth, with limited capability to shift existing refinery capacity to make more diesel fuel. Unlike the increased ethanol use in the U.S. that is reducing the demand for conventional gasoline, biodiesel is less competitive and is thus having a much smaller impact on diesel fuel demand. As a result of these factors, diesel fuel prices around the world are rising relative to gasoline prices.

- Gasoline and diesel fuel prices are set as a result of thousands of transactions between buyers and sellers on a global basis. Price variations between regions in large part are caused by differences in product specifications, supply and transportation costs, operating costs and taxes.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00260 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.198

Gasoline prices are not rising as quickly as crude prices this year

The average U.S. retail gasoline price on May 12 was $3.72 per gallon, which is about 20 percent higher than during the same week last year. Retail gasoline prices are rising this year primarily as a result of higher crude oil prices. However, the rise in absolute terms is masking the underlying trend of weakening gasoline prices relative to crude oil prices. Figure 1 below shows that relative to last year, crude prices increased significantly more than gasoline prices.

Figure 1

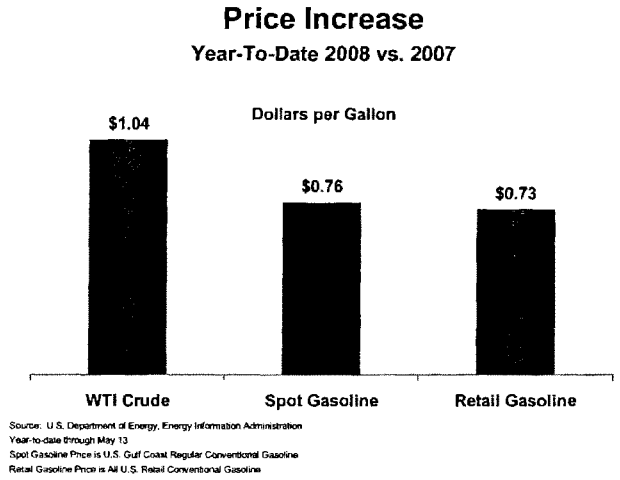


Figure 2 also shows that spot gasoline prices relative to crude oil prices have been unseasonably weak this spring, which is highly unusual for the start of driving season. There are several reasons for this relative weakness:

- Weakening gasoline demand due to the relatively high crude oil price level and the slowing U.S. economy,

- Rapidly increasing ethanol blending, which has expanded fuel supplies,

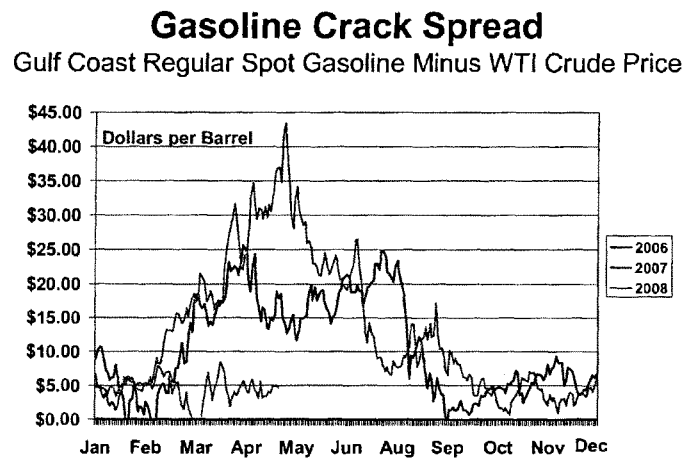
VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00261 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.199

- The return of the domestic refinery capacity that was disrupted last year, and

- An increase in gasoline imports due to demand weakness in Europe, which continues to dieselize its automobile fleet.

Figure 2



Source: U.S. Department of Energy, Energy Information Administration, spot historical through May 13, 2008

The failure of gasoline prices to keep pace with crude oil price increases reflects a longer term trend of a rising surplus of gasoline supply in the U.S. and Europe due to a long-term slowdown in gasoline demand growth. In contrast, diesel fuel prices are strengthening due to the ongoing trend of strong demand growth relative to the ability of refiners around the world to manufacture ultra-low-sulfur diesel fuel. Unfortunately, there is only a limited ability for refiners to convert existing gasoline production capacity from gasoline to diesel fuel. As a result, diesel fuel prices are strengthening globally, reaching $4.33 per gallon in the United States on May 12 compared to a gasoline price of $3.72 per gallon.

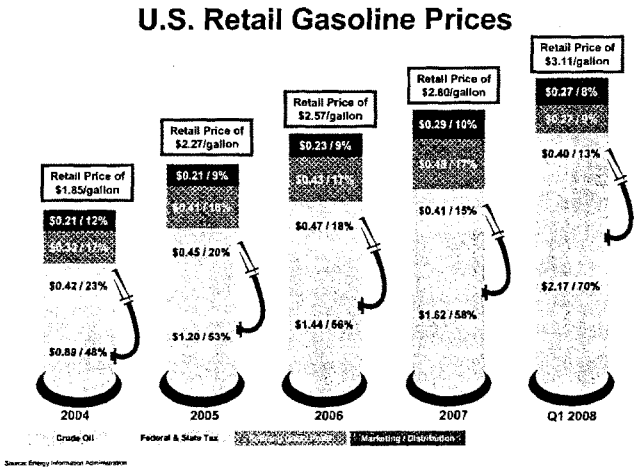
VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00262 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.200

Global crude oil prices are the biggest driver of gasoline prices

The biggest driver of increased gasoline prices has been higher global crude oil prices. The cost of crude oil is the largest single component of retail gasoline prices, representing about 70 percent of the pump price in the first quarter of 2008 (see Figure 3 below).[1] All costs and profits for the refining, distribution and marketing segments only accounted for 17 percent of the pump price in the first quarter of this year, with federal and state excise taxes accounting for 13 percent. Historical analysis also shows that changes in crude oil prices explained about 97 percent of the variation in the pre-tax price of gasoline between 1918 and 2006.[2] Figure 4 below demonstrates graphically that gasoline prices have historically moved with crude oil prices.

Figure 3

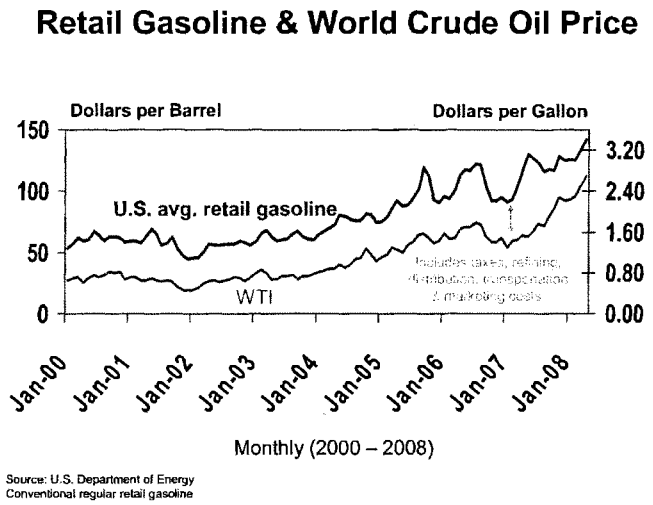


[1] U.S. Department of Energy, Energy Information Administration
[2] Carol Dahl, Colorado School of Mines, "What Goes Down Must Come Up; A Review of the Factors Behind Increasing Gasoline Prices, 1999-2006," April 2007

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00263 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.201

Figure 4



Crude oil is a global commodity with prices determined by the interaction of thousands of buyers and sellers in physical as well as futures markets around the world. Prices set in this global market reflect both current and future expected supply and demand.

The increase in global crude oil prices has been caused by:

- A period of strong global economic growth and thus oil demand growth, especially in developing Asian countries, Russia and the Middle East,

- A weak demand response to higher prices outside the United States due to price subsidies in developing countries and the weakening U.S. dollar,

- Constraints to expanding supply, including constrained resource access in many nations (including the United States), cost inflation and increased taxes,

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00264 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.202

- Increased geopolitical supply risk,
- Little excess OPEC production capacity,
- A rotation by the financial sector into commodities.

Global economic growth – One of the primary drivers of higher global oil prices over the last five years has been a sustained period of robust global economic growth, which led to stronger-than-expected energy demand growth. In fact, real growth in global gross domestic product between 2004 and 2007 of nearly 5 percent per year was about 40 percent higher than the average growth rate since 1980.[3] Due to this economic prosperity, between 2004 and 2007, oil demand grew by 2 percent per year, almost twice the rate experienced from 2000 to 2003. Nearly half of the demand growth since 2000 has been in emerging Asian nations that have reached a highly energy-intensive stage of their development. In these nations, rising per-capita income also enables a larger proportion of the population to afford affluent lifestyles similar to those in the United States. Oil demand growth in the Middle East, Russia and other oil-producing regions is also robust due to strong economic growth and fuel price subsidies.

Weak demand response to higher prices – Outside of the United States, high oil prices have not done much to trim demand growth. In Europe, tax rates on fuel consumption are sufficiently high to dwarf the impact of crude price increases. In developing countries, about 70 percent of demand is subsidized by the government so consumers are not experiencing the full impacts of price increases. Another factor is the decline in the U.S. dollar, in which oil is priced. Other countries have not experienced the same degree of crude price increase because their currencies have appreciated versus the U.S. dollar. Figure 5 below shows that the increase in crude oil prices in euros per barrel is significantly lower than the increase in crude oil prices in dollars per barrel.

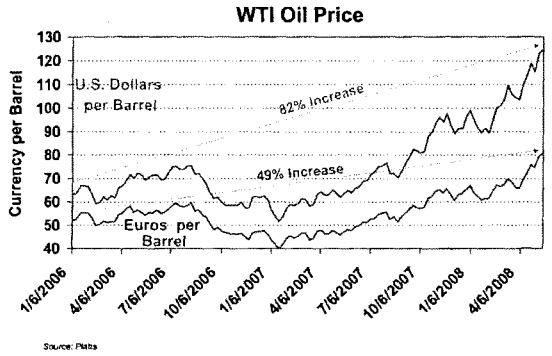
[3] International Monetary Fund, "Updated October 2007 World GDP Growth and PPP Weights," January 30, 2008 (4.7% average for 2004-2007 vs. 3.3% average from 1980-2007)

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00265 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.203

Figure 5

Weak U.S. Dollar Blunts Price Effects on Oil Demand Outside the U.S.



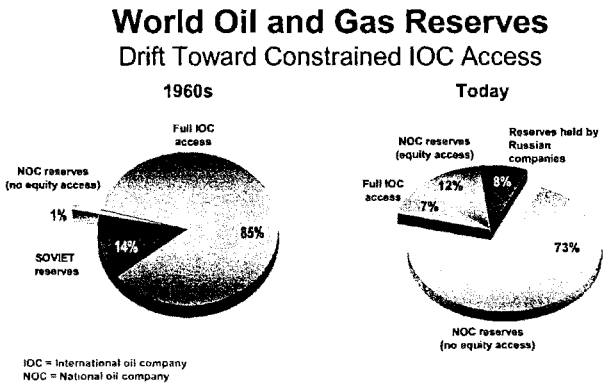
Supply constraints – A second reason for high global crude oil prices is constraints on expanding conventional supplies. The biggest constraint is rising resource nationalism that limits access to resources for development. Figure 6 below shows that in the 1960s, 85 percent of global oil and natural gas reserves were available for direct development by international oil companies, versus only 7 percent today. In addition, rising competition for access to the relatively limited resources that are open for development has enabled host governments to dictate fiscal terms that are so onerous that publicly traded oil companies cannot economically pursue them. Increased taxes are a part of the change in fiscal terms. Morgan Stanley estimates that the exploration and production tax rates of major oil companies have increased from about 30 percent to 45 percent since 2000.[4] In some cases, governments change fiscal terms after investments have been made or increase taxes on existing production, even in mature producing areas in otherwise stable countries (Alaska in the United States, and the United Kingdom). Such actions can make it uneconomic to invest the capital required to slow decline rates in existing fields. Increases in tax rates and other forms of government take are particularly problematic due to the maturity of oil provinces in areas such as the United States, the North Sea and Western Siberia and the increasing amount of capital required to offset the rising decline rates.

[4] Morgan Stanley Research, "Integrated Oil," March 14, 2008, Exhibit 17, page 11, exploration and production taxes divided by exploration and production earnings before taxes

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00266 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.204

Figure 6



Source: PFC Energy, Oil & Gas Journal, BP Statistical Review 2007
Note: Excludes unconventional crude oil and bitumen reserves

Resource access is also very limited in the United States, where an estimated 40 billion barrels of technically recoverable oil resources are either completely off limits or subject to significant lease restrictions. Similar restrictions apply to more than 250 trillion cubic feet of recoverable natural gas resources.[5]

Another constraint on expanding supplies is rapid inflation in industry drilling and service costs and difficulties in obtaining contractors to perform work on the desired time schedule. An upstream capital cost index, published by Cambridge Energy Research Associates, indicates that industry capital costs have approximately doubled since 2000,[6] reflecting higher costs for materials, equipment and personnel. Driving factors include higher industry activity and spending levels and the decline in the U.S. dollar, as well as strong demand for materials, equipment and people in other sectors of the global economy. Industry costs are also pushed upward by limited resource access and depletion of existing lower-cost resources, which force the industry to develop higher-cost resources. Such resources are typically located in deeper water or more remote locations, or may be unconventional in nature, requiring specialized development and refining techniques. Goldman Sachs estimates that marginal oil reserve

[5] National Petroleum Council, "Facing the Hard Truths about Energy," 2007, page 20
[6] Cambridge Energy Research Associates, "Upstream Capital Costs Index," December 5, 2007

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00267 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.205

replacement costs today to achieve a cost-of-capital return are about $90 per barrel.[7] Higher oil prices reflect the higher costs of reinvesting in new supplies.

Geopolitical risk – Also pushing crude oil prices upward is the high geopolitical supply risk attributable to the world's low level of excess oil production capacity and the fact that in several key oil-producing countries, political factors are constraining production (e.g., Nigeria, Iraq, Venezuela and Iran). The combination of strong demand growth and the need to offset lost production from these countries left the Organization of the Petroleum Exporting Countries (OPEC) at year-end 2007 with only 2.5 million barrels per day of excess capacity, equal to just 3 percent of global oil demand. This contrasts sharply with the greater than 10 million barrels per day of excess capacity that existed in the mid-1980s. This lack of spare capacity leaves world markets more vulnerable to oil supply disruptions caused by political events, storm damage to producing facilities, or unforeseen operational problems.

Role of OPEC – Within limits, OPEC could historically influence prices by adjusting its production to tighten or loosen the supply and demand balance. However, today the large amount of oil traded in futures exchanges (1.3 billion barrels per day) is 36 times greater than OPEC's oil production of 36 million barrels per day.[8] In addition, given OPEC's small excess production capacity, its member nations have significantly less influence on the price of crude oil than they had in the past.

Financial sector rotation to commodities – A final possible reason for recent increases in crude oil prices is the rising attractiveness of commodities to financial investors. Commodity index funds have been developed to provide investors with a financial vehicle to gain commodity price exposure. Investors have moved large amounts of capital into these funds in order to seek higher returns than are currently available through the stock and bond markets, to hedge the risk in their portfolios given the negative correlation between commodity prices and prices of stocks and bonds, or to hedge against inflation. Declines in U.S. interest rates or the value of the dollar stoke concerns about inflation, prompting an inflow of cash into these

[7] Goldman Sachs, Global Roundtable, "$100 oil reality, part 2: Has the super-spike end game begun?" May 5, 2008, page 6

[8] OPEC production is 2007 estimate from the International Energy Agency Monthly Oil Market Report, The 1,272 million barrels per day trading estimates from futures exchanges are for March 2008 and include 679 million barrels per day for NYMEX WTI, 280 million barrels per day for Intercontinental Exchange WTI and 313 million barrels per day for Intercontinental Exchange Brent; OPEC production includes natural gas liquids

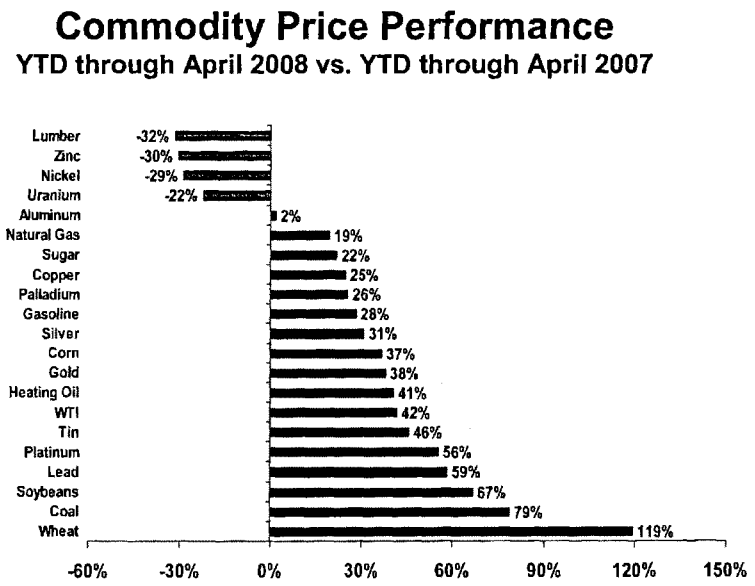
VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00268 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.206

funds. According to Daniel Yergin, chairman of Cambridge Energy Research Associates, "oil has become the 'new gold' – a financial asset in which investors seek refuge as inflation rises and the dollar weakens." [9]

It is possible that the inflow of capital into long-only commodity futures funds is temporarily exaggerating upward oil price movements, as well as upward movements in the prices of other commodities (e.g., platinum, tin, gold and wheat). The funds are disproportionately weighted in energy commodities – one popular fund reports over a 70 percent weighting for energy. Figure 7 below shows that year-to-date in 2008 versus 2007, most commodities experienced substantial price increases, with many other commodity prices increasing more than the price of WTI crude oil.

Figure 7



Source: Bloomberg, Platts, spot prices, January 1 – April 30 2008 vs. 2007

[9] Daniel Yergin, Alexander's Gas and Oil Connections, volume 13, issue 7, April 15, 2008

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00269 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.207

Other causes of high gasoline prices in recent years

While most of the variation in refined product prices is due to changes in crude oil prices, the supply and demand balance in the market for refined products also contributed to higher gasoline prices in the mid 2000s. However, as previously mentioned, those prices increased at a slower rate than crude oil prices this year. The factors that had contributed to rising gasoline prices until recently were:

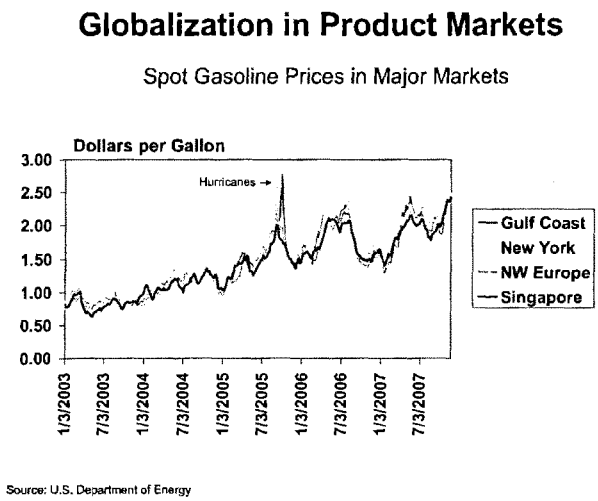
- High global refinery capacity utilization due primarily to a period of strong global gasoline, diesel and other refined products demand growth,
- Constraints to the U.S. supply system, such as state or local requirements for "boutique" fuels,
- Refinery outages due to hurricanes and other unforeseen events, and
- Higher refining costs.

Before addressing these trends, it is important to point out that like crude oil, refined products also trade in the global marketplace at prices determined by global, regional, and local supply and demand fundamentals. Illustrating the point that this is a global market, Figure 8 below demonstrates that wholesale or spot gasoline prices in four diverse regions have experienced similar upward and downward pressures. There are occasional temporary regional dislocations due to weather conditions or refinery or transportation outages. However, any regional surplus products tend to rapidly move to supply-short regions and thus restore the global equilibrium, provided that geographic isolation or specialized product specifications do not interfere with this flow of products.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00270 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.208

Figure 8



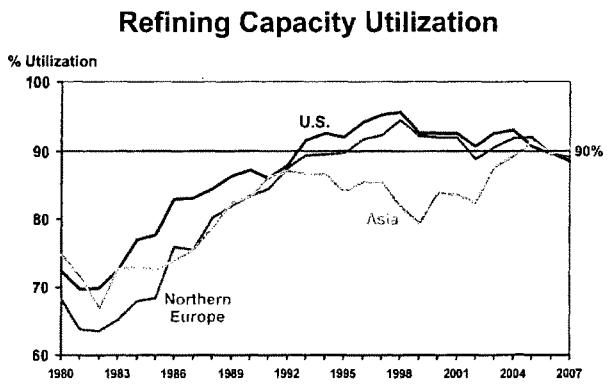
Global refinery capacity utilization – Until the mid 2000s, substantial excess refinery capacity in other nations enabled the United States to benefit from imports of surplus refined products. However, *strong global demand growth* has generally absorbed that surplus. Figure 9 below shows that refinery capacity utilization rates in the United States, Europe and Asia have all increased substantially in recent decades. High utilization, in turn, led to higher refinery margins that have in turn made economically possible a large number of currently planned refinery capacity expansions. The International Energy Agency estimates that 10.6 million barrels per day of global refining capacity is being added between 2007 and 2012. These additions represent a 12 percent increase in global refining capacity and are 9 percent greater than the Agency's projected oil demand growth during that period. Half of the additions are from incremental expansions in the United States and Asia and half are from new refineries being built in the Middle East and developing Asian nations. In addition to the 1.1 million barrels per day of expansions in distillation capacity planned in the United States by 2012, there are also large-scale upgrading capacity additions that will process increasing amounts of Canadian heavy, sour crude oil, and increase yields of clean-fuels products. [10]

[10] International Energy Agency, "Medium-Term Oil Market Report," July 2007, pages 54 and 60

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00271 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.209

Figure 9



Source: BP Statistical Review, 2007; U.S. Department of Energy for U.S.
2008 = YTD DOE for U.S., COP estimates for other regions

In addition to a prolonged period of strong demand growth, there are several other reasons why refinery capacity growth had not kept pace with demand in recent years. The refining industry has historically had *weak returns on capital*, which made it difficult to justify major expansions. For example, between 1995 and 2005 the return on investment in the refining sector was 10 percent, about 4.7 percent less than the average returns realized by the S&P industrials.[11] In addition, the U.S. refining industry has been required to *invest substantial sums on making cleaner fuels and reducing emissions, which has crowded out investment on expansions*. The U.S. refining industry has invested more than $84 billion since 1990 to improve the environmental performance of its products, facilities and operations.[12]

Even when the considerable economic hurdles for major expansions can be overcome, we are finding it *extremely difficult to obtain permits for expansions*. For example, ConocoPhillips applied in May 2006 for a permit to expand the Wood River refinery (a 50 percent joint venture with EnCana) in Illinois, and still does not have a final permit. At our refinery in Wilmington, California, local permit challenges and litigation have threatened an ultra-low-

[11] Timothy J. Muris and Richard G. Parker, "A Dozen Facts You Should Know About Antitrust and the Oil Industry," June 2007, page vi
[12] American Petroleum Institute, Environmental Expenditures by the U.S. Oil and Gas Industry, page 3

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00272 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.210

sulfur diesel fuel project since 2004. An expansion at our Rodeo refinery near San Francisco took 28 months to permit. The International Monetary Fund, in recognition of the barriers that hamper U.S. investment in downstream infrastructure such as refineries, stated "even when investment is allowed, environmental regulations and policies may drive up capital costs, causing delays."[13]

Our industry is often asked why the number of operable refineries in the United States has declined rather than increased in the last few decades, falling from 319 in 1980 to 149 in 2007. According to the Federal Trade Commission (FTC), the closures typically involved small, relatively unsophisticated facilities.[14] Between 1973 and 1981, federal government incentives enabled companies to own and profitably operate these small and often inefficient refineries. However, these refineries were hurt by the elimination of these incentives in 1981 as well as by the large capital expenditures that were required to meet government-mandated product specifications (such as clean fuels) and emissions reductions.

New refineries have not been built in the United States because building new refineries would cost considerably more than expanding existing refineries, and would face much greater permitting challenges. Thus, the industry has focused on incremental expansions of existing refineries. In fact, continuous expansions and improved efficiency have enabled the U.S. refining industry to increase crude runs nearly 30 percent since 1983,[15] despite closures of the smaller refineries and the refining industry's historically low returns on investment.

Constraints to the supply system – Another factor causing upward gasoline price volatility is the *proliferation of different grades of gasoline* required by various state and federal government environmental mandates. The existence of multiple unique product specifications makes it difficult to replenish supplies in the event of a disruption, such as storm-related refinery equipment outages. Regions with unique product specifications therefore experience greater price volatility than regions with standard specifications. A study by the U.S. Department of Energy indicated that "boutique" specifications did in fact result in upside

[13] International Monetary Fund, "What Hinders Investment in the Oil Sector," February 22, 2005, page 5
[14] U.S. Federal Trade Commission, Bureau of Economics, "The Petroleum Industry: Mergers, Structural Change, and Antitrust Enforcement," August 2004, page 7
[15] U.S. Department of Energy, Energy Information Administration, U.S. Weekly Crude Inputs Into Refineries, website (11.8 mmbd in 2003 and 15.2 in 2007)

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00273 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.211

volatility of gasoline prices,[16] a particular concern since more states are in the process of mandating new "boutique" grades of biofuels. The U.S. also requires lower sulfur gasoline than many other nations, which limits the sources from which gasoline can be imported into the United States. Other constraints to the supply system include limited import infrastructure, particularly on the West Coast, and the inability to ship ethanol-blended fuels in pipelines.

Refinery outages – While this has not been a large factor to date this year, unplanned refinery outages contributed to higher gasoline prices in some regions last year. In addition to unplanned outages, refineries undertake planned maintenance turnarounds, which are required to ensure the continued safe and efficient operation of refineries. Turnarounds are normally planned multiple years in advance and are scheduled before or after driving season to enable the refineries to run at full capacity during the peak demand period. The U.S. Department of Energy noted in a recent report that "the size and complexity of a refinery turnaround leaves little flexibility to change plans. The large commitments for labor, equipment and materials needed for process improvements make changes very costly at best, and safety concerns can override all other considerations."[17]

Higher refining costs – Additionally contributing to higher gasoline prices are higher refining costs. The refining industry has experienced substantial increases in energy, labor and materials costs. For example, the Nelson-Farrar composite index of refinery operating costs increased by 50 percent since 2002.[18] Contributing to this inflationary pressure is the fact that much of the domestic refining industry is competing for a limited pool of goods and services as multiple companies are working simultaneously to expand capacity. The refining industry has also had to expend capital on projects that reduce emissions and produce lower-sulfur fuels. Unfortunately, although performed for worthy causes, such projects often tend to increase operating costs.

[16] U.S. Department of Energy, Energy Information Administration, "Gasoline Type Proliferation and Price Volatility," September 2002, page 4
[17] U.S. Department of Energy, Energy Information Administration, "Refinery Outages: Description and Potential Impact on Petroleum Prices," March 2007, page v
[18] Oil and Gas Journal data base, "Nelson-Farrar refinery operating index," monthly as of November 2007

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00274 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.212

Gasoline supply and demand balance is moving back into equilibrium

Even as concerns grow over rising gasoline pump prices, the U.S. gasoline market is already moving back toward equilibrium due to:

- Slowing growth in demand caused by the higher gasoline price levels (in turn caused by higher crude oil prices) and the slowdown in the U.S. economy,
- Refinery capacity expansions,
- The restoration of domestic refining capacity that was disrupted last year,
- The increased use of ethanol in gasoline, and
- An increase in gasoline imports versus last year due to weakening gasoline demand outside the United States. The continued dieselization of Europe's automobile fleet is causing gasoline demand there to decline, and much of the surplus gasoline comes to the United States.

Evidence for the restoration of the balance in gasoline markets is the fact that as stated earlier, gasoline price increases are not keeping pace with crude oil price increases this year.

The relatively high gasoline-to-crude oil price spreads experienced in the last few years indicated tightness in the gasoline balance and provided the impetus for slower demand growth and increased production capacity. The market functioned properly to restore the gasoline balance. The best example of the market's effective response to a supply shortfall can be found in the aftermath of hurricanes Katrina and Rita in the fall of 2005, which temporarily shut down nearly 30 percent of total U.S. refining capacity as well as crude oil and product pipelines originating in the Gulf Coast. The higher gasoline price caused by the disruption resulted in increased refinery production outside the impacted area and higher gasoline imports. During the three weeks following Hurricane Rita, gasoline imports to the United States rose by 65 percent versus the previous year's rate. As a result of the market response, U.S. Department of Energy data indicates that the average retail gasoline price in

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00275 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.213

the United States dropped below pre-hurricane levels within one month (October 24, 2005) of the hurricane's landfall (Rita landfall: September 24, 2005).

Tightening global diesel supply and demand balance

The other shift occurring in global and U.S. product markets is the strengthening of diesel fuel prices relative to gasoline prices. Globally, and within the United States, diesel fuel demand has increased faster than gasoline demand in recent years. In the United States, diesel fuel demand growth has been robust due to strong economic growth until recently, and the heavy use of diesel fuel to transport products that are sold in the United States. Europe has had strong diesel fuel demand growth as a result of the tax-driven dieselization of the passenger vehicle fleet. Meanwhile, due to strong economic growth, Asia constitutes a greater share of the world's oil demand growth. It has traditionally had stronger demand growth for diesel fuel for use in the shipment of products and for generating electricity than it has had growth in demand for gasoline for use in personal transport. As a result of these global structural changes, overall world diesel fuel demand increased by 2.5 percent per year over the last decade, while gasoline demand grew by 1.5 percent per year. In 2000, global distillate demand (diesel fuel and heating oil) became a larger portion of global demand than gasoline.

The issue with the acceleration of diesel fuel demand relative to gasoline demand is that – to meet past demand patterns – refineries were generally configured to maximize gasoline production with a typical distillate yield in the United States of only about 25 percent. The ability to change the configuration of an existing refinery to produce more diesel fuel is limited and it would reduce gasoline production. Building new diesel-oriented refineries will require a significant amount of time and capital. Thus, the global diesel fuel supply/demand balance has tightened relative to gasoline.

Another reason for rising diesel prices is that the U.S. and Europe have substantially lowered the sulfur content of their diesel fuels in recent years. In addition to costing more to manufacture lower-sulfur products, other potential suppliers around the world can no longer meet the more stringent U.S. and European diesel fuel specifications, which reduces available imports. In addition, the production of ultra-low-sulfur diesel fuel can reduce the volume

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00276 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.214

produced from some refineries. Thus, acceptable diesel fuel supplies are more limited and cost more than in the past.

Diesel fuel prices are also stronger than gasoline prices because biodiesel is having less of an impact on demand than ethanol is on gasoline demand. While increased U.S. ethanol use is reducing demand for conventional gasoline, biodiesel is less competitive and is contributing less to overall diesel fuel supplies.

As a result of these global and U.S. market forces, U.S. prices for on-road retail diesel fuel averaged about 10.5 cents per gallon above gasoline prices since 2005, compared to averaging 5.5 cents per gallon below gasoline prices between 1995 and 2004.[19] In recent weeks, spot diesel prices in the Gulf Coast have been trading 50 cents per gallon above spot gasoline prices.

In addition, diesel fuel prices in the United States are being buoyed this year by strong demand and pricing in other nations. For example, there have been reports of additional diesel fuel demand for use in power generation as a result of disruptions in power markets and coal shortages in other nations, including China.[20]

Reasons for regional variations in retail gasoline or diesel prices

There is a common misperception that differences in retail prices across regions indicate that the market is not functioning properly. There are many legitimate reasons for regional variations in gasoline prices:

State or local environmental programs – Some areas of the country are required to use special "boutique" gasolines. Environmental programs, aimed at reducing carbon monoxide, smog and air toxics include the manufacture of federal and/or state-required oxygenated, reformulated and low-volatility gasolines. Other environmental programs put restrictions on transportation and storage. The reformulated gasolines required in some urban areas and in California cost more to produce than conventional gasoline used elsewhere, increasing the

[19] U.S. Department of Energy, Energy Information Administration, Weekly Petroleum Status Report, U.S. Gasoline and Diesel Retail Prices
[20] International Energy Agency, Oil Market Report, April 11, 2008, page 17

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00277 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.215

price paid at the pump. Many different states are now considering mandating differing percentages of biofuels usage, which will create additional boutique gasoline and diesel fuels.

State and local taxes – State gasoline sales tax rates in the United States range from a low of 7.5 cents per gallon in Georgia to a high of 34 cents per gallon in the state of Washington. Some localities also levy taxes on fuel.

Proximity of supply – The farther a location is from refineries or major pipelines, the higher you would expect the price to be given the necessity of trucking products from a pipeline terminal to the site. Trucking is more costly than pipeline transport.

Supply disruptions – Events that temporarily slow or stop production of gasoline or diesel fuel, such as storms or unplanned refinery maintenance, can prompt market participants to bid up the price of available supplies. Then, if the transportation system cannot easily move supplies from regions where they are in surplus to where they are needed, prices will remain comparatively high.

Operating costs – Even stations located adjacent to each other may have different traffic patterns, rents, and sources of supply that influence retail fuel prices. States also have different refinery production costs and product transportation costs, due to such factors as different crude oil supply sources, electricity and other utility costs, land values and wage rates.

The Impact of Mergers on Energy Markets

This section of my testimony indicates that mergers are not a cause of higher energy prices and instead have helped constrain energy prices from levels they might have otherwise reached. The main points are that:

- One of the primary reasons for the merger between Conoco Inc. and Phillips Petroleum Company was a response to adversely changing market conditions, such as the trend toward limited resource access discussed earlier, and growing size and risk of the remaining available development opportunities. These are the same trends that are

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00278 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.216

currently working to drive crude oil prices higher, despite the positive impact of industry mergers.

- "Big Oil" – the traditional publicly owned international oil companies – in fact is not so big when its small market share relative to that of national oil companies is considered. In addition, concentration levels of the various segments of the petroleum industry are low relative to those of other industries.

- Oil pricing and oil industry mergers have been subject to greater scrutiny by the Federal Trade Commission (FTC) than other industries. FTC merger reviews have more closely analyzed oil than other industries and the FTC have challenged mergers at lower levels of concentration. The FTC has also conducted several investigations of pricing anomalies and generally concluded that market forces were responsible.

- Our experience with the merger between Conoco Inc. and Phillips Petroleum Company suggests that consumers have benefited from the improved cost structure and higher efficiency of our greater scale of operations.

- Financial data included below indicates that oil and gas industry profitability is commensurate with that of other industries despite the current high point of an investment cycle.

Consolidation driven by reduced resource access and need to improve efficiency

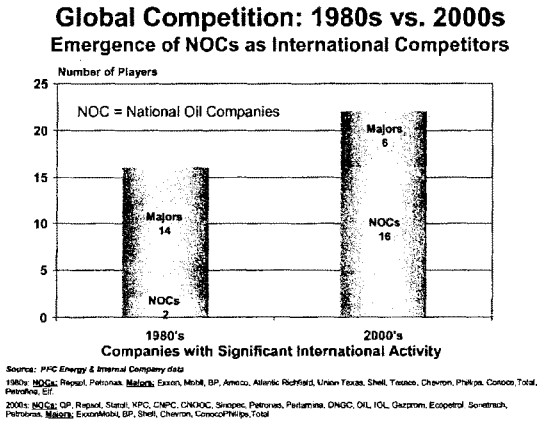
I would like to share our general view on why the petroleum industry has been consolidating. First, it is important to point out that over the last decade there have been mergers in many industries. To some degree, the trend toward consolidation is driven by globalization, with mergers in mature markets giving companies from various industries sufficient scale and a lower cost structure that enables them to compete in a global arena. For petroleum companies, the global business environment has become particularly challenging as government-owned enterprises from both oil-producing and consuming nations have emerged as new global petroleum players, adding to competition in the marketplace. In fact, Figure 10 below shows that the emergence of national oil companies competing outside their borders has more than

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00279 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.217

offset the decline in the number of international oil companies due to mergers. Thus, the number of international competitors has increased since the 1980s.

Figure 10



The upstream segment of the petroleum business consists of exploration for and development and production (E&P) of crude oil and natural gas supplies. Access to crude oil and natural gas reserves is the principal challenge in the upstream segment of the petroleum industry today. In the United States, oil and gas production is declining, largely because many areas with the best remaining prospects for exploration and development are off limits due to state or federal drilling moratoriums. These access restrictions extend well beyond the most environmentally sensitive areas. This constrained access increasingly forces the U.S. energy industry to look for resources abroad, where resources often are controlled by national oil companies. Resource access – both domestic and international – has been steadily eroding since the 1960s. As shown in the previous Figure 6, international oil companies can directly access only 7 percent of the world's oil and gas reserves today, with only an additional 12 percent theoretically accessible through joint ventures with national oil companies.

Competition for the limited resources available – combined with rising foreign government taxes – make it difficult for publicly traded oil companies to access resources that offer the potential to earn acceptable returns to our shareholders. This has led to declining organic

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00280 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.218

reserve replacement rates for many international oil companies. Meanwhile, national oil companies from oil-producing and consuming nations, along with privately held Russian companies, are now competing globally and adding to the resource access challenge.

This constrained access at home and abroad has required international oil companies to undertake increasingly large and complex projects that host governments may not have the financial strength, skills or technology to undertake on their own, including in some developing countries that may not have the same rules of law and contract sanctity as most industrialized nations. At the same time, regime change has destabilized some jurisdictions and introduced risk at levels unforeseen at the time of the original investment. The expropriation of ConocoPhillips' assets in Venezuela is an example of such changes that highlights the enormous amount of risk companies are facing today, and the value of being a large and highly geographically diversified company.

The industry is also seeking opportunities in places that are more operationally challenging and thus expensive, such as prospects located in deep water, remote or arctic areas or unconventional oil projects that required downstream processing. A typical large ConocoPhillips exploration and development project requires several billion dollars of initial investment and may not generate revenues for over a decade from project sanction. A single large offshore platform in the Gulf of Mexico designed to operate in thousands of feet of water costs more than $1 billion to develop. A project to produce and deliver liquefied natural gas currently costs from $7 billion to $21 billion, depending on its size, location and complexity. The proposed Alaska natural gas pipeline is expected to cost $25 to $40 billion. Only large companies with substantial financial capacity and technical resources can effectively develop these projects, while sufficiently diversifying the number of projects and geographies to manage the risk. For U.S. companies to compete in today's environment of mega projects, they have been forced to consolidate to gain scale commensurate with the growing magnitude, complexity and risk of available opportunities. The forces demanding that oil and gas companies become larger and more diverse in order to compete will continue growing in the years ahead.

For the refining business, international competition and large required expenditures on environmental projects that generate little economic return have driven this industry as well to

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00281 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.219

strive for increased economies of scale and greater efficiency. The FTC has also observed that, "the United States has fewer refineries than it had 20 years ago, but the average size and efficiency of refineries have increased, along with the total output of refined products."[21]

The U.S. petroleum industry is not highly concentrated

Despite the consolidation that has taken place in the petroleum industry, it is still not highly concentrated today. The 2004 FTC report on mergers and structural changes in the industry concluded that "mergers of private oil companies have not significantly affected worldwide concentration in crude oil, and that concentration for most levels of the petroleum industry has remained low to moderate."[22] That conclusion was reiterated in FTC testimony to the U.S. Congress in 2006 that stated that "despite some increases over time, concentration for most levels of the United States petroleum industry has remained low to moderate."[23]

Exploration and production – There is a common misperception that the oil majors control a substantial portion of the world's oil and natural gas reserves. However, Figure 11 below shows that "Big Oil" is not so large compared to the national oil companies. In fact, the top six major companies (as defined in Figure 10) together hold only 4.5 percent of the world's oil and gas reserves.

Concentration in domestic crude oil production and ownership of crude oil reserves remained at very low levels between 1990 and 2002 as measured by the Herfindahl-Hirscchman Index (HHI), which equals the sum of the squared market shares of all market participants in the relevant product and geographic market. An HHI of 1,000 or less is considered to be unconcentrated. In 2002, domestic crude oil production had an HHI of 297, up only slightly from 284 in 1990.[24]

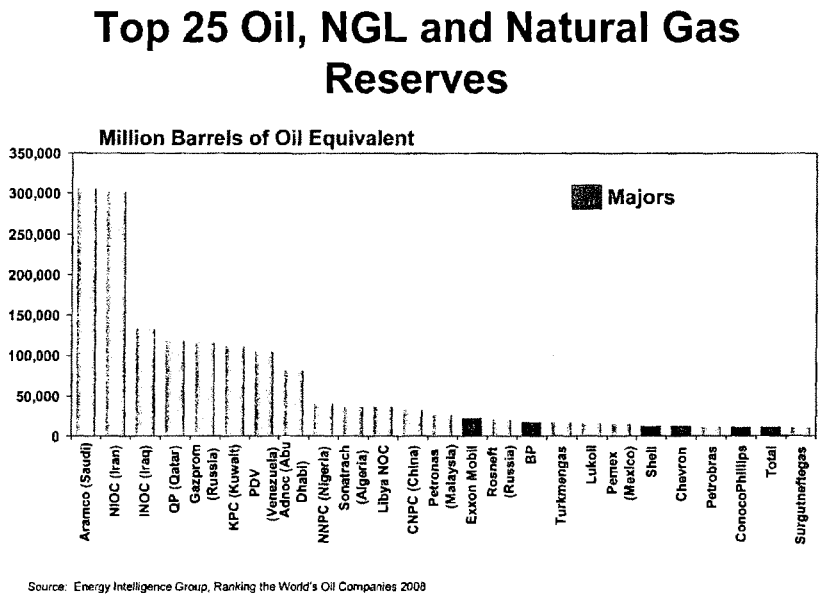
---

[21] Michael A. Salinger, "Petroleum Industry Consolidation: Prepared Statement of the Federal Trade Commission Before the Joint Economic Committee of the U.S. Congress," May 23, 2007, page 7
[22] William E. Kovacic, Commissioner, Federal Trade Commission, "Market Forces, Competitive Dynamics, and Gasoline Prices: FTC Initiatives to Protect Competitive Markets before the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce, May 22, 2007, page 22 referring to Federal Trade Commission, "The Petroleum Industry: Mergers, Structural Change and Antitrust Enforcement," 2004
[23] William E. Kovacic, Commissioner, Federal Trade Commission, "Petroleum Industry Concentration," Prepared Statement to the Committee of the Judiciary, U.S. Senate, February 1, 2006, page 5
[24] Timothy J. Muris and Richard G. Parker, "A Dozen Facts You Should Know About Antitrust and the Oil Industry," June 2007, pages 11 and 13

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00282 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.220

Figure 11

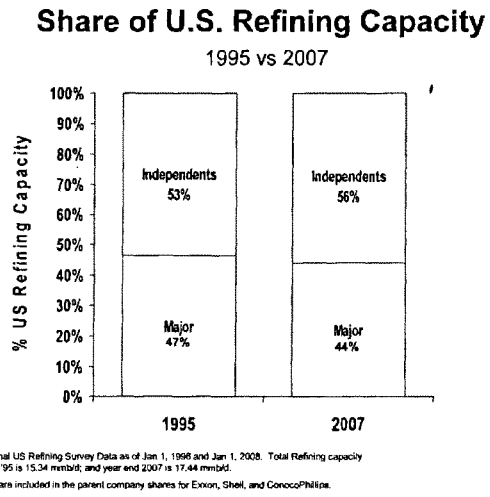


Refining – Ownership in the U.S. refining industry is also not concentrated. Valero, an independent refiner, has the largest share with 13 percent of capacity. Figure 12 below demonstrates that despite the mergers that have taken place over the last decade, ownership of refining capacity has shifted slightly away from the U.S. integrated majors to independents.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00283 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.221

Figure 12



The U.S. refining industry is also not very concentrated compared to many other industries. The top four refining companies in the U.S. have a market share of 59.4 percent. The market share of the four largest companies is far more concentrated in these other industries:[25]

	Percent
Carbonated soft drink	94.8
Carpet	84.4
Brewing	84.2
Light bulb	77.3
Automobile	74.2
Fast Food	66.9
Pharmaceuticals	61.5

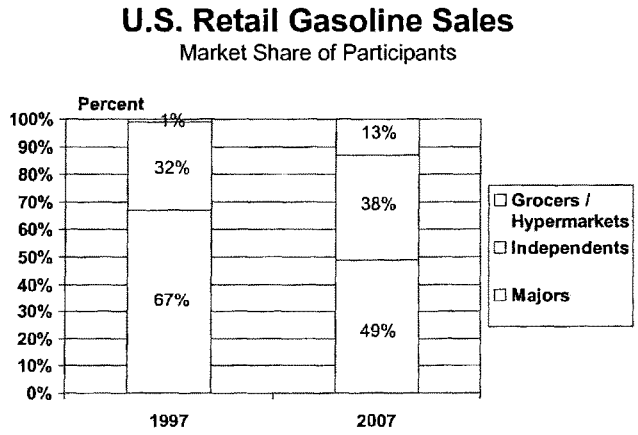
[25] Timothy J. Muris and Richard G. Parker, "A Dozen Facts You Should Know About Antitrust and the Oil Industry," June 2007, pages 17 and 18

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00284 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.222

Retail marketing – The share of the four largest companies in the retail gasoline industry stands at 62 percent, which is far less concentrated than other industries.[26] Ownership of retail operations by the major companies has declined considerably over the last decade as shown in Figure 13 below. Over the past decade, the majors companies' gasoline brand share has decreased from 67 percent to 49 percent. There have been many new entrants into the retail business. Over the past ten years, giant grocery store chains and hypermarkets have increased their share from 1 percent to 13 percent. Independents have also grown their share from 32 percent to 38 percent over the last decade. These figures refer to market shares of gasoline sales. Major integrated oil companies have much smaller participation in the ownership and operation of retail stores. According to the Association for Convenience and Petroleum Retailing, the major integrated oil companies own and operate fewer than 3% of all retail locations in the United States.[27]

Figure 13



Source: The NPD motor fuels index, The NPD group

[26] Timothy J. Muris and Richard G. Parker, "A Dozen Facts You Should Know About Antitrust and the Oil Industry," June 2007, pages 17 and 18

[27] Testimony of Bill Douglass on Behalf of The National Association of Convenience Stores Before the House Judiciary Committee, Anti-Trust Task Force, Hearing to Examine the Consumer Effects of Rising Gas Prices, May 7, 2008, page 2

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00285 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.223

The petroleum industry receives more scrutiny than other industries

The petroleum industry receives closer scrutiny from antitrust authorities than other industries. An FTC review of merger investigations and enforcement actions from 1996 to 2005 concluded that the Commission brought more merger cases with lower levels of market concentration in the petroleum industry than any other industry.[28] During the period of oil industry mergers in the late 1990s, the FTC's Bureau of Competition spent almost one-fourth of its enforcement budget on investigations in the energy industry.[29]

In addition to merger reviews, the FTC also actively monitors wholesale and retail gasoline and diesel fuel prices. The agency regularly scrutinizes price movements in 20 major urban areas and approximately 360 cities across the country. The FTC has previously testified to the U.S. Congress that "in no other industry does the Commission so closely monitor prices."[30] The Commission's experience from its past investigations and from the current monitoring program indicates that unusual movements in gasoline prices typically have a business-related cause including movements in crude oil prices, supply outages (e.g., from refinery fires or pipeline disruptions), or changes in and/or transitions to new fuel requirements imposed by air quality standards.[31] States also have investigated gasoline and diesel fuel prices on a number of occasions. ConocoPhillips cooperates fully – both on a voluntary and a formal basis – with authorities and expends significant resources in providing information and other assistance to the authorities monitoring the petroleum industry.

ConocoPhillips' merger experience

ConocoPhillips' mergers, acquisitions and joint ventures have benefited consumers by reducing cost and improving the efficiency of our business, and increasing supplies of petroleum products for American consumers. Fundamentally, the supply of petroleum products depends on the ability of U.S. companies to access crude oil and natural gas and to transform them into petroleum products for American consumers. The transactions

[28] Michael A. Salinger, "Petroleum Industry Consolidation: Prepared Statement of the Federal Trade Commission Before the Joint Economic Committee of the U.S. Congress," May 23, 2007, page 3
[29] Ibid., page 8
[30] Ibid., page 16
[31] Ibid., page 17

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00286 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.224

undertaken by ConocoPhillips have been motivated by and have subsequently achieved increased access to crude oil and natural gas, and increased refining capacity to turn that crude oil into petroleum products. This increased supply has benefited – and can be expected to continue to benefit – American consumers through lower prices than would have otherwise been obtained and through greater energy security. These mergers and acquisitions also have strengthened the sustainability of the company's competitive position and long-term viability.

Given the size and importance of the merger of Conoco Inc. and Phillips Petroleum Company to our company's history, I would like to use this transaction as an example of how this merger has benefited U.S. consumers. This $36 billion merger of equals was completed on August 30, 2002. The rationale was to form a company of sufficient size and scale to address opportunities that could not be achieved by either company on a stand-alone basis. The merger was intended to develop a diversified growth portfolio and leverage the intellectual capital of the two companies. It also was intended to strengthen our financial position through diversifying earnings and cash flow, developing a stronger balance sheet and improving capital efficiency and the cost structure. We estimated cumulative cost and efficiency savings of approximately $1.9 billion in 2004 resulting from this merger.

In the Exploration and Production (E&P) segment of the business, our increased scale, financial strength and diversification have enabled ConocoPhillips to expand our investments in traditional core areas and to develop new legacy assets. The E&P business segment also benefited from the combination of the companies' complementary competencies. For example, by combining Phillips' liquefied natural gas (LNG) technical expertise with Conoco's extensive gas marketing experience, ConocoPhillips has become a more effective global gas player. These capabilities enabled us to compete successfully for participation in a major LNG project in Qatar (Qatargas III), which puts our company in a strong position to help expand imports of natural gas to American consumers over the coming years as the domestic supply declines.

In the refining and marketing (R&M) business segment, we benefited from lowering our cost structure, which was made possible by sharing technology and best practices, optimizing crude supply and improving management of intermediate refining feedstock across our entire refining system. Unit cost reductions have resulted from initiatives in the areas of energy

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00287 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.225

efficiency, operations optimization and maintenance. Additionally, the sharing of technological expertise and best practices has helped mitigate increases in the capital costs of projects.

The merger also resulted in increased efficiency in R&M operations. We have been able to improve reliability and increase clean refined product yields at our refineries by sharing technology and best practices across our refinery network. These include initiatives in preventative maintenance, reduced turnaround time, improved tuning and control of operating units and installation of improved technologies.

Since the merger, refinery utilization has improved from the low 90 percent range to the mid 90 percent range, which is equivalent to adding 100,000 barrel per day of refining capacity. In addition, since the merger we have increased the nameplate capacity of our U.S. refineries by approximately 2 percent, resulting in a further 50,000-barrel-per-day capacity increase.

Having multiple U.S. refineries that can be upgraded now enables us to bring additional crude oil from Canadian oil sands production into the United States. For example, in 2007 we formed a joint venture with EnCana, which created an integrated North American heavy oil business consisting of two 50/50 operating businesses that include two of their large oil sands projects and two of our U.S. refineries. The joint venture is presently working to expand the capabilities of the Wood River refinery in Illinois to handle additional volumes of crude oil from the Canadian oil sands. We are currently awaiting approval of permits to commence construction.

All across our post-merger refining system, we can point to numerous examples of higher crude-oil throughputs stemming from our enhanced ability to balance crude oil supplies among a larger number of refineries. For example, crude oil throughput at our Sweeny, Texas refinery was maintained at higher levels during the Venezuelan supply disruption in 2003 due to our ability to divert the specialized crude from three other ConocoPhillips refineries that could more easily adapt to alternative supplies. In several instances, we have been able to maximize our refining system throughput during Gulf of Mexico storms that delayed crude oil deliveries, including during the aftermath of Hurricane Katrina thanks to greater balancing options among waterborne cargoes, pipeline receipts and inventories.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00288 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.226

We also have produced greater volumes of clean products since the merger through our ability to balance intermediate and blendstock inventories among refineries. For example, we increased the supply of imported gasoline and gasoline blendstocks from Conoco's Humber refinery in England through Phillips' Bayway and Trainer refineries on the U.S. East Coast. We also move premium gasoline blendstocks (e.g., alkylate, toluene) from our East Coast refineries to our West Coast refineries to increase the supply of CARB gasoline and to enhance octane. In addition, when we plan refinery turnarounds, we can process intermediate products (not yet upgraded to a finished product due to capacity lost in turnaround) at other plants. Even in the case of unplanned downtime, we are able to transfer intermediate products between facilities to enable crude rates to be maintained and to utilize stocks from other facilities to maintain supply to consumers.

We also have realized significant efficiency gains in operations of U.S. pipelines and terminals since the merger. For example, we improved access for Canadian crude oil on the Spearhead pipeline and improved crude oil import capability on the West Coast.

Divestitures stemming from the merger also moved refining capacity into the hands of new industry participants. Although we believed it was unwarranted, in response to an FTC mandate before the merger was closed, our Woods Cross refinery in Utah was sold to Holly Corporation, and our Denver refinery in Colorado was sold to Suncor. In both cases, the new owners have invested capital in order to maintain output and to make new clean fuels at these refineries.

Industry Profits: Addressing Common Misperceptions

There are many common misperceptions about industry profits that I would like to clear up. This section of my testimony makes the following major points:

- Costs of operations and supply expansion have increased along with rising oil prices. In fact, these cost increases have substantially raised industry reserve replacement costs.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00289 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.227

- The large absolute size of earnings by major oil companies mostly reflects the enormous size of required investments in major projects.

- Petroleum industry profitability is similar to the profitability of other industries, with the exception that refining industry profitability has been historically weak.

- The petroleum industry is reinvesting in new supplies.

Costs catch up with prices

Oil and natural gas industry earnings are highly cyclical, as is the case with other commodity industries. Although the industry's profits have increased in recent years, along with the overall strengthening of underlying commodity prices, costs have escalated rapidly and are still rising. In fact, Morgan Stanley estimates that the returns on capital employed earned by the exploration and production operations of integrated oil companies actually peaked in 2005, and have since declined.[32] I previously mentioned that Goldman Sachs estimates that marginal reserve replacement costs today are approaching $90 per barrel. Morgan Stanley also estimates that from 2008 to 2012, new upstream investments will require crude oil prices of nearly $85 per barrel (West Texas Intermediate) to be profitable at the industry's cost of capital, and that given continuing cost increases, crude oil prices by 2012 of approximately $90 - $100 per barrel will be needed to justify investment.[33] Thus, today's higher prices actually reflect higher reserve replacement costs.

Large earnings reflect scale of investment

There is a common misperception that the absolute dollar amount of major oil company earnings is indicative of the industry's profitability. Rather, its earnings reflect the industry's enormous scale and the capital investment needed to replenish depleting supplies and to grow. I have already talked about the high cost of the mega projects that the majors are developing. A single large offshore platform in the Gulf of Mexico designed to operate in thousands of feet of water costs more than $1 billion to develop. Our earnings need to be large in absolute

[32] Morgan Stanley Research, "Integrated Oil," March 14, 2008, Exhibit 18, page 12
[33] Morgan Stanley Research, "Integrated Oil," March 14, 2008, page 12

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00290 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.228

terms to support the scale of investment required. For example, ConocoPhillips earned nearly $12 billion in 2007, but spent close to $13 billion in capital expenditures and investments.

Petroleum industry profitability is similar to other industries

There is also a common misperception that energy industry earnings and returns on investment are higher than those of other industries. Figure 14 below shows that the industry's earnings are comparable to those of other manufacturing industries.

Figure 14

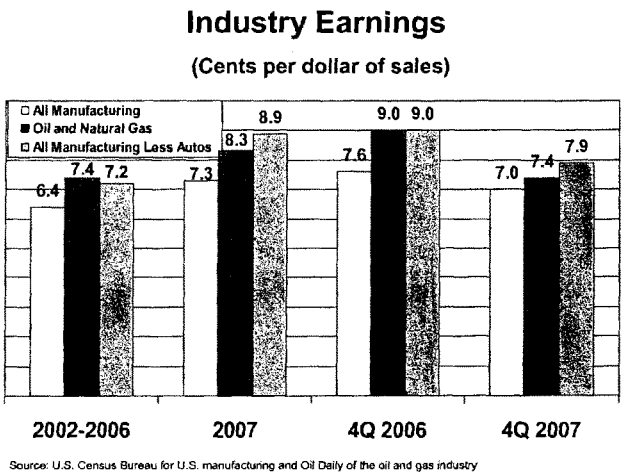
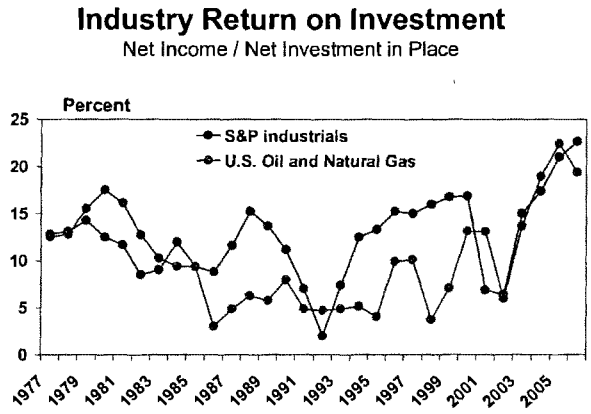


Figure 15 below, based on U.S. Department of Energy data, shows that the return on investment for the oil and natural gas industry is currently comparable to average returns for the S&P industrials, after lagging those returns for many years.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00291 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.229

Figure 15



Source: U.S. Department of Energy, Energy Information Administration, Performance Profiles of Major Energy Producers, various issues and 2006 S&P figure compiled by PWC from Compustat data

The refining segment has historically had weak returns

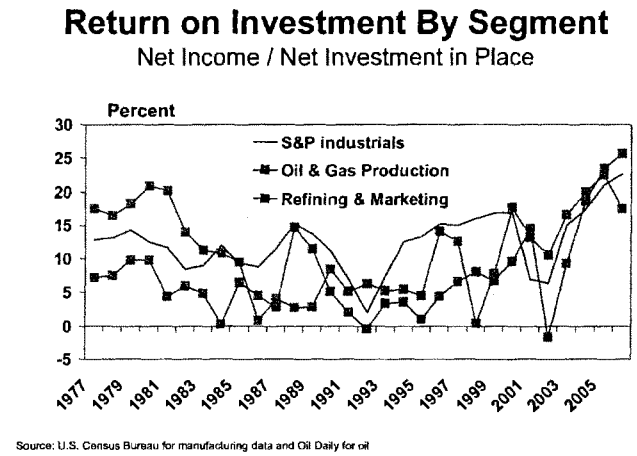
Figure 16 below compares returns on investment for the S&P 500 industrial companies against those of U.S. oil and natural gas production and for U.S. refining and marketing. It reveals that the refining and marketing segment had relatively weaker returns for all years except for 2005 and 2006, and actually had negative returns in several years, most recently in 2002. This chart ends in 2006, which was an exceptionally attractive year for refining. Subsequent data from other sources indicate that industry profitability moved back towards more typical (lower) levels after 2006. Further, the Congressional Research Service indicated that downstream net income for integrated majors as well as independent refiners and marketers in 2007 declined by about 4-5 percent versus 2006. In the fourth quarter of 2007, net income for independent refiners and marketers declined 67 percent versus the fourth quarter of 2006.[34]

[34] Congressional Research Service, "Oil Industry Profit Review 2007," April 4, 2008, pages 4, 6 and 7

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00292 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.230

Figure 16



Historical returns for the refining industry have been weak because the industry is highly capital intensive and is required to invest substantial amounts of capital to meet environmental mandates for which there is often no financial return. Historically, the industry has continuously added incremental capacity that, except for a brief period in recent years, has kept pace with demand growth.

Refining margins are also highly cyclical. During periods when there is a price signal that justifies new investments, the entire industry tends to invest heavily and overshoot the new capacity needed to satisfy demand. Given the relatively slow rate of demand growth, it then takes many years to utilize the surplus capacity. Thus, the industry experiences long periods of very weak margins interrupted periodically by a few years of higher profitability that attracts new investment. I have already discussed how much capacity the International Energy Agency reports is presently being added.

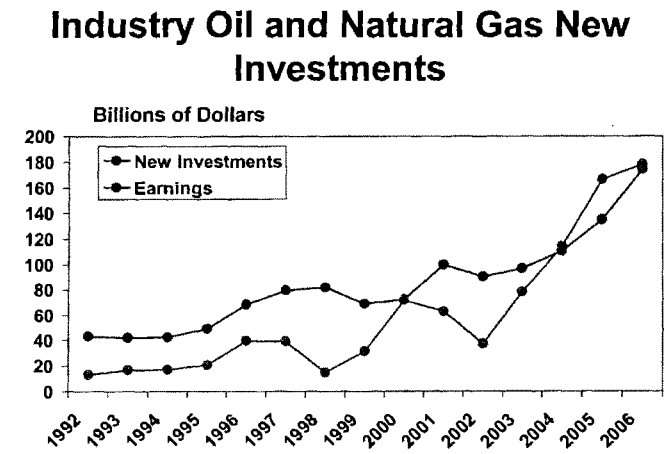
VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00293 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.231

The petroleum industry is reinvesting in new supply

Another common misperception is that the oil and natural gas industry is not reinvesting its earnings to develop new supplies. Figure 17 below shows that investments have increased along with earnings. For example, 2006 investments of more than $174 billion increased by 29 percent over 2005. Between 1992 and 2006, the U.S. oil industry invested more than $1.25 trillion into a variety of long-term energy initiatives, compared to net income of $900 billion. Some also express concerns over the industry's rate of stock repurchases. However, according to U.S. Department of Energy data, for the last 11 years, the industry spent only 21 percent of net income on stock repurchases, compared to the S&P industrials repurchase rate of 52 percent.[35] Despite the relatively low stock repurchase rate, the oil and gas industry would likely reinvest at even higher rates if governments made more resources available for development.

Figure 17



Source: Ernst & Young

[35] American Petroleum Institute, "The Truth About Oil and Gasoline: An API Primer," May 9, 2008, page 13

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00294 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.232

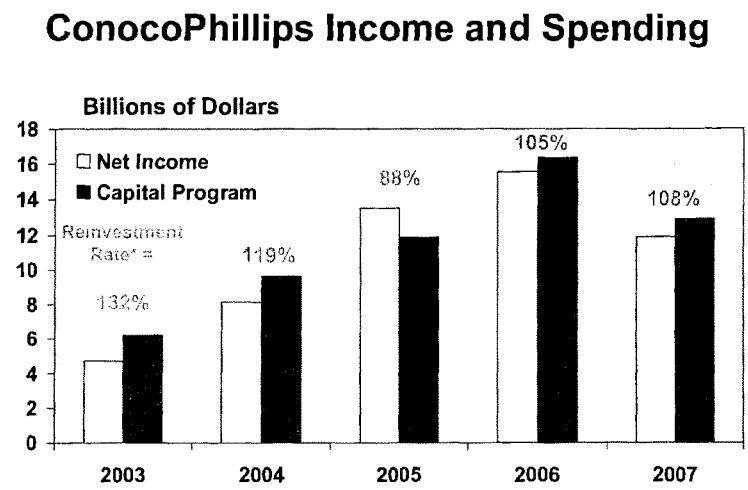
ConocoPhillips' Activities to Increase Supplies

ConocoPhillips is making substantial investments to add new oil and natural gas supplies, and thus help to ease upward pressure on consumer prices.

Reinvestment Rates

ConocoPhillips' reinvestments to develop new supplies have typically exceeded its earnings. Figure 18 below shows that between 2003 and 2007 the company's reinvestment rate as a percent of net income averaged 106 percent. In addition, capital spending increased nearly 150 percent between 2003 and our projected 2008 spending level of about $15 billion.

Figure 18



* Reinvestment rate as a percent of net income
Source: ConocoPhillips' SEC filings

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00295 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.233

Upstream investment and exploration

ConocoPhillips has significant investments planned to develop oil and natural gas resources in North America. In 2008, we will spend more than $6 billion in North America, with two-thirds of that amount earmarked for the United States.

North America is a key focus area for ConocoPhillips. For exploration, we predominantly operate in large resource plays onshore and the deepwater trend in the Gulf of Mexico offshore. In the Arctic, we have exploration acreage in the Chukchi Sea, Mackenzie Beaufort Sea and Canadian arctic islands. In fact, we are planning on spending more than $890 million this year alone for our high bids in Gulf of Mexico and Chukchi Sea lease sales.

Heavy oil – The Canadian oil sands are projected to become an increasingly important source of oil for the United States, particularly considering recent declines in heavy oil production in Mexico, Venezuela and California. The Canadian oil sands are projected to potentially provide nearly 20 percent of U.S. oil supplies by 2020.[36]

ConocoPhillips has a leading land position in the Canadian Athabasca oil sands and is actively investing to produce this oil, transport it to and refine it at our U.S. refineries, including our EnCana joint venture refineries. We have access to over 15 billion barrels of net potential oil resources, and plans are in place to increase our net production to about 400,000 barrels per day over the next decade. In 2008 alone, we are spending $900 million in development capital on the Canadian oil sands. ConocoPhillips is also spending significantly on technology to improve heavy oil output and reduce the resulting environmental and carbon footprint of the steam-assisted gravity drainage (SAGD) extraction process that is increasingly used to produce the heavy oil.

ConocoPhillips also has a 50 percent interest in the planned 2,148-mile Keystone oil pipeline, which will transport additional Canadian crude oil to the United States. The pipeline will have an initial nominal capacity of 435,000 barrels per day in late 2009 and will be expanded to a nominal capacity of 590,000 barrels per day in late 2010.

[36] Purvin and Gertz (18.5%)

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00296 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.234

We are working to expand the Wood River refinery in Illinois to enable it to utilize additional volumes from the Canadian oil sands. This expansion will increase Wood River's heavy oil inputs by 54,000 barrels per day and increase the yield of total clean-fuel refined products by 80,000 barrels per day. This proposed expansion has been delayed by a pending appeal of a permit that was previously granted for the project by the Illinois Environmental Protection Agency.

Natural gas – ConocoPhillips was one of the leading natural gas producers in the United States in 2007, producing about 2.3 billion cubic feet per day. ConocoPhillips has a significant domestic natural gas resource base (about 12.6 trillion cubic feet of proved gas reserves), and is actively adding acreage in large resource plays and exploring for additional supplies. For example, we plan to drill more than 200 exploration wells onshore in North America during 2008.

We are also investing to improve our natural gas delivery capabilities. We have a 25 percent ownership position in the Rockies Express pipeline, which is being built to move trapped natural gas from the Rocky Mountains region to Midwest and East Coast markets. We also have invested in liquefied natural gas (LNG) regasification facilities on the Gulf Coast in order to provide a potential outlet for LNG supplies we are developing around the world.

Arctic – ConocoPhillips is Alaska's largest oil and natural gas producer, with production of nearly 300,000 barrels of oil equivalent per day in 2007.

Alaska holds significant stranded natural gas resources, which if connected to the lower 48 states, would increase commercially proven U.S. gas reserves by about 17 percent. ConocoPhillips has long urged progress on the proposed 4 billion cubic feet per day Alaska natural gas pipeline, and we applaud Congress for your bipartisan efforts in passing the needed "Enabling Legislation" to progress this project. We are moving forward on planning the pipeline and are continuing our dialogue to deliver a project acceptable to all stakeholders. In order for this project to advance, it will ultimately need close cooperation between all resource owners, the State of Alaska and the Canadian and U.S. federal governments.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00297 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.235

ConocoPhillips is also working with our partners, native groups and the Canadian federal government to move the 763-mile Mackenzie Delta gas pipeline project forward. The 1.2 billion cubic feet per day pipeline project would connect northern onshore gas fields with North American markets and provide consumers additional supplies of much needed natural gas.

Refining, marketing and transportation

In 2008, ConocoPhillips plans to invest $2.8 billion in our global refining, marketing and transportation operations. Of that amount, 74 percent will be invested in the United States and 69 percent will be invested in global refining.

Over the next five years (2008-2012), we plan to invest $7.0 - $7.5 billion in our base refining, marketing and transportation business, with 80 percent of that allocated for investments to improve reliability and safety, expand clean fuels production and reduce emissions. The other 20 percent will be for projects that reduce costs and improve efficiency. The large scale of ongoing capital requirements for safety and reliability and to meet all regulatory requirements makes it challenging for the refining industry to achieve attractive returns on capital.

We also plan to spend $6.5 - $7.0 billion over the next five years (2008-2012) on strategic investments, which are primarily refinery projects that increase crude oil refining capacity, raise clean product yields, or enhance the ability to utilize low-cost (and thus more difficult to refine) crude supply.

We are also targeting a 10 percent reduction in the energy intensity index of our U.S. refining system by 2012, as part of a voluntary commitment through the American Petroleum Institute to reduce carbon dioxide emissions in the U.S. refining sector. This reduction also makes good business sense because, as a large consumer of energy, the refining industry has been adversely impacted by higher energy prices in recent years.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00298 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.236

Alternative and unconventional fuels

Renewable energy – ConocoPhillips is already a large blender of conventional ethanol in the United States. As the nation's second-largest refiner and fuels producer, during 2007 our marketers in the United States sold about 425 million gallons of ethanol, equivalent to a nationwide blend rate of 4.7 percent. About 55 percent of our gasoline sales contain ethanol. Additionally, we are rapidly expanding our U.S. ethanol blending capabilities. We have expanded capability for blending ethanol to 120 terminals this year (including proprietary and third party terminals) and are evaluating additional expansions. We are selectively adding biodiesel blending capabilities, although this fuel is currently priced higher than petroleum-based diesel fuel, and the economics of blending are challenged.

E-85 fuel is being test marketed under our branded canopy in a number of states with over 2,500 potential sites, provided the marketer meets certain image, safety and fuel-quality guidelines. Thus far, the consumer response to E-85 has been disappointing. Many retailers who have installed E-85 dispensers report insufficient consumer demand to justify the expense of the conversion. The problem is that only 3 percent of the U.S. passenger vehicle fleet possesses flexible fuel capability today and consumers who own these vehicles are often unaware of it. In addition, consumers are concerned about the roughly 25-percent reduction in gas mileage sustained from using E-85 versus conventional gasoline.

Biodiesel is also being test marketed under our branded canopy, with under-the-canopy sales of unbranded B11 in Illinois and of branded B5 in certain farm states, again provided that the marketer meets specific image, safety and fuel-quality guidelines. Over 800 branded sites could potentially pilot market biodiesel in certain states.

The company is also engaged in the development and production of new biofuels that have a better environmental footprint than existing sources. We currently produce renewable diesel fuel at our Whitegate refinery in Ireland using vegetable oils as a feedstock, and are test manufacturing the process at the Borger refinery (a joint venture with EnCana) in Texas as part of our arrangement with Tyson Foods to utilize by-product animal fat as a feedstock. The technology is performing well, but the economics are threatened by rising raw material costs

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00299 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.237

and the prospective loss of federal tax credits that are available to competing biomass-based diesel fuels.

ConocoPhillips conducts or funds internal and external research on new biomass fuels and has a joint development agreement with Archer Daniels Midland to develop fuels from agricultural waste. We have a major relationship with Iowa State University to research all phases of biofuels, and are a founding member of the Colorado Center for Biorefining and Biofuels, a cooperative research and educational center devoted to the conversion of biomass to fuels and other products.

Further, ConocoPhillips has created an internal group dedicated to evaluating opportunities to invest in solar, wind and geothermal power projects.

Alternative automotive technology – ConocoPhillips has participated in the FreedomCAR and Fuel Partnership with the U.S. Department of Energy, automobile manufacturers and other fuel providers since 2003. We are also working to facilitate wider use of electric vehicles by developing high-performance materials for lithium-ion batteries, a critical component in these vehicles.

Gasification – ConocoPhillips' E-Gas™ technology is a leading, commercially proven gasification technique. We are developing projects based on this technology and licensing it to others to utilize in producing synthetic natural gas, electrical power and a variety of chemicals. Our two major E-Gas™ equity gasification projects could be on line by 2014, at total expected gross capital costs of up to $7 billion.

Heavy oil and unconventional oil and natural gas – ConocoPhillips is presently undertaking significant research to improve the recovery of heavy oil and unconventional oil, such as oil shale, and improve energy efficiency throughout the production, transportation and processing value chain. We are also undertaking research and development focused on reducing their environmental footprint in terms of greenhouse gas emissions, water and land use.

Other focus areas for our research and development efforts include improving recovery of challenged natural gas and developing methods to commercially produce methane hydrates.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00300 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.238

Carbon dioxide capture and storage and water usage – ConocoPhillips believes that development of carbon capture and storage (CCS) technology is essential, in that, it will improve the environmental sustainability and acceptability of available fossil fuel resources. The company funds internal research as well as university research programs in the United States, Canada, Australia, Norway and the United Kingdom that are investigating CCS technology and how it can be customized to meet our industry's needs and the needs of our specific sites. We are in the planning phases for selecting several possible CCS sites in the United States and other countries.

ConocoPhillips believes that reducing the footprint of energy production operations on water resources will help improve the sustainability of both conventional and alternative energy sources. We are measuring our freshwater usage and developing detailed water assessments of selected business units, bringing greater focus to water management as a fundamental component of business planning. In addition to technology work underway in our existing Oklahoma laboratories, we recently announced the establishment of the Qatar Water Sustainability Center, with the long-term vision that it will become a corporate center of excellence for water-related technologies.

Path To A Sound Energy Policy

ConocoPhillips believes there are several concrete steps that Congress can take to enhance the nation's energy security. We want to first emphasize that despite the current tight market, the world is not short of energy supplies. Rather, it lacks sufficient political will to develop the vast fossil fuel and alternative resources that are available. Additionally, it is vital to point out that there is no "silver bullet" that would quickly and inexpensively replace fossil fuels and create energy security. Instead, the United States must bring all economic sources of energy to the marketplace, while promoting energy conservation and addressing environmental concerns. Doing so will require a national commitment and strong political leadership, as well as sound insight into the realities of the energy market.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00301 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.239

ConocoPhillips believes a sound U.S. energy policy must incorporate the six actions explained below:

- Encouraging conventional supplies,
- Optimizing biofuels production,
- Encouraging alternative and unconventional sources,
- Lowering the carbon intensity of energy supplies,
- Improving energy efficiency, and
- Encouraging technology innovation

All of these policies are designed to reduce demand and increase conventional and alternative supplies, which are the only effective ways to reduce energy prices and increase energy security. We believe it is equally important for policymakers to refrain from adopting policies that will either increase demand or reduce supply, such as removing important price signals during supply disruptions or raising taxes on the energy companies that need high cash flow to reinvest in new, higher-cost supplies.

Encouraging conventional supplies

U.S. reserves could be increased by suspending federal drilling moratoria on non-sensitive lands and offshore areas that are currently off limits but doing so under strict environmental regulations. All together, these areas are estimated to hold 80 billion barrels of recoverable oil and natural gas equivalent – enough to double current U.S. reserves.

Congress should also facilitate the building of the critical infrastructure needed to deliver energy supplies to the public. The United States needs more ethanol unloading and blending terminals, more pipelines, power transmission lines, and more refinery expansions. But duplicate and overlapping federal and state laws, and overly long and difficult regulatory

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00302 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.240

processes, discourage or delay such infrastructure additions, particularly for refineries. Where infrastructure is clearly needed to serve the national interest, Congress should expedite federal and state permitting processes to ensure a balance between federal, state and local and special interests.

A related issue is the proliferation of different types of gasoline. State mandates require production of 16 localized "boutique" blends for particular markets, multiplied by three different octane grades and by different winter and summer blends. Also, some states now require boutique biofuels blends. The result is a profusion of different fuels, each with its own specifications. These boutique blends raise gasoline prices for consumers, and prevent the transfer of fuels from one region to another in the event of logistical or operational challenges. This causes shortages and price spikes. Congress could alleviate these problems by setting uniform national fuel requirements.

Optimizing biofuels production

Moving to biofuels, the Energy Independence and Security Act of 2007 mandates the use of 36 billion gallons by 2022. While this is a laudable objective, some improvements to that statute are needed.

First, the creation of different "silos" or categories of biofuels reduces flexibility in complying with the mandate, which is likely to cause inefficiency and increase costs. The Act also presumes to know what the best technologies will be 14 years from now. Congress should not attempt to pick "winning" technologies. Instead, a more sound approach would be to enact incentives or mandates that are both technology-neutral and fuel-neutral. For example, it is not reasonable for biodiesel to qualify for tax support, while renewable diesel fuel does not. As long as both processes use renewable feedstock, support should be neutral and treatment equal.

A second concern is mandating a level of biofuels use exceeding 15 billion gallons. Such concentrations will exceed the capability of both the vehicle fleet to consume the fuel and the supply infrastructure to deliver the fuel. Also, advanced biofuels that do not use potential food sources as a feedstock cannot be produced commercially today. The Environmental Protection

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00303 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.241

Agency has the ability to waive high mandated volumes if technology and production have not advanced sufficiently. However, such waivers are made known only a few months before the start of a compliance year, which does not allow fuel providers sufficient time to plan optimized and efficient compliance activities.

A third concern is the current 54-cent-per-gallon tariff on imported ethanol, which penalizes lower-cost and less carbon-intensive imports, such as from Brazil. This tariff should be phased out or eliminated.

Finally, ConocoPhillips is quite concerned about the potential for governments to layer on overlapping policies. For example, we hear that policies are being considered to add a national low-carbon fuel standard on top of a low-carbon renewable fuel standard. The overlap between these programs would further confound the overlap of state programs previously discussed. If the United States continues to overly constrain its production and supply systems, the result will likely be higher fuel costs and possibly even supply outages.

Encouraging alternative and unconventional sources

While alternative and unconventional energy sources will be essential in the future, it is important to recognize that new technologies take time to commercialize and usually cost more than conventional supplies. Here, Congress is at risk of too strongly favoring politically expedient energy sources. The market should determine the best technologies in order to avoid over-reliance on old technologies or uneconomical energy sources.

Lowering the carbon intensity of energy supplies

We would encourage future Congressional policies to focus on lowering the carbon intensity of U.S. energy supplies, and work to encourage the global community to join in this effort.

Congress could take action to reduce our nation's carbon footprint by creating a mandatory framework that would lower our greenhouse gas emissions, and set a price for carbon avoidance. This could be done by either a tax or a cap-and-trade system.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00304 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.242

Incentives should be offered for development of carbon capture and storage, as well as establishing a national legal and regulatory framework for liability and permitting. And the government should provide access to federal lands that offer the potential for underground carbon storage.

Next, Congress should encourage greater use of renewable sources – such as solar and wind power – by extending their investment tax credits by five years at a time. This would help provide the financial certainty needed for investment. Development of these renewables benefits the public at large and should be paid for with public funding, not by imposing discriminatory tax provisions on three or four American companies, as is being considered.

Congress should also encourage greater use of nuclear power. To do so, the federal government should fulfill its commitment to dispose of waste generated by nuclear power plants. It should also sponsor research into advanced technology that uses the fuel more completely – while reducing waste volumes and half-life – and lowering proliferation risks.

Improving energy efficiency

The Energy Independence and Security Act of 2007 did much to improve fuel efficiency standards for light-duty vehicles and appliances, and ConocoPhillips commends Congress for this bold action. We also encourage governments to take action to slow the rate of growth in peak electricity use, which would otherwise increase natural gas demand in the United States. The government could help reduce peak electricity demand by enacting regulatory and fiscal incentives that encourage utilities to reduce electricity demand by offering more transparent real-time pricing that shows consumers the cost of power as they use it.

Encouraging technology innovation

It is also vital that Congress encourage investment in new technologies in all areas of energy conservation and development. Both the public and private sectors should increase spending on energy research and development. Government technology investments should be made in a transparent and market-based manner, with incentives going to the best ideas.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00305 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.243

The government could further drive technological innovation through greater support of education. With half of the energy industry's technical work force expected to reach retirement eligibility in the next 10 years, there is growing need for more university students majoring in engineering, geology, geophysics and the other technical disciplines.

Policies to avoid

Avoiding policies that will reduce energy security is as important as implementing good policies. We highly recommend avoiding the following policies that we believe will make consumers worse off than they are today.

Petroleum price-gouging legislation – ConocoPhillips does not condone or tolerate taking advantage of consumers in times of crisis. However, we do not support price gouging legislation because it will exacerbate shortages during supply disruptions and consumers will be worse off.

Price gouging is a difficult concept to define. Many state statutes and regulations that attempt to address price gouging utilize definitions that either are difficult to apply or fail to give clear guidance as to what constitutes "price gouging." This makes it difficult for businesses to comply and governments to enforce. More importantly, price gouging legislation tends to function like price controls, which distort market price signals that act to efficiently allocate fuel. During supply disruptions, the rising price sends an important signal to consumers to conserve and suppliers to move more refined product into the impacted area. In this manner, the balance between supply and demand is restored. Without this price mechanism, panic stockpiling would increase demand and additional supplies would not be forthcoming. The shortage would be exacerbated. That is exactly what we saw in the early 1970s when price controls caused long lines at gasoline stations. According to the American Council for Capital Formation, if price controls were in effect following Hurricanes Katrina and Rita, it would have added an extra $1.9 billion in economic losses due to supply shortages.[37]

[37] Dr. Margo Thorning, "U.S. Gasoline Supplies: What Should Congress Do?" American Council for Capital Formation, June 13, 2007, page 2

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00306 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.244

Markets are working. Repeated investigations, including those associated with hurricanes Katrina and Rita, have consistently found that petroleum markets operate competitively. The FTC concluded in their investigation of post-Katrina gasoline price increases "in light of the amount of crude oil production and refining capacity knocked out by Katrina and Rita, the sizes of the post-hurricane price increases were approximately what would be predicted by the standard supply and demand paradigm that presumes a market is performing competitively."[38] The FTC also concluded that "evidence gathered during our investigation indicated that the conduct of firms in response to the supply shocks caused by the hurricanes was consistent with competition. After both hurricanes, companies with unaffected assets diverted supplies to high-priced areas. This is what we would expect in competitive markets. Refiners deferred scheduled maintenance in order to keep refineries operating. Imports increased and companies drew down existing inventories to help meet the shortfall in supply."[39] The industry's supply response after these hurricanes that temporarily shut down nearly 30% of total U.S. refining capacity was so effective that the average retail gasoline price returned to pre-hurricane levels within one month of the landfall of Hurricane Rita.

Tax increases on the oil industry – H.R. 5351 contains a number of tax incentives for alternative fuel and conservation programs that would be paid for by the oil industry. Specifically, this bill repeals the Section 199 domestic manufacturing deduction for the major integrated oil companies. It would discriminatorily deny our company the benefit of a tax deduction that is available to every other industry. It would discourage new domestic oil and natural gas investments by making those comparatively costly energy projects even less economically competitive with competing foreign investments. The Section 199 deduction encourages more oil and natural gas production in this country and in doing so, preserves high-paying U.S. jobs, which was intended by its enactment.

H.R. 5351 would also further restrict our industry's use of foreign tax credits, which would negatively impact our ability to compete for the energy resources that American consumers

[38] Federal Trade Commission, "Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases," Spring 2006, page 17
[39] Ibid., page 17

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00307 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.245

need. The foreign tax credit has been characterized by some as a "tax break" for our industry. It is not. It simply eliminates double taxation.

We are also concerned about proposals for windfall profits taxes on the oil industry. We are concerned that any tax increases on the industry would reduce our ability to invest in new supplies, which is already challenged by constrained resource access and high cost inflation. Tax increases reduce the cash available for spending on new supplies and reduce the value of growing or even maintaining high cost, marginal production, which is typical of mature oil basins in the United States. This would further tighten the energy market and increase oil imports – the opposite of Congress' intent. This nation already learned this lesson from the windfall profits tax imposed on the domestic oil industry between 1980 and 1988. According to the Congressional Research Service, this tax reduced domestic oil production by as much as 6 percent and increased oil imports by as much as 16 percent.[40] In addition, much of what is perceived as a windfall today is actually the substantially higher cost structure of the industry.

These tax proposals also ignore the fact that our industry already pays more than our fair share of taxes. In a recent survey of 80 diverse American companies, ConocoPhillips' effective tax rate between 2004 and 2006 of 43.6 percent was the highest, about 14 percent higher than the average.[41] Income taxes paid by domestic energy producers have already increased by 460 percent between 2002 and 2005.[42] Income taxes are only one of the ways we contribute to government revenues. We also pay royalties, production and excise taxes, and lease bonuses, the latter of which are paid whether you discover hydrocarbons or have a dry hole. When you take all these other forms of government payment into account, our effective tax rates are much higher. For example, our incremental fiscal-take rate[43] in Alaska is about 90 percent at current oil prices.

---

[40] U.S. Congressional Research Service, "The Windfall Profits Tax on Crude Oil: Overview of the Issues," September 12, 1990, page 2

[41] Martin A. Sullivan, "Reported Corporate Effective Tax Rates Down Since Late 1990s," Tax Notes, February 25, 2008

[42] U.S. Department of Energy, Energy Information Administration, "Performance Profiles of Major Energy Producers 2006," Table B12 ($14.5 billion in 2002 to $81.5 billion in 2006)

[43] The amount of an incremental dollar in revenue that is paid to the government (state and federal) in the form of production taxes, royalties, federal and state income taxes and any other taxes; incremental rate in Alaska is 90% at $115/bbl oil price

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00308 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.246

Conclusion

Improving energy security and reducing the risk of climate change are formidable challenges. As one of America's leading energy suppliers, ConocoPhillips intends to be part of the solution to both problems. We encourage an atmosphere of cooperation between the U.S. Congress and the energy industry and we are eager to engage with you in finding solutions for meeting this country's energy needs.

Unfortunately, at a time when the world needs more energy, rising worldwide resource nationalism in other countries and limited access to resources here at home are impeding our crucial efforts to replace current production with new reserves. In other countries, governments work closely with their domestic energy industry to assure access to resources and to build critical energy infrastructure. In the United States, government regulations have made it increasingly difficult to develop new sources of supply and build new energy infrastructure. The threats made by some to increase taxes on an industry that already has very high tax rates will, if carried out, further reduce our ability to expand supply.

The United States has much to gain from a healthy U.S. energy industry that can compete domestically and globally to expand the energy supply available to the United States. Actions taken to weaken the U.S. energy industry will accelerate the shift in control of resources into the hands of national and foreign oil companies at our expense. China, India, the European Union and other nations are deeply engaged in helping their energy industries capture resources to meet the future energy needs of their constituents. We must work together to ensure that our nation's energy needs are met.

Again, Mr. Chairman, thank you for inviting ConocoPhillips to participate in today's hearing. We look forward to working with this important Committee in the days ahead.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00309 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.247

Senate Judiciary Committee
May 21, 2008

Written Testimony

Robert A. Malone
Chairman & President, BP America

My name is Bob Malone and I am Chairman and President of BP America.

BP appreciates the opportunity to provide the Committee with information concerning our operations and investments. I am proud of our investments and the commitment they represent to the development of a secure energy future in the US. I am here today to convey BP's perspective about the marketplace and share our understanding of the choices we as Americans must make in order to ensure a diverse and adequate energy supply for future generations.

We are privileged to be the nation's largest producer of domestic oil and gas and one of the nation's largest energy investors. In 2007 BP's US production of oil was 513,000 bpd and gas production was over 2 Bcfd.

We operate the largest integrated solar manufacturing plant in the United States in nearby Frederick, Maryland.

We are major investors in wind generation and have amassed a land portfolio capable of potentially supporting 15,000 megawatts (MW) of wind generation, one of the largest positions in the country. We are building 700 MW of wind generation this year and expect to have an installed capacity of 2,400 MW of wind power by the end of 2010.

We are one of the largest blenders and marketers of biofuels in the nation. Last year, BP blended 763 million gallons of ethanol with gasoline and we are underwriting cutting edge research – investing

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00310 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.248

more than $500 million over the next 10 years –in the search for a new generation of biofuels that contain more energy... have less impact on the environment... and which do not reduce the supply or increase the cost of food. Further, we just announced the creation of a new $1 billion joint venture in Brazil that will build two sugarcane ethanol manufacturing facilities to supply Brazil and the growing demand markets in the US and Europe.

BP and ConocoPhillips have recently announced the launch of Denali - The Alaska Natural Gas Pipeline project. Denali will be largest private sector construction project ever built in North America, and the first major commercialization of Alaska North Slope gas.

We are attempting to develop hydrogen power generation with carbon capture and sequestration. In California we are evaluating a $2 billion, industrial scale project that will use petroleum coke to make hydrogen for use in power generation. Carbon dioxide, a byproduct of producing hydrogen, will be captured and safely and permanently stored underground.

In short, BP America is working to expand the supply of energy available to the United States and is committed to continue reducing the environmental impact of both energy production and consumption.

Our approach has been shaped by a hard truth.

Hard Truths

The US today is faced with tremendous energy challenges. It is experiencing the impact of years of policies, poor market dynamics and company decisions that have limited access to resources, discouraged development and constrained new investment to meet growing consumer demand for energy. BP recognizes the negative effects high prices have on the economy and the consumer. We alone can't change the conditions that brought us here. Energy companies, policymakers and consumers all have a role to play in creating a new energy future for the US.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00311 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.249

This relationship must be shaped by the recognition that the US economy needs both to better conserve energy and to produce more energy of every type to meet growing demand. We need to invest in conventional oil and gas. We also need to invest in renewables and alternatives to begin the transition to a low carbon future. However, we must all understand that this future is many years away and that renewables and alternatives will not make a material contribution to total US energy supply for many years.

This view is reflected in a recent study issued by The National Petroleum Council in July of 2007 - Facing the Hard Truths About Energy. It was an in-depth, comprehensive review of the entire energy sector that benefited from participation and support from a diverse group of stakeholders and more than 1000 persons/groups involved in energy.

I have integrated its observations and conclusions below and added emphasis as necessary.

There is no single, easy solution to the global challenges ahead. Given the massive scale of the global energy system and the long lead-times necessary to make material changes, actions must be initiated now and sustained over the long term. Over the next 25 years, the US and the world face hard truths about the global energy future:

- ***Coal, oil, and natural gas will remain indispensable to meeting total projected energy demand growth.***
- *The world is not running out of energy resources, but there are accumulating risks to continuing expansion of oil and natural gas production from the conventional sources relied upon historically. These risks create significant challenges to meeting projected total energy demand.*
- *To mitigate these risks,* ***expansion of all economic energy sources will be required, including coal, nuclear, biomass, other renewables, and unconventional oil and natural gas****. Each of these sources faces significant challenges including safety, environmental, political, or economic hurdles, and imposes infrastructure requirements for development and delivery.*

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00312 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.250

The Council proposed five core strategies to assist markets in meeting the energy challenges to 2030 and beyond. All five strategies are essential, the US must:

- ***Moderate the growing demand for energy*** *by increasing efficiency of transportation, residential, commercial, and industrial uses.*
- ***Expand and diversify production*** *from clean coal, nuclear, biomass, other renewables, and unconventional oil and gas; moderate the decline of conventional domestic oil and gas production; and increase access for development of new resources.*
- ***Integrate energy policy into trade, economic, environmental, security, and foreign policies****; strengthen global energy trade and investment; and broaden dialogue with both producing and consuming nations to improve global energy security.*
- ***Enhance science and engineering capabilities*** *and create long-term opportunities for research and development in all phases of the energy supply and demand system.*
- ***Develop the legal and regulatory framework*** *to enable carbon capture and sequestration. In addition, as policymakers consider options to reduce carbon dioxide emissions, provide an effective global framework for carbon management, including establishment of a transparent, predictable, economy-wide cost for carbon dioxide emissions.*

The above excerpts only begin to touch upon the level of analysis contained in the nearly 400 page report. This report provides a complete assessment and a non-partisan roadmap on how and what to do in the area of energy policy.

BP Operations in America

BP's US operations have been challenged over the last few years - significantly impacted by a series of accidents and operational problems in both our refining and upstream businesses. BP has made significant investments to upgrade its assets, strengthen operations, improve its safety performance, and enhance compliance to prevent another such period from happening again.

Over the last 5 years, BP in America earned approximately $31.7 billion after-tax. Income taxes paid over the period have steadily increased to an effective rate of 37% in 2007 – with BP paying over $14 billion in income tax over the period. Regarding investments,

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00313 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.251

over the last 5 years BP has reinvested in the US $31.5 billion into projects across the energy spectrum. In 2007 alone, we invested three quarters of a billion dollars or 10 percent of our $7.5 billion US capital budget in alternative energy. And, over the next decade, we expect to continue to invest an average of $6 billion a year.

There are some who say oil industry profitability is excessive. But this ignores the size and scale of our business. Comparing oil industry performance to that of the broader market average (Exhibit 1) shows that our earnings are comparable. Looking at all the industrial sectors, oil and gas industry performance was in the middle of the pack (Exhibit 2).

BP's investments stretch from the Gulf of Mexico to the North Slope of Alaska and from the East Coast to the Midwest and the West Coast. The company's major spending programs also touch every major segment of the energy industry, from exploration and production of oil and natural gas through refining and distribution of fuel products, as well as alternative energy and biofuels. By heavily investing in a diverse range of energy sources – from traditional oil and natural gas production to alternative and renewable energy including solar, wind and hydrogen power – BP is helping meet America's energy needs today while ensuring a more secure energy future.

Below is a partial list of our current major investments:

Energy Biosciences Institute - $500 million
The institute is a joint collaboration with the University of California Berkeley, University of Illinois – Urbana Champaign and the Lawrence Berkeley National Lab. The project will look at the entire biofuels value chain – from feedstock to enzymes to process and on through to advanced biofuels molecules.

Colorado Natural Gas - $2.4 billion
Increase ultimate recovery of coalbed natural gas from the San Juan Basin of southwestern Colorado by an estimated 1.9 trillion cubic feet. The 13-year development program would

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00314 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC
43354.252

increase current BP net production of 425 million cubic feet per day by more than 20 percent, and maintain production above present levels for more than a decade.

Whiting refinery modernization - $3.8 billion
Upgrade and expand the Whiting refinery to increase Canadian heavy crude oil processing capability by about 260,000 barrels per day. The project also has the potential to increase motor fuels production by about 15 percent, or about 1.7 million additional gallons of gasoline and diesel per day.

Wind Power - $700 million
BP and its partners invested about $700 million in 2007 to develop wind capacity throughout the US, including California, Colorado and Texas. During 2008, BP will construct 5 US wind farms with a total generating capacity of 700 MW and a total value of over $1.5 Billion. This will bring our total installed capacity of wind generation to over 1,000 MW by the end of 2008. By 2010, we expect to have 2,400 MW installed. This is enough power to meet the needs of 720,000 households.

Solar Manufacturing Expansion - $97 million
BP is expanding the BP Solar manufacturing facility in Maryland, nearly doubling its capacity. When completed in 2009 the plant will have a manufacturing capacity of 150 MW in its casting and sizing processes.

Deepwater Gulf of Mexico - $20 billion
BP is increasing exploration and production of oil and gas from deepwater reservoirs in the U.S. Gulf of Mexico. BP will continue development plans to explore new lease area and bring producing areas on-line (Thunderhorse, Atlantis...).

Alaska renewal - $685 million
BP is investing hundreds of millions of dollars in Alaska each year to commercialize and produce the billions of barrels of known oil resources in our Alaska portfolio. We have enough

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00315 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC
43354.253

known oil and gas resources to sustain production for the next 50 years but this will require billions of dollars in new investments.

Wyoming Natural Gas - $2.2 billion
Over the next 15 years BP will double our natural gas production in Wyoming. Several hundred new wells are planned in the Wamsutter Field, BP's largest onshore development drilling program.

Husky Energy Joint Venture – $5.5 billion
BP and Husky will jointly develop Canadian oil sands resource and upgrade and modernize BP's Toledo, OH refinery. When fully operational the project is expected to deliver an incremental 200,000 bpd of oil to the US market and allow Toledo to produce 600,000 gpd more product to Midwest consumers.

Denali – The Alaska Gas Pipeline - $600 million
BP and ConocoPhillips have launched this project to bring 4 Bcf of Alaska gas to markets in the lower 48 states. The project is expected to cost in excess of $30 billion and will be the largest private sector construction project ever built. Near term spending will be to advance the project to an open season within the next 36 months.

However, as we look to the future, the US investment climate is deteriorating. Various efforts have unnecessarily impeded viable and critical infrastructure projects; promising development areas have been declared off-limits; existing manufacturing operations have been challenged in their efforts to upgrade and expand; and new taxes have been proposed which will discourage future energy resource development. Furthermore, these stumbling blocks exist across the energy profile and are not just confined to oil and gas activities.

Support for Renewables

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00316 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.254

Emblematic of these gaps are policy discussions concerning how to support and fund the development of alternative energy resources like wind, solar and biofuels. Not surprisingly, policymakers and consumers generally support efforts that promote the development of renewable energy. As reflected in our investment portfolio, BP concurs with this sentiment. However, there is significant divergence of opinion regarding the question of how to fund the necessary financial incentives.

BP strongly supports the renewal of incentives for wind, solar, and biofuels. They are an important part of why the US has been so successful in developing its renewable energy sector, but we cannot support a tax package that discourages efforts to bring on other much needed energy sources (oil and gas production). As shown in Exhibit 3, the oil industry is already heavily taxed compared to others in the manufacturing sector. In fact, the effective rate for 2006 was nearly double that for all manufacturing companies.

Despite the growth and development activity we are experiencing in alternatives, they cannot close the supply gap that is projected to occur over the next 20 year period. Fossil fuels like coal, oil, and natural gas will be critical to meeting expected energy demand growth.

Based on our experience in developing renewable infrastructure, there are many non-financial opportunities that would be effective in stimulating additional investment. These include:

- Expedited siting and permitting of transmission to allow for the distribution of clean power (wind, solar) from generating areas to load centers;
- Providing for market, time-of-day pricing for solar power installations to allow homeowners and others to provide excess power back to the grid during the peak demand periods at the same rate utilities charge others;
- Adopting a renewable portfolio standard (RPS) that requires power generators to utilize renewable sources like wind and

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00317 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.255

solar in their mix. Experience has shown that in those states that have a RPS, renewable usage has increased significantly.

Biofuels

Similar policy gaps exist in the area of biofuels. Last year's energy bill created significant opportunities to develop and grow the contribution of biofuels to the transportation fuels market. BP shares the view of policymakers that biofuels may be able to attain penetration rates of 30% by 2030 thus playing a huge role in meeting future transportation needs. However, the legislation created new challenges that could in the end create market distortions, supply disruptions and higher consumer prices if not adequately addressed. First, the implementation timetable is very aggressive, creating a risk to delivery of fuel in sufficient quantities to the markets where it is needed. Congress, while mandating biofuels blending, did nothing to ensure that the market was prepared to accommodate the huge storage, transportation and delivery infrastructure requirements necessary to get the product to the consumer.

Perhaps the greatest concern is that if biofuels producers can't supply – fuel retailers pay a penalty; if biofuels manufacturers can't produce – fuel retailers still pay a penalty. In order to make the emerging biofuels market work effectively, there must be a shared obligation with biofuels producers to ensure product reaches the consumer at the lowest possible price. Further, we support efforts to transition incentives away from first generation biofuels to support the research, development and deployment of advanced non-food feedstocks, conversion technologies and fuel molecules. Similarly, policymakers should explore how trade policy can be improved to stimulate greater worldwide biofuels production and supply options for the US.

Climate policy

Our nation will face difficult choices as we take steps to foster economic growth, ensure our nation's energy security and protect the environment. Chief among these environmental concerns is that of global climate change.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00318 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.256

A decade ago BP was the first oil company to acknowledge the need to reduce greenhouse gas emissions. In the years since, we have worked to reduce emissions from our own operations and to provide consumers with cleaner, lower carbon energy options. However, because the energy industry is so large, diverse and complex, there are limits to what a single company or a single facility can do to address this global problem.

For that reason, BP has long advocated for the creation of a single, mandatory US greenhouse gas emissions registry and a market-based price for carbon. Market-based programs deliver the greatest and fastest reductions at the least cost. Just as important, they create a level playing field, meaning that everyone must be part of the solution and first movers aren't placed at competitive disadvantage.

The fact that Congress has not yet addressed national climate policy has not deterred some from trying to impose requirements as if a national policy existed.

Most recently, legislation has been adopted to discourage development of Canadian oil sands - the single largest oil resource base outside of Saudi Arabia. Additionally, a bill has been introduced to prevent the US from utilizing its world leading resource position in coal for power generation. Similarly, efforts are underway to either allow or encourage state or local jurisdictions to try and impose CO2 reduction targets on individual projects in order to make them uncompetitive and further discourage resource development.

Why do I mention these examples? They clearly represent efforts to limit energy development opportunities that would enhance US energy security, economic development and environmental protection. One may only conclude that by limiting engagement, understanding and dialogue concerning the choices facing consumers, the public will accept the notion that all fossil fuel energy development should be discouraged.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00319 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.257

We believe Congress should set policy goals and allow the market to decide which technologies best deliver upon the objectives it sets. To do otherwise stifles the very technology breakthroughs and developments Congress supports.

Energy imports

Over the years, US policy has, in effect, encouraged oil and gas providers to look beyond the US border to meet growing US energy demands, yet policymakers often question our reliance on foreign oil imports. Policymakers also implore OPEC to produce and develop its own oil resources in order to reduce crude oil prices in the US. I question whether it is reasonable to rely on OPEC to solve a problem abetted by inconsistent US policy?

The US should strive to more fully develop its own resource base – to make a greater contribution to world oil supply – otherwise we will increasingly rely on imported energy to meet the needs of our growing economy.

Our nation, with 5 percent of the world's population, demands 25 percent of daily world production. I don't think this is sustainable. The US must produce more of the energy it consumes and has a responsibility to use that energy wisely.

Industry frustration levels are high because we see the potential to greatly expand US development opportunities (Exhibit 4). In fact, we have experience in the US Gulf of Mexico that demonstrates with the proper policy enablers industry will respond overwhelmingly. Since 1985, oil production from the deepwater Gulf has increased 15-fold, from 58,000 to 870,000 barrels per day. Despite water depths in excess of 1 1/2 miles, well depths as great as 30,000 ft and operating temperatures and pressures greater than we have ever experienced, industry responded to Government encouragement to invest, explore and develop this resource base. This is a huge success story as the deepwater Gulf now accounts for every sixth barrel of oil produced in the US.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00320 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.258

We have no reason to believe that this success can't be replicated in other areas across the US.

Energy Markets

Your hearing notice indicated an interest in understanding the drivers behind the run-up in crude oil and gasoline prices. The following provides a brief synopsis of our market view.

Crude oil prices have increased sharply in recent years and have recently set record inflation-adjusted highs. The US benchmark West Texas Intermediate rose from an average of about $26 per barrel in 2001/02 to $72.20 in 2006. So far this year, WTI has averaged $102.51 (through May 6th), and peaked at $121.86 on May 6th.[1]

Tightening oil market fundamentals have been the key driver of higher prices. Economic growth is always a key driver of oil demand, and the world has just seen the strongest 5-year period of global economic growth since the early 1970s. While China has seen strong (and particularly energy-intensive) economic growth, so has the rest of the world.

Complicating this growth profile, some developing countries and oil exporters with rapidly growing economies subsidize prices in their domestic markets, thereby shielding consumers from the impact of rising world prices. For example, Venezuelan drivers pay about 7 cents per gallon—the world's lowest price—and Iranian drivers pay about 42 cents per gallon.[2]

Supply factors have also contributed to higher prices. Production is declining in mature provinces such as the US, the North Sea, and Mexico. Growth in Russian production has slowed. Shortages of labor and supplies as our industry has ramped up spending, combined with growing resource nationalism, have resulted in widespread project delays.

---

[1] Source for price data: Platts
[2] Venezuela: NY Times 29 Oct 07; Iran: Yahoo News 17 Mar 08

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00321 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC
43354.259

In addition, OPEC has more successfully managed production levels. OPEC production cuts in 2007 were a key factor in reducing inventories and increasing prices. In addition, a number of OPEC members have experienced supply outages in recent years that continue to affect production levels, beginning with the PDVSA strike in late 2002 and including the Iraq war and civil unrest in Nigeria.

In addition to current fundamentals, changing expectations about the future have also affected oil prices. Many observers feel that geopolitical risks to oil supply have increased in recent years. Expectations of rising costs (including taxes) as well as policy changes in oil-producing countries that constrain the industry's development opportunities have bolstered long-term price expectations.

At the same time, a variety of factors have resulted in growing interest among financial investors in oil and other commodities. Recently, investors have responded to fears about a US economic downturn and a weakening dollar by seeking safety in oil and other stores of value, such as gold.

All of these factors have increased the price of oil.

The capacity for energy companies to respond with more supply has been constrained by several factors:

- The project development capacity of the global energy industry atrophied in the 1990s after years of low prices. Accumulating new specialized labor and equipment takes time and is expensive.
- Marshalling sufficient labor, materials, and equipment has been slowed by competition for resources from other industries that also took part in the rapid global economic expansion earlier this decade. The shortage of workers with relevant skills in the sciences is a particular concern.
- Finally, governments have limited the ability of companies to respond by limiting access to resources and raising the cost of

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00322 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC
43354.280

doing business through new taxes and greater government regulation.

Given the labor and equipment capacity constraints, companies can and do continue bidding for a limited number of resources (drill ships, platforms, supply and heavy lift vessels) needed to produce oil. This has raised the cost of producing oil in the US and around the world.

What are the impacts of high oil prices?

Both producers and consumers are responding to higher prices. Our industry is growing investment rapidly: Official DOE data shows that US onshore Lower48 production rose in 2006 and 2007—the first increases since 1985. More broadly, non-OPEC supply continues to increase, driven by new investments in deepwater production, heavy oil, and biofuels. Consumers are also responding: Despite above average economic growth, global oil consumption growth was below average in 2006 and 2007.

However, medium-term fundamentals continue to look supportive of a high crude oil price. It appears unlikely that the outlook for supply and demand will result in a massive build-up of OPEC spare capacity as was seen prior to the price collapse in the mid-1980s.

Oil has always been—and will remain—a cyclical commodity. Lead times for capital-intensive projects are long—it can take upwards of a decade to develop a deepwater oilfield, and (on the demand side) 15 years to turn over the vehicle fleet. It is reasonable to expect that prices will again experience a downside of the cycle...at some point. At the same time, a number of factors—such as rising taxes, more costly forms of production, and difficulty accessing reserves—suggest that prices will remain above previous lows in any future downturn.

How does oil price influence gasoline price?

As shown in Exhibit 5, gasoline and diesel product price trends virtually mirror those of crude oil over the last 6-year period.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00323 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.261

However, examining recent price movements reveals that for the period of January 1 through May 8, 2008 gasoline price increases have lagged those experienced in the crude oil market (Exhibit 6, API, and NYMEX)

Exhibit 7 graphically represents the components that make up the cost of a gallon gasoline:

- The biggest single component of retail gasoline prices is the cost of the raw material used to produce gasoline - crude oil. Crude oil alone makes up 70 percent of pump prices (API, 2007 EIA data).
- Another major factor in gasoline prices is federal, state and local taxes, which account for 13 percent of the cost (API, 2007 EIA data). The nationwide average for gasoline taxes is currently almost 46 cents per gallon.
- Refining the crude oil into gasoline and retailing accounts for 17 percent of the retail price (API, 2007 EIA data). Refining costs can be affected by several factors:
    - U.S. refineries customarily reduce production each spring for routine maintenance before the heavy summer driving season.
    - Costs to comply with various government fuel regulations
- The imbedded profit within the refining and retailing of gasoline is currently about 7.5%.

Service stations may sell gasoline from a major oil company, but about 95% of stations are operated by independent business people who determine their own prices, which include a margin to pay for their cost of doing business and to provide a profit (although a profit can't always be assured).

Retailers base pricing on a variety of factors including the station's location and size, and such expenses as delivery costs, taxes, and contractual obligations to suppliers. Retailers also react to the prices charged by competing stations. If a station prices its gasoline too high compared to competitors, customers may take their business to

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00324 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.262

a station with lower prices. If a station loses enough volume, it may then reduce prices to attract customers.

A station's retail price also typically reflects the cost to replace the gasoline currently in its tanks. If the station doesn't generate enough cash to buy its next delivery, the retailer would be using debt to finance that purchase.

What's next?

As I stated earlier, the US faces energy challenges today because of policies, market dynamics and decisions of the last few decades. Our focus should be to improve the situation and to lay the groundwork necessary to create a secure new energy future. We believe US interests are served by a strong energy industry enhancing US economic growth and enabling successful companies to better compete in the world economy.

Economic development will facilitate the necessary improvements in environmental performance across all sectors. However, a strong economy can't develop absent a coherent, comprehensive energy policy that focuses on near, mid and long-term policy measures.

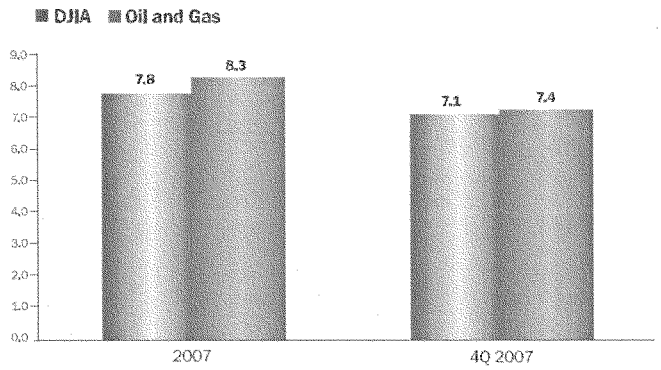
BP has heard from consumers who truly feel the economic impacts of high energy prices. They recognize that prices are the culmination of policy choices made decades ago. Further, they question why energy has become a partisan issue and acknowledge that we as a country should reevaluate the choices that threaten our economic security.

It is my commitment to pursue policies and investments that will enhance oil and gas supplies, produce more motor fuels and begin to make the transition to a lower carbon future. I would like Congress to partner with us in this journey?

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00325 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.283

Earnings of Dow Jones Industrial Average (DJIA) Companies and Oil and Gas Companies
(net income divided by revenue)

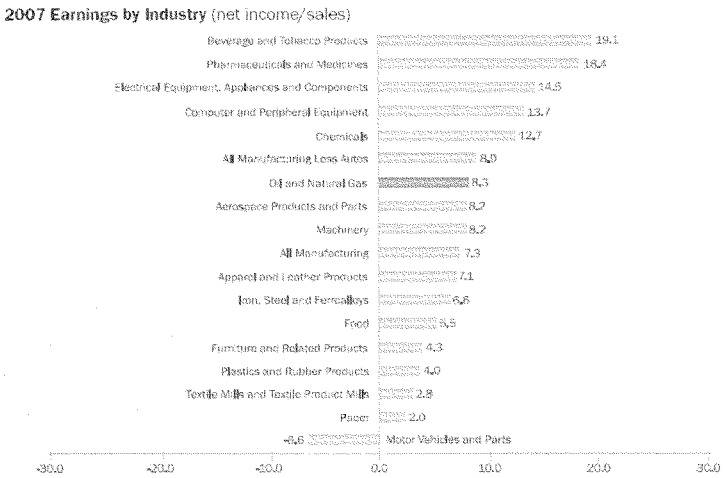


The information contained in this document is based on publicly available information. The companies included in these documents are based on the Dow Jones Industrial companies. However any reference to Dow Jones is for informational purposes only and should not be construed as an affiliation with, sponsorship of, or endorsement of the information or documents in which the Dow Jones name is referenced.

The fourth-quarter and full-year 2007 earnings for the oil and natural gas industry are very large because the companies are very large. But the earnings are not out of line when they are compared with the earnings rate of other Dow Jones Industrial Average companies by measuring the cents earned for every dollar of revenue. In fact, the average earnings rate for the Dow Jones companies is only slightly below the earnings rate for the oil and gas industry. And there are other industries that do far better than oil and gas, including pharmaceuticals, computers and chemicals.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00326 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.264



Sources: Based on company filings with the federal government as reported by U.S. Census Bureau and *Oil Daily*.

It may seem surprising that oil and natural gas earnings are typically in line with the average of other major U.S. manufacturing industries. This fact is not well-understood, however, in part because reports usually focus on only half the story—the profits earned.

Profits reflect the size of an industry, but they're not necessarily a good reflection of financial performance.

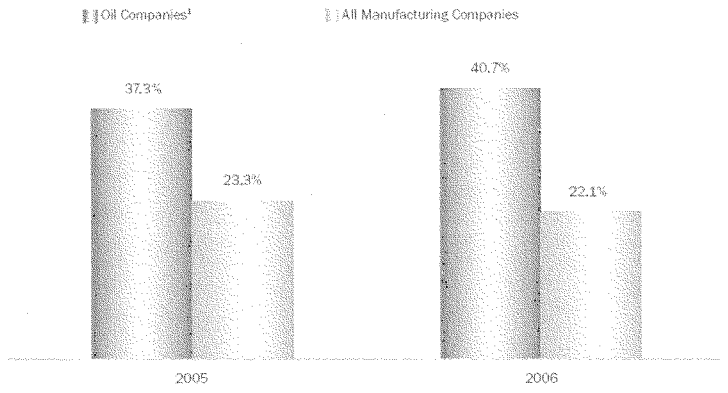
Profit margins, or earnings per dollar of sales (measured as net income divided by sales), provide one useful way to compare financial performance among industries of all sizes.

The latest published data for 2007 show the oil and natural gas industry earned 8.3 cents for every dollar of sales compared to 7.3 cents for all U.S. manufacturing and 8.9 cents for U.S. manufacturing, excluding the financially challenged auto industry.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00327 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.265

Income Tax Expenses as Share of Net Income Before Income Taxes



Source: EIA, *Performance Profiles of Major Energy Producers*, Table B2

Taxes: Our Industry Pays More Than All Manufacturing

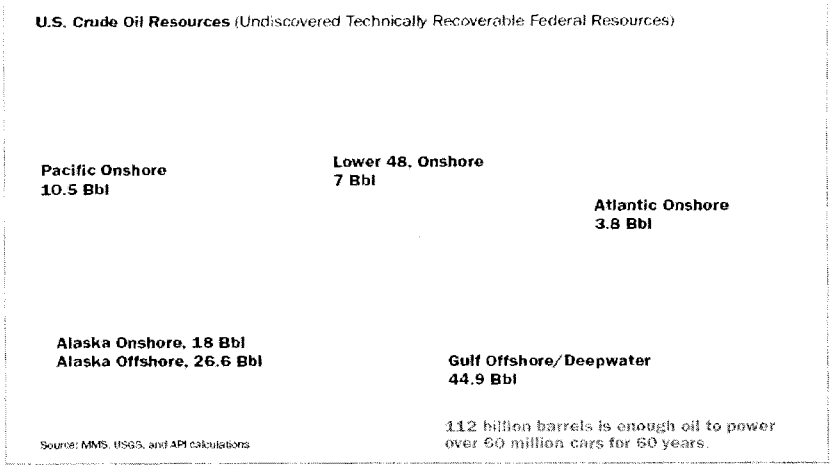
An important part of the revenue earned by U.S. oil and natural gas companies goes to taxes. U.S. oil and natural gas companies pay considerably more in taxes than do manufacturing companies. According to the U.S. Energy Information Administration, the industry's 2006 income tax expenses (as a share of net income before income taxes) averaged 40.7 percent, compared to 22.1 percent for U.S. manufacturing companies.

1 Energy Information Administration, 2006 *Performance Profiles of Major Energy Producers*, December 2007. These 27 companies accounted for about 84 percent of the total U.S. crude and NGL production, 45 percent of natural gas production, 61 percent of U.S. refining capacity and 3 percent of U.S. electricity. These companies include: Amerada Hess, Anadarko Petroleum, Apache, BP America, Burlington Resources, Chesapeake Energy, Chevron, CITGO Petroleum, ConocoPhillips Petroleum, Devon Energy, Dominion Resources, El Paso, EXCO Resources, Equitable Resources, ExxonMobil, Kerr-McGee, Lyondell Chemical, Marathon Oil, Murphy Exploration, Occidental Petroleum, Shell Oil, Sunoco, Texaco Petroleum, Total Holdings USA, Valero Energy, The Williams Companies, XTO Energy

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00328 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.286

U.S. Crude Oil Resources (Undiscovered Technically Recoverable Federal Resources)



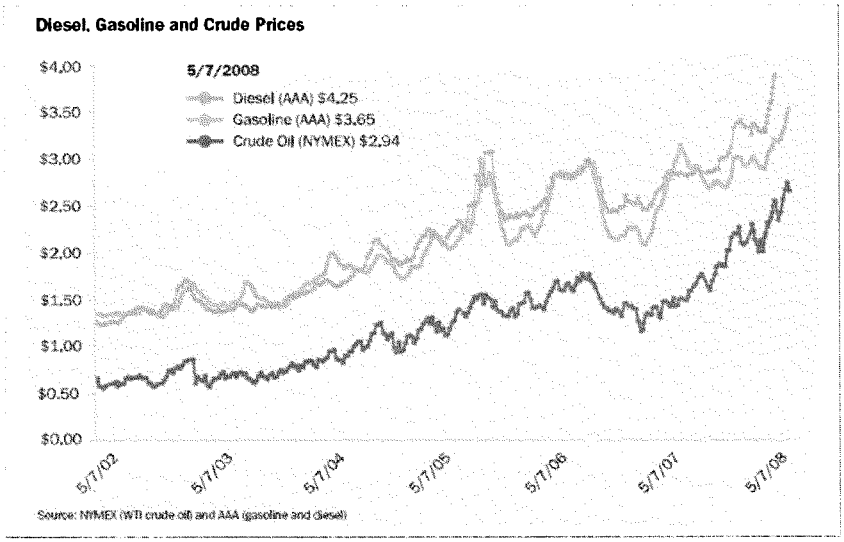
Source: MMS, USGS, and API calculations

Our nation's energy security requires policies that do not disadvantage the investor-owned oil companies, but rather enables them to be competitive in the global marketplace. Our nation needs policies that promote greater supplies of oil and natural gas, not policies that hinder our industry's ability to provide American consumers the energy they demand and need. We have abundant volumes of oil and natural gas resources beneath federal lands and coastal waters, but the bulk of these resources have been placed off-limits to development.

For example, according to federal government estimates, there is enough oil in these areas to power more than 60 million cars for 60 years.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00329 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.267



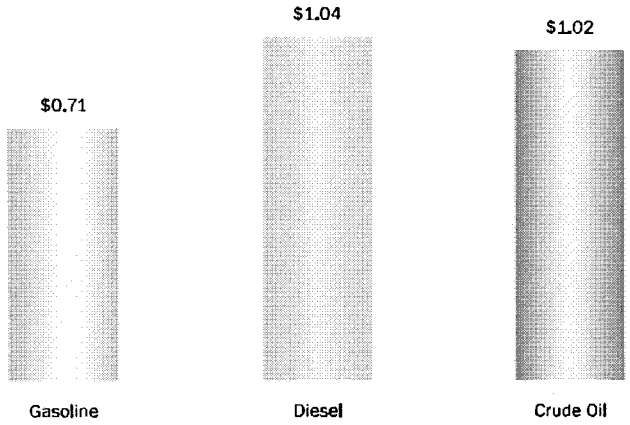
Until recently, gasoline and diesel fuel prices closely tracked the cost of crude oil. But over the last year the supply and demand picture has changed. Demand for gasoline has been met with strong supply fed by record refinery production and high levels of imports. By contrast, the market for diesel is much tighter. While production has been strong, supplies have been limited by weaker imports. The Europeans are exporting less to the United States, because they are keeping more diesel for domestic consumption.

Diesel prices also are higher today, because it is a more advanced, low-sulfur fuel. Such fuels help improve air quality but they are more expensive to refine. Today's diesel contains less than 15 parts per million of sulfur, compared with 500 parts prior to 2006.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00330 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.288

Average Price Increases Year to Date (cents per gallon) — **January 1 to May 8**



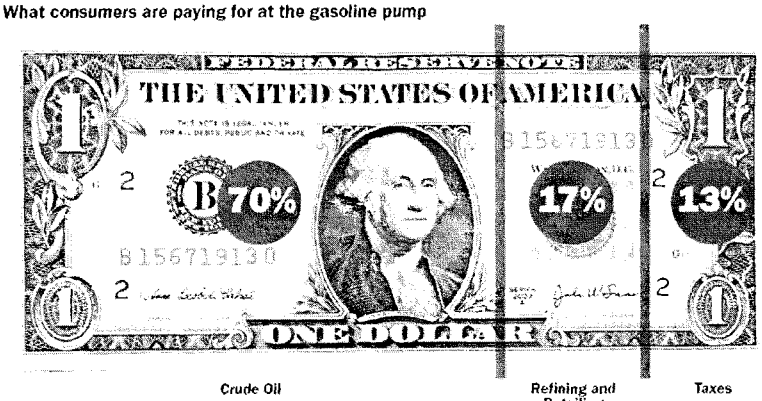
Source: NYMEX (WTI crude oil) and AAA (gasoline and diesel)

The price of West Texas Intermediate crude oil has increased by $1.02 per gallon for the period from January 1 through May 8th of this year compared to the same period last year. Diesel prices are averaging $1.04 more per gallon and gasoline 71 cents per gallon more.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00331 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.289

What consumers are paying for at the gasoline pump



Crude Oil | Refining and Retailing | Taxes

7.5% Earnings*

Source: Average of gasoline components from January through March 2008.

*Earnings differ by company. With 24 companies reporting as of May 8, 2008, figure represents net income divided by sales calculated from company financial reports filed with the federal government.

The biggest single component of retail gasoline prices is the cost of the raw material used to produce gasoline – crude oil. For example in the first quarter of 2008, crude oil alone made up 70 percent of pump prices. Refining the crude oil into gasoline accounted for 8 percent of the retail price. Retailing added another 9 percent to the retail price of gasoline. Taxes accounted for 13 percent of the price of gasoline.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00332 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.270

Peter J. Robertson
Vice Chairman
Chevron Corporation
Statement Prepared for the Senate Committee on the Judiciary
May 21, 2008

Chairman Leahy, Ranking Member Specter, Members of the Committee. My name is Peter Robertson, and I am vice chairman of Chevron Corporation. I am here to represent the more than 59,000 Chevron employees (of whom 27,000 work here in the U.S.) and more than 1.5 million stockholders who put their trust in our company each day. I am proud to be a part of an industry so vital to every American's way of life and to the development and growth of economies around the world.

Given the many challenges our country faces on the energy front, I appreciate the opportunity to appear before you today. I will address the factors behind rising oil and gasoline prices, discuss some realities of the highly competitive global energy market, and outline what Chevron is doing to ensure reliable supplies of energy to U.S. consumers.

Although Chevron has been firmly rooted in California for almost 130 years, our operations and customers span the globe and extend across the entire energy spectrum. Globally, we produce approximately 1.7 million barrels of crude oil per day—less than 2 percent of global demand. Chevron's U.S. production of approximately 410,000 barrels of crude oil per day represents about 8 percent of U.S. total.

We refine, transport and sell petroleum products. Chevron is the sixth-largest refiner in the U.S., producing about 5.8 percent of the country's refined products. And we blend ethanol into almost 40 percent of the gasoline we sell in the U.S.

Chevron is a leading producer of renewable energy. We're the world's largest producer of geothermal energy (operating 1,250 megawatts), and we're pursuing next-generation biofuels and other alternatives with a number of important strategic partnerships.

Chevron is unique among major oil companies as a leading provider of energy efficiency services and clean energy solutions in the nation. Our subsidiary, Chevron Energy Solutions, has a strong track record of providing solar power to large commercial clients across the country. To date, it has handled more than 800 projects, helping clients lower their energy consumption and costs by nearly 30 percent on average.

Chevron strives to be a strong partner in the communities where we operate. Our company supports more than 11,000 large and small businesses throughout the country. Last year alone, we spent $10.8 billion with our business partners in the U.S. and supported 2,000 charitable organizations across 43 states and the District of Columbia.

It is precisely Chevron's size and scope that allow us to successfully compete for the energy resources the world and America needs.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00333 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.271

Strong global demand, weak U.S. dollar have driven up oil prices

As we meet today, the question on the minds of most Americans is, "Why are gasoline prices so high?" The short answer? Because global crude oil prices are so high.

The price of oil has risen recently to above $125 a barrel – a record level and double its price at this time last year. Given that the largest portion of the cost of gasoline is crude oil, gasoline prices have risen to record heights. According to the Department of Energy, a gallon of regular gasoline retailed on average for $3.72 in the first week of May, with the price of crude oil accounting for about $2.65 of this amount. Federal, state and local taxes averaged 47 cents per gallon, making the combined effect of crude costs and taxes $3.12 per gallon or 84 percent. (*See Appendix chart #1)* While the price of crude oil has soared, it is important to understand that the market forces of demand, supply and competition have prevented gasoline prices from keeping pace. That average gasoline price for the first week of May rose 20 percent over the price for the same week last year – a relatively small amount compared to the jump crude has experienced.

Consumers and businesses feel the effects of high crude oil and gasoline prices from the supermarket to the airport. Chevron is both a producer and a user of energy, and we are concerned about escalating oil prices just as any other energy consumer is. To address these concerns going forward, it is important to understand the many factors affecting the price of oil—and, therefore, the price of transportation fuels.

There are fundamental factors affecting the current price of oil, including rising demand, the reduction in the supply system's spare capacity to deal with unforeseen disruptions, the value of the U.S. dollar and the associated flight to commodities, and rising risk—both above ground and below ground.

We have reached a point where worldwide demand is straining the global energy system. Demand in non-OECD countries—what we typically think of as developing nations—is experiencing robust growth, pushing up overall global demand despite essentially flat or slightly lower demand in OECD countries. In fact, growth in non-OECD regions has accounted for over 80 percent of the rise in oil demand since 2000, including rapidly increasing demand throughout Asia, particularly in China and India. The expansion has been driven by exports and infrastructure investment, and has consumed commodities at an unprecedented rate. It is important to highlight that in many important energy-consuming non-OECD countries government treasuries have subsidized price (*Appendix chart #2)*—a factor that has contributed to additional stress on supplies and price.

The Middle East is also in the middle of a substantial investment cycle, a process that has kick-started oil product demand growth in the face of rising oil prices. Thus far, non-OECD oil demand growth has shown few signs of softening despite the U.S. economic slowdown.

It is this economic growth overseas, especially in India and China that has helped hundreds of millions of people to rise above the poverty level to a better quality of life. These basic human aspirations and the resulting energy demand growth are forecasted to continue. Global energy demand is projected to increase roughly 50 percent by 2030, with demand in the Asia-Pacific expected to grow 90 percent over the same period (*See Appendix chart #3)*. And,

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00334 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.272

according to the Department of Energy, demand in the U.S. is also forecasted to grow by 16 percent over the next 20 years.

The accelerated increase in demand since 2004 has reduced the global spare capacity of crude oil, creating a tighter relationship between supply and demand and heightened concerns in markets around the world *(See Appendix chart #4)*. Falling or flat U.S. production is a contributing factor and adds to these pressures. According to the Department of Energy, U.S. crude oil production has fallen approximately 40 percent since 1985, while U.S. consumption has grown more than 30 percent to more than 20 million barrels per day today. In real barrels, U.S. oil production is now approximately 5 million barrels per day— down from approximately 9 million in 1985. The narrowing of spare production capacity in the world means that even when a relatively small amount of resource is at risk of disruption due to a variety of factors, it can affect the price of oil.

This heightened market sensitivity is exacerbated by other risks. "Below ground risk" is increasing as energy is harder to find and more expensive to produce. "Above ground risk" is also occurring around the world. At home and abroad, access to new supplies has been restricted, making it increasingly difficult for the energy industry to invest and expand operations. And calls for increased taxation only serve to shrink the capital base available for energy development. As the recent National Petroleum Council study pointed out, our country's greatest concern relative to future supplies stems not from a lack of hydrocarbon resource but, rather, from the risks to our ability to expand production in a manner timely enough to meet growing demand. Policies restricting access to new areas with resources in the United States combined with naturally declining mature crude oil and natural gas fields have increased U.S. reliance on imports from international sources. *(See Appendix chart #5)*.

Demand and supply pressures on oil prices are compounded by the weakening of the U.S. dollar. The higher oil price is in part a market adjustment that reflects the weakening purchasing power of oil exporting countries that sell their oil in U.S. dollars but buy goods with stronger currencies such as the euro. Additionally, the weak dollar—and concern by stock investors over the subprime issue and its impact on the stock market—has contributed to a flight to commodities by investors seeking better returns *(See Appendix chart #6)*. Oil has gone up along with many other commodities such as gold, corn, copper and even coal.

In the U.S., consumers have begun to respond to the high fuel prices by using less. Recent figures from EIA suggest that petroleum product demand in the U.S. has fallen 1.4 percent over the first two months of the year, compared with the same period last year. Gasoline production at U.S. refineries was at record levels over the first quarter of 2008, leaving inventories at their highest levels in a decade. Capacity increases at existing refineries have added the equivalent of 10 new refineries over the past decade. Overall refining capacity has increased by 20 percent since 1985 even though there are 57 fewer refineries *(See Appendix chart #7)*. That retail fuel prices still remain high underscores the fact that many factors are in play, and, unfortunately, there are no short-term fixes to today's price levels.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00335 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.273

Finally, it is important to note that the U.S. transportation fuel markets are not only well supplied but also highly competitive. We are the sixth largest U.S. refiner and operate five of the nation's roughly 150 refineries. Our market share is less than six percent. Marketing operations are similarly competitive. Chevron is the fourth largest U.S. branded marketer operating under the Chevron and Texaco brands. We have roughly 9,700 of the country's 168,000 branded stations. And it's important to note that 95 percent of our stations are operated by independent business people, who must compete aggressively against at least 40 other companies.

Energy companies are making very little money on retail gasoline sales despite the high price environment. Energy company earnings from the first quarter of 2008 tell the tale. Chevron's U.S. downstream operations – that part of our business responsible for refining, marketing and transportation of gasoline and other refined products – effectively broke even. That portion of our business lost money over the last six months of 2007.

Over the years the Federal Trade Commission has scrutinized our industry carefully. Summarizing its oversight of the industry in 2004, FTC concluded: "In sum, mergers have contributed to the restructuring of the petroleum industry in the past two decades but have had only a limited impact on industry concentration. The FTC has investigated all major petroleum mergers and required relief when it had reason to believe that a merger was likely to lead to competitive harm. The FTC has required divestitures in moderately concentrated markets, as well as highly concentrated markets."[1] *(See Appendix chart #8)*

Energy challenges are immense – so is the infrastructure needed for supplies

To understand today's energy reality, I would emphasize that the energy system is global, vast and complex. For each minute we spend here today, the world will consume the equivalent of 7 million gallons of oil-equivalent. For decades it also has delivered energy to over a billion people around the globe efficiently and reliably. The infrastructure that produces energy in one part of the world and delivers it to another is highly interconnected—physically and to the global markets that set oil prices. Each depends upon the other. Although the United States is a key producer and *the* leading global consumer, we are only one part of this global system and cannot be isolated or immune from issues that either shape or upset global market dynamics.

There has never been a more urgent need to be realistic about the energy system's *inter*dependence and its size and scale. We also need to recognize the magnitude of resources—both financial and organizational—needed to keep it running. Today's energy infrastructure requires substantial ongoing investment to sustain production, tap new sources and meet growing demand. In fact, in its 2007 Energy Outlook, the International Energy Agency has projected that the world will require $22 trillion in new energy investments by 2030, with $7 trillion needed to produce the resources—the crude oil, natural gas, coal and biofuels—needed to meet demand. Nearly half of these investments will be in developing countries.

[1] Federal Trade Commission, "The Petroleum Industry: Mergers, Structural Change and Antitrust Enforcement," August 2004

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00336 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.274

As we strive to meet demand, we are overcoming increasingly extreme and remote environments while responding head-on to the challenges posed by climate change. Our industry has evolved over the last 100 years from drilling with relatively simple wooden derricks that barely scraped the earth's surface to complex offshore platforms that produce oil from reservoirs located miles below, where pressures can exceed 20,000 pounds per square inch and temperatures can surpass the boiling point. One new crude oil project on the frontiers of the Gulf of Mexico can cost more than $5 billion and take more than 10 years to bring onstream. A recent expansion of production at the Tengiz field in Kazakhstan which added less than one percent to global oil supplies took more man hours of labor than the construction of the Panama Canal. We will need as many of these projects as we can get.

And costs are escalating. The competition for resources to meet that demand has resulted in rising costs for our industry. Costs in the upstream sector have doubled since the year 2000, reflecting higher prices for everything from steel, drilling rigs and offshore vessels to bulk materials, engineering, construction and labor. Similarly, the capital costs for our downstream refining, processing and chemical businesses are sharply higher.

Today's environment illustrates an industry truism: The era of easy access to cheap oil is over.

There are significant challenges and paradigms about energy that need to be resolved so that we can generate the kind of production at a scale needed to meet U.S. demand. These challenges will take time, money, new infrastructure and advanced technology to solve. For the foreseeable future it also will take contributions from all energy sources—traditional energy, renewables and energy efficiency.

Competing in the global marketplace requires scale and strength

Today's global resources are increasingly nationalized, and single crude oil and natural gas development projects run in the billions of dollars. The search for the next source of energy and delivering it to markets on six continents—whether oil or next-generation fuels from renewable sources—takes enormous capital, specialized expertise, advanced technology and human energy that characterizes Chevron.

From a global perspective, sovereign states and their national oil companies own the majority of the resources consumers need. Chevron ranks 18th in terms of its access to oil reserves. (*See Appendix chart #9*). U.S. energy companies need the scale that is necessary to partner and compete with these large national oil companies to gain access to critically needed energy resources that fuel America's cars, heat America's homes and power America's businesses.

The U.S. is advantaged by having large, well-capitalized oil and gas companies that can partner and compete with this group of national oil companies. And, policies that disadvantage U.S. companies' ability to compete in the global marketplace—such as proposals to levy addition taxes on the industry—diminish our ability to provide new sources of energy.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00337 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.275

Chevron is aggressively investing to develop new energy supplies

We are actively responding to the energy demand of the United States and countries around the world—investing aggressively to develop energy supplies to meet today's and tomorrow's needs. Our activities span a diverse portfolio of energy interests, including traditional oil and gas, renewables, alternatives, energy efficiency services, and research and development in future energies. Between 2002 and 2007, Chevron invested approximately $73 billion back into the business to bring new energy supplies to market—investing what we earned. Some $22 billion of that sum was invested in our U.S. operations.

Our capital program for 2008 is close to $23 billion, an increase of nearly $3 billion over our 2007 investment, and nearly triple what it was in 2004. Globally, Chevron currently has 40 major capital oil and natural gas projects in the planning, engineering or development stage, each with a net Chevron share of the investment over $1 billion. These projects are critical to supplying the energy that the world needs and will be important to closing the gap between supply and demand, which is key to addressing the challenge of high prices. Out of this queue of 40 major supply projects, eight are located in the United States. And there are many other upstream projects under $1 billion that will have significant production once they come onstream.

A number of these projects are situated at the forefront of development and employ leading-edge technology. As alluded to earlier, factors such as size, organizational capability and the ability to assume the inherent risks in developing technology and undertaking large investments are essential assets when competing in today's global energy environment. Even though Chevron is relatively small compared with its nationalized competitors, it is a strong competitor. This is an industry in which size, technological capabilities and financial strength are the new "price of entry," and large-scale and frontier energy developments are the norm versus the exception today and in the future.

Let me highlight an example to illustrate what we do. We are working on several deepwater crude oil and natural gas projects in the U.S. Gulf of Mexico. One of these, known as Tahiti, offers a typical case study in the risks facing this business today in terms of timing, scale and cost. We acquired the Tahiti leases in the 1990s. In 2002, we used leading-edge technology to drill in 4,000 feet of water and found an estimated 400 million to 500 million barrels of recoverable resources. It will take seven years to build the infrastructure required to produce the oil and gas more than a 100 miles offshore. When Tahiti finally comes online next year, we will have invested $4.7 billion—and dedicated personnel and resources for over a decade to manage exploration, permitting, engineering and development —before realizing $1 of return on our investment. Once in production, Tahiti is expected to produce for up to 30 years. Tahiti is expected to add 125,000 barrels of oil and 70 million cubic feet of gas per day to the U.S. domestic supply.

Today in the United States, the major oil and natural gas projects we have under construction have a total peak production capacity of 420,000 barrels per day of oil-equivalent. All these projects are expected to be in production by 2010.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00338 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.276

We are also aggressively developing and applying new technologies to extend the life of existing fields. This year we expect to spend nearly $1 billion on the sophisticated technology and ongoing development activities required to produce as many barrels as possible out of our 100-year-old Kern River field in California. This investment in our base business is a very important. Aside from sustaining our capability to provide oil today, these efforts help us understand how complex oil reservoirs work—knowledge and technology that we can apply around the world so that our partners also can enhance their oil recovery from known resources. In fact, one of the reactions to high oil price has been a renewed focus on existing fields industrywide, a trend that is helpful in the near term and should be encouraged.

Chevron is investing in critical downstream refining and marketing infrastructure

We are also investing in our refineries and marketing business to continue to improve our ability to supply the products U.S. consumers need. We are investing $2.3 billion in 2008 in our U.S. downstream assets. Since 2002, we have invested $5.2 billion and we have developed additional production capacity of more than 1 million gallons of transportation fuel production per day. Our investment in U.S. downstream refining and marketing assets in 2007 accounted for almost half of our 2007 global downstream capital expenditures, even though our U.S. operations only accounted for about a quarter of our downstream business earnings. We also are investing in refineries outside the United States, such as Pembroke, Wales, which can produce gasoline to meet U.S. and California specifications.

Chevron's refinery investments have focused on achieving several goals, including upgrading our capability to provide more transportation fuels from more diverse crude oil feedstocks, improving reliability and energy efficiency, enhancing environmental performance of our facilities, and producing cleaner burning fuels.

At present, we are working on major projects at each of our big three U.S. refineries. We are advancing through the permitting process for projects at our El Segundo and Richmond refineries in California. At Chevron's Pascagoula, Mississippi, refinery, construction began this year on a new gasoline production unit. The project will improve equipment reliability and utilization and allow the refinery to optimize product yields. Gasoline production at the refinery is expected to increase by approximately 10 percent, or about 600,000 gallons per day, upon completion of the project in mid-2010.

Focusing on the longer term, we have recently announced a research and development project to further advance refining technology. Known as VRSH, which stands for Vacuum Resid Slurry Hydrocracking, this technology will help us produce transportation fuels from heavy crude oil otherwise used for other lower-grade petroleum products. We spent almost five years working on the project in a lab setting testing the technology. We announced in March that we are beginning work on a pre-commercial plant at our Pascagoula refinery that will take two years to construct. We will learn more about the technology for a few years before we will be able to confirm whether we can build one of these plants at full scale. Once that decision is made, it will take another several years after that to complete. This kind of step-by-step process is needed to ensure we are making the right decisions. They take time.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00339 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.277

We are committed to remaining a reliable supplier to our customers, but it is important to remember that investments are sensitive to local permitting decisions and market forces. For example, we hope to soon finalize the plans for the Richmond refinery project The process of obtaining these permits has already taken more time than constructing a new state-of-the-art refinery we are investing in with partners in India or completing a major refinery expansion in at our joint-venture refinery in Yeosu, Korea.

At a more fundamental level, government policies—such as the recently passed energy bill with its very ambitious program for renewable fuels—have created new uncertainties over how much additional U.S. refining capacity may be needed to meet future U.S. demand. Nonetheless, we are aggressively investing in the critical energy infrastructure this nation needs to continue to reliably supply fuels to customers.

Diversifying energy and fuel sources

At the same time that we are investing at the forefront of traditional energy such as oil and gas, we also are pursing advances in renewable technologies that are needed to help diversify supply and meet the challenges of tomorrow. To add to domestic energy resources, Chevron and many other companies are making investments in renewable energy. Since 2002, Chevron has spent more than $2 billion to develop renewables and energy efficiency services. Between 2007 and 2009, our spending on renewable technologies and energy efficiency solutions will be an additional $2.5 billion.

Chevron is investing in new technology to unlock the enormous potential of cellulosic ethanol. In 2006, we formed a biofuels business to advance technology and pursue commercial opportunities related to the production and distribution of ethanol and biodiesel in the United States. We recently announced a joint venture with Weyerhaeuser Corporation to pursue the research necessary to commercialize production of biofuels from nonfood sources. Catchlight Energy will work to develop technology that will lead to commercial biofuels production.

And more research is needed. We have strategic biofuels alliances with Georgia Tech, UC Davis, Texas A&M, the U.S. Department of Energy's National Renewable Energy Lab and the Colorado Center for Biorefining and Biofuels. We also are participating with AC Transit in the San Francisco Bay Area (California) on a zero-emission hydrogen bus project.

Chevron is taking aggressive steps to increase energy efficiency

The energy challenges we face, globally or in the United States, cannot be met by addressing only the supply side. It is also important for all of us to realize that the most readily accessible source of new energy is conservation and efficiency. At Chevron, we embrace conservation as an important business strategy, and we are in our 17th year of a focused effort to increase our own energy efficiency. Since 1992, we have increased energy efficiency by 27 percent.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00340 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.278

And through Chevron Energy Solutions (CES), we are delivering energy efficiency projects that benefit federal, state and local governments; the public; and the environment. CES has completed over 800 projects involving energy efficiency and renewable power in the United States. These projects have accounted for over $1 billion in energy and operational savings, helping clients lower their energy consumption and costs by nearly 30 percent on average.

Chevron Energy Solutions has implemented energy efficiency, energy management and related energy improvements at government facilities across the United States. These projects include U.S. military bases such as: Beale Air Force Base, California; Department of the Navy, Marine Corps Logistics Base, Georgia; Department of the Army, Picatinny Arsenal, New Jersey; and the Department of the Army, Corpus Christi Army Depot, Texas. CES also has developed energy efficiency, solar power and clean energy projects for the U.S. Postal Service, including its Processing and Distribution Center in Oakland, California, and Mail Processing Facility in San Francisco, California. Another California solar project at Contra Costa Community College near San Francisco is the largest of its kind at an institution for higher learning in North America. The project, when completed, will generate 3.2 megawatts of solar power and will save the college $70 million in energy costs over 25 years.

The National Petroleum Council Study: Urgent action is needed

There is no single or short-term solution to satisfy the world's growing appetite for energy—or to prevent the United States from being affected by the global energy dynamic. We are in a new energy era, one defined by increased demand and constrained supply.

We need a *range* of realistic solutions, and we need them at scale.

We literally need all the energy we can develop and to use energy more wisely. This includes oil, natural gas, coal and nuclear power. It also includes renewables. And, just as important, it includes a focus on energy efficiency. The U.S. Energy Information Agency forecasts that over the next 25 years oil, coal and natural gas will provide roughly the same 86 percent of the world's total energy mix as they do today. The energy industry and other parties are making investments in all these areas, and it is important that they continue. All are needed to provide important additions to our energy supply portfolio. And all will play an important role in meeting increased energy demand.

At a time when more supply is needed, the United States has been reluctant to access some of its own resources. Chevron and others have been talking about the constrained supply-demand dynamic for the last several years, urging greater access to U.S. resources, onshore and offshore—especially given the time it takes for projects to come onstream. Instead, we have been increasing our demand on exporting countries because of policy decisions made here at home. Any serious measures toward energy security must seek to reverse this equation. As the world's largest consumer of energy, actions we ask of other producers must be matched at home.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00341 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.279

Energy underpins every aspect of our society and our growing economy. The scale and breadth of the U.S. energy system is unsurpassed in the world, as is our energy demand, which is forecast to soon to need 1 million barrels of oil an hour of supplies. A sustained, reliable supply is essential, and that is achieved by bolstering supplies and moderating demand. The Energy Independence and Security Act of 2007 had important measures to moderate demand. However, it missed taking the additional step we believe is also urgently needed— improved access to "off-limits" oil and natural gas resources that we will need 10, 20 and 30 years from now.

Last summer, the National Petroleum Council (NPC) issued a sobering study called "Facing the Hard Truths About Energy," which outlines a comprehensive, integrated approach to U.S. energy security. The NPC study is a broad-based consensus effort representing the views of an impressive range of experts and stakeholders. Input was sought from more than 1,000 other stakeholders, in the U.S. and abroad; there were 350 participants with backgrounds in all aspects of energy including efficiency, economics, geopolitics and environment; 65 percent of participants were from outside the oil and gas industry, including nongovernmental organizations, academia, government, environmental and financial.

The NPC study highlights the need for an integrated national strategy given accumulating risks to the supply of reliable, affordable energy. The study highlights a number of "hard truths":

- Coal, oil and natural gas will remain indispensable to meeting total projected energy demand growth.
- The world is not running out of energy resources, but there are accumulating risks to continuing expansion of oil and natural gas production from the conventional sources relied upon historically. These risks create significant challenges to meeting projected energy demand.
- To mitigate these risks, expansion of all economic energy sources will be required, including coal, nuclear, renewables, and unconventional oil and natural gas. Each of these sources faces significant challenges—including safety, environmental, political, or economic hurdles—and imposes infrastructure requirements for development and delivery.
- "Energy independence" should not be confused with strengthening energy security. The concept of energy independence is not realistic in the foreseeable future, whereas, U.S. energy security can be enhanced by moderating demand, expanding and diversifying domestic energy supplies, and strengthening global energy trade and investment. There can be no U.S. energy security without global energy security.
- A majority of the U.S. energy sector workforce, including skilled scientists and engineers, is eligible to retire within the next decade. The workforce must be replenished and trained.
- Policies aimed at curbing CO_2 emissions will alter the energy mix, increase energy-related costs and require reductions in demand growth.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00342 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.280

The NPC study sets forth five core strategies to assist markets in meeting the energy challenges to 2030 and beyond. The United States must:

1. Moderate the growing demand for energy by increasing efficiency of transportation, residential, commercial and industrial uses.
2. Expand and diversify production from clean coal, nuclear, biomass, other renewables, and unconventional oil and natural gas; moderate the decline of conventional oil and natural gas production; and increase access for development of new resources.
3. Integrate energy policy into trade, economic, environmental, security and foreign policies; strengthen global energy trade and investment; and broaden dialogue with both producing and consuming nations to improve global energy security.
4. Enhance science and engineering capabilities and create long-term opportunities for research and development in all phases of the energy supply and demand system.
5. Develop the legal framework to enable carbon capture and sequestration (CCS). In addition, as policymakers consider options to reduce CO_2 emissions, provide an effective global framework for carbon management, including establishment of a transparent, predictable, economy-wide cost for CO_2 emissions.

The study further recommended that markets should be relied upon wherever possible to produce efficient solutions. Where markets need to be bolstered, policies should be implemented with care and consideration of possible unintended consequences.

The study is a catalyst for action. And action is needed now on all of the recommendations.

Changing the conventional wisdom on energy

We welcome serious dialog about measures that can be taken to help the consumer deal with these rising energy and fuel prices and develop a comprehensive energy policy.

Let me reiterate that the NPC study has given us sound, sensible and achievable solutions. To successfully implement these recommendations, we need to change our conventional wisdom about energy development and its use.

First, we need to value energy as a precious resource. Energy efficiency is the most immediate and important action that each of us can take to contribute to rising energy prices. The United States must become a nation of energy savers. In short we need a "Made in America" solution enabled by everything from human ingenuity, to "smart" buildings, to advanced vehicles and transportation systems. Increased energy efficiency and conservation will help reduce demand for energy and will reduce pressures on the system. Markets are indicating U.S. consumers are already taking action. Congress has a critical role to play to engage the U.S. public and put the United States at the forefront of responsible energy use.

Second, we need all the energy we can get from every available source. We must continue to bring traditional energy supplies to market, and invest in the critical energy infrastructure this nation needs, even as we are developing alternatives sources of energy.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00343 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.281

Third, on the supply side, we need your help to open up the 85 percent of the Outer Continental Shelf that is now "off limits" to environmentally responsible oil and gas exploration and development. We cannot expect other countries to expand their resource development to meet America's needs when our government limits development at home. Along with access, it is also important to streamline permitting processes to enable new resource development, additional recovery in existing fields and continued investment in critical downstream infrastructure to progress in a reasonable timeframe.

Fourth, I would encourage careful evaluation of policies that can lead to unintended consequences and create inefficiencies in the gasoline supply system. Today we have 17 "boutique" fuel requirements across the country, requiring us to blend unique gasoline products for different states and different localities. More requirements on fuels are being added through renewable fuel mandates and proposed climate policies. For example, we are under a mandate to include rising levels of corn-based ethanol in our gasoline products and, over time, add significant quantities of cellulosic ethanol. At the same time that we are accommodating these new mandates, policymakers have proposed legislation to reduce greenhouse gas emissions that again is disproportionately burdensome on the transportation fuels sector. We urge you and your colleagues to reflect on how to advance these important national policies without inadvertently disrupting our ability to provide the gasoline and transportation fuels that the United States needs. Rationalization of these multiple requirements will create greater efficiencies in the fuel supply system.

Finally, we urge you to reject punitive measures on our industry. Regardless of intent, these will diminish our ability to invest in the long term solutions critical to maintaining this country's energy infrastructure and supplies, as well as our ability to develop diverse energy resources for the future. As reported recently by the Congressional Research Service, a similar measure in the 1980s resulted in lower domestic production and increased dependence on foreign sources. [2] Put simply, actions drawn more from emotion than sound policy will hurt everyone.

American energy companies operate at the frontier of geography, geology and technology. As the world's largest energy consumer, and as a country blessed with rich natural resources, Americans need our ingenuity and your leadership. With your help we can continue to develop the critical energy supplies and infrastructure needed to supply this nation and support this economy. Our collective actions today will demonstrate leadership on issues that are within our control. They will bolster us today, prepare us for tomorrow and set in motion a wave of innovation and responsible development for many years to come – to help us weather the powerful forces we cannot control.

How we as a country deal with our energy future is nothing less than an urgent matter of our energy and national security

---

[2] (Salvatore Lazzari, "The Crude Oil Windfall Profit Tax Of The 1980s: Implications for Current Energy Policy," *Congressional Research Service*, 3/9/06)

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00344 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.282

Ultimately, polices should recognize the *inter*dependence of the United States within the global energy system, while at the same time capitalizing on our country's own extensive energy endowment. These are not insignificant challenges, and they will require leadership and collaboration. We look forward to working with you to address these challenges.

Chevron will continue to do its part.

Thank you.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00345 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.283

J. S. Simon
Exxon Mobil Corporation
Hearing of the U.S. Senate
Committee on the Judiciary
May 21, 2008

Thank you Chairman Leahy, Ranking Member Specter, and members of the Committee.

Energy is essential to the U.S. economy and is a topic on many Americans' minds. They are raising important questions about how our industry is helping meet their vital energy needs at competitive prices.

I welcome the opportunity to respond to these questions, and to clear up some misconceptions regarding our industry. And to this end, I would like to make two points during my allotted time.

First, the prices Americans pay at the pump reflect the dynamics of an enormous, international market for energy – which means that in order for American energy companies like ExxonMobil to successfully compete, it is vital that we have sufficient financial strength and scale.

To meet the world's growing demand for energy of all types, an estimated total investment of $22 trillion is needed between 2006 and 2030 – or roughly eight times the size of the estimated 2007 federal budget.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00346 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.284

Within this vast global marketplace, competition is fierce. ExxonMobil is the largest U.S. oil and gas company – but we account for only two percent of global energy production, only three percent of global oil production, only six percent of global refining capacity, and only one percent of global petroleum reserves. With respect to petroleum reserves, we rank 14th. Government-owned national oil companies dominate the top spots.

For an American company to succeed in this competitive landscape and go head-to-head with huge, government-backed national oil companies, it needs financial strength and scale to execute massive, complex energy projects requiring enormous, long-term investments.

To simply maintain our current operations and make needed capital investments, ExxonMobil spends nearly one billion dollars a day.

Over the past 25 years, we have invested $355 billion dollars in new energy projects – which is more than we earned during this same period. Over the next five years, we plan to invest at least $125 billion more.

Our profitability in absolute terms is large, but it must be viewed in the context of the massive scale of our industry, and our dependence on high earnings in the current up cycle to sustain the huge investments required over the longer term.

The second point I would like to make addresses the concerns your constituents and our customers have about where their gas dollars are going.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00347 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.285

Last year, the average price in the United States of a gallon of regular unleaded gasoline was around $2.80.

On average, in 2007 approximately 58 percent of the price reflected the amount paid for crude oil.

Consumers pay for that crude oil – and so do we. Of the 2 million barrels per day ExxonMobil refined in 2007 here in the United States, 90 percent were purchased from others. Last year we spent over $40 billion ourselves buying crude oil and feedstocks on the open market to fill our U.S. refineries.

Fifteen percent of the average price Americans paid at the pump last year reflected the amount collected in federal, state and local taxes.

The remaining 27 percent reflected refining, marketing and transportation.

For our refining and marketing business, that 27 percent would be more than 23 percent costs and less than 4 percent earnings – which translates to earnings of only about 10 cents per gallon of product sold. That is about one quarter of the amount claimed by taxes.

Since last year, the increase in gasoline price – and more – can be attributed to the rise in the cost of crude oil. Product prices have not risen as much as crude oil, so industry margins have been reduced. In fact, our U.S. refining and marketing earnings have actually been cut by more than half compared to last year, to approximately 4 cents a gallon sold.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00348 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.286

Our margins are tight because our industry is very competitive. The Federal Trade Commission and other government agencies have repeatedly confirmed this fact.

When energy prices are high, the urge to point fingers at oil companies is strong.

But undercutting the ability of American companies like ExxonMobil to compete in a huge global marketplace only makes it harder for Americans to secure the energy they need at competitive prices.

We should instead work together to strengthen U.S. competitiveness and meet the needs of the American people we all serve.

Thank you.

VerDate Aug 31 2005 14:52 Sep 18, 2008 Jkt 043354 PO 00000 Frm 00349 Fmt 6633 Sfmt 6633 S:\GPO\HEARINGS\43354.TXT SJUD1 PsN: CMORC

43354.287

Table referenced in Senator Feingold's opening statement:

Capital Spending

WHERE FUNDS WILL GO FOR U.S. PROJECTS

	2008 ($ million)	% Change 2008-2007	2007 ($ million)	% Change 2007-2006	2006 ($ million)
Exploration/Production					
Drilling/Exploration	130,200	4.2	125,010	0.8	124,000
Production	24,750	4.2	23,760	0.8	23,560
OCS Lease Bonus	5,250	87.8	2,795	205.8	914
Subtotal	**160,200**	**5.7**	**151,565**	**2.1**	**128,474**
Other					
Refining	13,000	57	8,280	-8	9,000
Petrochemicals	1,000	19	8,40	7.7	780
Marketing	3,000	20	2,500	0	2,500
Crude and Products Pipelines	6,629	269.1	1,796	1,173.80	141
Natural Gas Pipelines	5,710	30.8	4,367	94.5	2,245
Other Transportation	1,200	23.7	970	14.1	850
Mining, Other Energy	1,200	26	1,000	0	1,000
Miscellaneous	5,000	22	4,100	10.8	3,700
Subtotal	**36,739**	**54**	**23,853**	**18**	**20,216**
Total	**196,939**	**12.3**	**175,418**	**4**	**168,690**

Source: *Oil and Gas Journal*, April 28, 2008