RETAIL GAS PRICES (PART I): CONSUMER EFFECTS

HEARING

BEFORE THE

TASK FORCE ON COMPETITION POLICY AND ANTITRUST LAWS

OF THE

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MAY 7, 2008

RETAIL GAS PRICES (PART I): CONSUMER EFFECTS

WEDNESDAY, MAY 7, 2008

HOUSE OF REPRESENTATIVES,
TASK FORCE ON COMPETITION POLICY
AND ANTITRUST LAWS
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Task Force met, pursuant to notice, at 12:09 p.m., in Room 2141, Rayburn House Office Building, the Honorable John Conyers, Jr. (Chairman of the Task Force) presiding.

Present: Representatives Conyers, Jackson Lee, Sutton, Chabot, Keller, Sensenbrenner, Cannon, Issa, Feeney, and Smith.

Staff present: Perry Apelbaum, Majority Staff Director and Chief Counsel; Anant Raut, Majority Counsel; Stacey Dansky, Majority Counsel; Sean McLaughlin, Minority Chief of Staff and General Counsel; and Stewart Jeffries, Minority Counsel.

Mr. CONYERS. Ladies and gentlemen, we are facing a crisis. What is happening in the oil industry today reflects the state of our trade policy, and how we have handled antitrust considerations. I want to begin our discussions here today considering the oil industry to be heavily consolidated.

I want to look back for just a moment and, because this is the Antitrust Task Force, I am looking at it with that particular focus. Look at the mergers.

Out of all the administrations, Exxon and Mobile, and then we went to Chevron and Texaco and Conoco and Phillips. And instead of achieving the economics, the economies of scale and consumer benefits, we received this bit of massive layoffs and increased consolidation and higher prices and profits.

Currently pending before this Committee is our evaluation of Northwest Airlines and Delta.

Now, over a century ago the gas-oil industry was a monopoly; John D. Rockefeller's Standard Oil. They controlled 84 percent of crude oil. And their dominance was, to me, the main reason we got Chairman "Andy Trust" to begin with.

That led to the breaking up of, then, Standard Oil and smaller companies. But now we are back to a literally vertically integrated monopoly where five companies control more than half of the refineries in the country, and their pre-tax profits were $33 billion in the first quarter.

After the so-called antitrust enforcers blessed the mergers; there was no oversight, no enforcement.

Then Katrina, prices skyrocketing on the Gulf Coast and across the nation due to temporary supply disruptions. Not a single price-gouging case was ever brought.

At the same time, in the face of what appears to be the most potent cartel the world has known, OPEC, we have not seen a single complaint, let alone legal action by the Department of Justice.

So even though OPEC controls two-thirds of the world's oil reserves and 40 percent of the oil production, I think we have to factor that in as a big reason for why prices are likely to go up as the summer driving season commences.

Now, last year, the House passed the Federal Price-Gouging Prevention Act, and we also passed another bill that would allow the Department of Justice to go after international oil cartels.

I thought these were common-sense, pro-consumer bills, but they were stalled. And, as a matter of fact, they are stalled now.

So this is not just any industry we are talking about. It is the key component of a modern industrial society, and we can't ignore the consequences of our failed antitrust policies with crude oil now reaching nearly $123 per barrel, some predicting it will be $200 per barrel within a couple of years.

And we have got the average American family with two cars and purchases 1,200 gallons of gas in a year. The national average price is $3.61. In some States, $4 gasoline is a reality.

So oil impacts every aspect of our economic life from the price of the gas to the cars sold that are made in Detroit to the price of food and plastic. And this Antitrust Task Force wants to inquire into this to see what it is that can be done about it.

So we turn now to Steve Chabot, the distinguished Ranking Member of the Committee.

Mr. CHABOT. Thank you, Mr. Chairman. I appreciate the opportunity to speak.

I would like to thank the Chairman for holding this important hearing today. There is not an issue that I hear more about from my constituents back home in Cincinnati, and who want to know what we are going to do about it, than the high price of gasoline in this country today.

These concerns won't diminish until this Congress is willing to take steps to make energy more affordable to consumers.

On Monday, the national average for a gallon of gas reached a record $3.63 a gallon; the sixth straight record in 14 days, according to our local newspaper.

Just yesterday, the Department of Energy issued its projected gas price for this summer estimating prices to peak at approximately $4 a gallon at some point during the peak driving season, not too far ahead of us.

As global demand, led by countries such as China and Russia and India continues to skyrocket and instability in certain regions of the world continues, there is no reason to believe that prices will decrease any time soon without significant action.

There is no doubt that we need to focus on both short-and long-term strategies to address these concerns.

We need, for example, increased domestic production in the Arctic National Wildlife Refuge (ANWR), up in Alaska; in the Outer

Continental Shelf, as well as greater refinery capacity in this country.

Now, relative to ANWR, this has been a subject of considerable debate in a number of votes in Congress for years now. And you will have people now that will say, well, even if we voted today to open up ANWR, we wouldn't see that oil for years and, therefore, that is not a real answer.

Well, that is one reason that we should have passed this years ago. Then we would have it now, and it would be impacting prices here; obviously, lowering them if we had that additional oil available to us.

So we should have done it a long time ago. And one of the reasons that oil prices continue to go up is because of speculation; what people think it is going to be tomorrow.

So if we passed allowing us to go after the oil up in ANWR, which is 16 billion, 18 billion barrels, it would have, many of us believe, an immediate impact as would the Outer Continental Shelf.

And so we need to do that.

Relative to the oil refineries, we haven't built a new oil refinery in this country in over 30 years now. So even if we had the crude, we can't refine it quickly enough.

And there is boutique fuels which is another problem.

So we need to have a much stronger emphasis on those as well as additional emphasis and money and research into alternative sources of energy and conservation as well.

So it has to be a multi-faceted approach.

But too often in this Congress, especially as it is currently constituted, we talk about the things which will be there in the future, the alternative conservation, et cetera, but we don't do anything about domestic production.

We absolutely have to.

The hearing today is important because it gives us the opportunity to examine these daily price surges and their impact on consumers from another perspective through the antitrust lens.

And so I certainly appreciate the Chairman holding this hearing.

And I would now like to yield my time to the Ranking Member of the full Judiciary Committee, Mr. Lamar Smith from Texas.

Mr. SMITH. Mr. Chairman, I thank the gentleman from Ohio, Mr. Chabot, the Ranking Member of the Task Force, for yielding.

But I also want to thank you, Mr. Chairman, for rescheduling this hearing.

Normally, we meet at 10 o'clock. You were nice enough to back that up an hour so that members of the Republican Conference could go to the White House for a meeting with the President. And that is appreciated, as always.

Mr. CONYERS. Can you give us a briefing after the meeting?

Mr. SMITH. I would be happy to, Mr. Chairman.

But the President actually did talk about the price of energy and what we could do about it.

But part of that is incorporated into my statement, so we will get there.

Mr. Chairman, fuel prices at the pump have caused a significant strain on individual and family finances across the nation.

This week, the nationwide average price per gallon of gasoline was at $3.66, up $.56 from the same period last year.

At every fill-up American families are reminded that driving anywhere is going to cost more than ever.

As the Federal Trade Commission has reported, though, changes in world oil prices have explained 85 percent of the changes in the price of gasoline in the U.S.

The price of gasoline at the pump closely tracks the price of a barrel of oil on the world market. Further, the FTC has repeatedly found that there is no broad-based collusion to fix prices or engage in price gouging in the retail sale of gasoline.

So what can Congress do to reduce fuel prices? It can expand the domestic supply of energy that, time and again, the Democratic leadership has rejected opportunities to increase that supply and bring gas prices down.

For example, last August 4, 217 of 231 House Democrats voted against a Republican proposal that would have opened up the Outer Continental Shelf and the Arctic National Wildlife Refuge to drilling for oil and natural gas.

It is estimated that there may be as much as 86 billion barrels of oil in the OCS and ANWR; enough oil to keep America running for 5 years with no foreign imports at all.

Drilling in ANWR alone could increase U.S. crude oil production by 20 percent over today's levels which would likely mean lower gas prices.

While no one contends that opening up the OCS and ANWR to drilling will make the United States energy independent overnight, it is, in fact, a step in the right direction. It is also a signal to OPEC that the United States is serious about meeting its own energy needs and, in the long term, can reduce the cost of oil and, ultimately, the price at the pump.

As important as alternative fuels are, including solar and wind, they account for only 6 percent of U.S. energy consumption. Even if we doubled our reliance on these types of energy, it would hardly be noticed at the gas pump.

In fact, *Investor's Business Daily* recently reported that oil and natural gas will still account for 80 percent or more of U.S. energy use 10 years from now. With fossil fuels constituting so much of our energy consumption, both now and in the future, expanding our access to oil and natural gas must be a part of the solution in reducing gas prices.

Any serious effort to address fuel prices must deal with the fundamental issue of American supply. This means drilling in the Outer Continental Shelf and Arctic National Wildlife Refuge.

At a time when Americans are hurting financially, it is unconscionable that we are putting so much of our own oil supply off limits. Every time Congress decides to restrict the supply of oil, like deciding not to drill in the OCS or ANWR, it has an impact at the pump which cannot be ignored.

There are several measures that have been introduced in this Congress that open up OCS and ANWR to exploration for oil and natural gas. Yet, despite the high cost of gas, not one has been brought up for a vote.

Instead, as President Bush recently noted, Congress is considering bills to raise taxes on domestic energy production, impose new and costly mandates on producers, and demand drastic emissions cuts that would shut down coal plants. “The cost of these actions would be passed on to consumers in the form of even higher prices at the pump.”

Mr. Chairman, I hope we will focus on the facts today, and I hope that this Congress will finally consider legislation to address the very real problem that rising gas prices pose for American families.

I now yield back.

Mr. CONYERS. Thank you very much.

I would like, now, to recognize the gentle lady from Ohio, Betty Sutton.

Ms. SUTTON. Thank you, Mr. Chairman. And thank you for holding this important hearing today.

American consumers across the country continue to pay outrageous prices at the pump. The price of gasoline and diesel has more than doubled in the past 6 years from about $1.50 per gallon in the second half of 2002 to a record national average of $3.61 per gallon today.

What response has the record high prices of the last 2 weeks elicited from the White House? The President says that a cost-benefit analysis of immediate action for consumers does not persuade him.

Such an action is potentially disastrous as we enter the summer travel season when prices could surpass $4 a gallon.

Speaker Pelosi has called on the President to suspend purchases of oil from the Strategic Petroleum Reserve temporarily. Filling the SPR takes 70,000 barrels of oil off the market each day even though the reserve is 97 percent full with plenty of oil to meet national security needs.

Experts project that this could lower gas prices by as much as $.25 a gallon and provide some immediate relief. In 2000, just the announcement of an SPR moratorium dropped oil prices in the market from $30 to $20 a barrel.

President Bush and Vice President Cheney, over the past 7 years, have consistently blocked initiatives that will help Americans at the pumps and put our nation on a path to energy security and our economy on a path to a greener, cleaner future.

The Administration’s wrong-headed approach began with the Vice President writing an energy policy in secret with energy execs. This policy is no longer a secret. In the last 7 years, the Administration has doled out billions of dollars to the oil companies instead of working for an energy independence plan for America.

Now, this Democratic Congress has taken significant steps to right the Administration’s misguided path. Passing landmark energy independence and security acts that were signed into law in December will reduce our dependence on foreign oil and lower energy costs for consumers by raising CAFE standards and increasing the efficiency of buildings and appliances and lighting.

And in February, the House passed a Renewable Energy and Energy Conservation Tax Act to extend tax credits for renewable energy sources like wind and solar power to 2011. These tax credits are paid for by repealing unnecessary subsidies to big oil companies.

I would be shocked and dismayed if anyone dared to argue that the oil companies are struggling and in need of these subsidies.

In 2007, the oil industry reported record profits of $155 billion, 75 percent of which was earned by the five major oil companies. Exxon alone made $40 billion last year.

Since 2002, the net income from domestic refining has accounted for about 44 percent of the total increase in domestic profits and grew almost three times as fast as income from foreign refining. The return on equity reported by these companies has skyrocketed compared to the rest of the economy.

So it is crystal clear to me that the oil companies are not struggling. And yet some, including all of the Republican leadership, oppose repealing these subsidies and continue to block this important legislation's enactment.

I strongly believe that investing in renewable energy now is vital to our long-term prosperity. The expanded renewable fuel standard enacted last year makes an unprecedented commitment to do so.

Drilling in ANWR is not the answer. Not only will that oil fail to reach us in any timely way, weaning ourselves off of oil is the answer.

With that, I yield back.

Mr. CONYERS. Thank you.

Does the Chairman Emeritus have a comment?

Mr. SENSENBRENNER. After listening to that, he does. [Laughter.]

Mr. Chairman, this hearing today duplicates hearings that have been held in this Committee and the Energy and Commerce Committee and in the Select Committee on Energy Independence and Global Warming.

I think the reason that the audience part of this room is almost empty is because we really don't expect to hear anything new, and this is, once again, a duplication of effort in an attempt by the Democratic majority to lay the blame game on Republicans in Congress and the White House for high energy prices.

I would remind both the distinguished Chairman and the gentlewoman from Ohio that before the last election, the, then, minority leader and now distinguished speaker of the house said, elect us and we will stop the increase in the price of gas at the pump.

Well, that was about $1.25 a gallon ago, and the response that we have heard from the majority party is, it is not our fault even though we broke our promise.

Now, all of that being said, at the Energy Independence and Global Warming Committee hearing where we had the CEOs of the five largest oil companies or their representatives in front of us, every one of them answered a question which I asked on what can Congress do to lower the price of gas at the pump the same way.

Every one of them said increase domestic exploration and domestic production whether it is in ANWR, whether it is in the Gulf of Mexico or anyplace else.

And what has the response been on the other side of the aisle? It has been no to practically everything.

Now, energy prices are just as subject as anything else to the law of supply and demand. There has been a huge increase in demand in the emerging economies of China and India.

And the price of crude oil, which represents about two-thirds of the price of gas at the pump, has gone up in reflection of the fact that China and India are buying a lot more oil and consuming a lot more oil.

And there isn't anything the U.S. Congress or the President can do to stop that. What we also should realize is that increasing taxes on domestic production of oil means that it is going to cost more money. And where does that end up being passed on to but the consumer.

And if it is more expensive to produce oil domestically, then what are the oil companies going to do? Buy more from OPEC. And that increases the chokehold of OPEC on our domestic economy and our foreign policy.

Folks, it is time for Congress to get down to passing Economics 101. From what I have heard today from the other side of the aisle, the grade is F. Let us get real.

Mr. CONYERS. I am real glad I called on you. [Laughter.]

And I didn't really have to do that, but I wanted to get the full range of how we are feeling.

How do you feel, Ric Keller?

Mr. KELLER. I feel great. I am ready to hear it.

Mr. CONYERS. Okay.

Can I go to Darrell Issa? Good morning, sir.

Mr. ISSA. Good afternoon, Mr. Chairman. And I apologize that the morning slipped away on us because of events on the floor.

I will be very brief.

We are living with the sins of two decades of mistakes on a bipartisan basis. And I hope today's hearings remain bipartisan.

It is very clear that high oil prices have a great deal to do with an absence of a comprehensive policy toward energy at a time when oil was $9 a barrel or $10 a barrel.

I am a Californian, a very proud Californian. We are the greenest State in America. We have a lot to be proud of. We have a lot to answer for.

We produce 1 million barrels a day. We consume 2 million barrels a day of oil. We, in fact, refine our fair share of it, more or less. But we boutique refine so many different types that we artificially raise our price beyond the national average.

Back in the very old days when I still had a gavel and we looked into electricity, primarily, we discovered very quickly that the environmentalists were right. We could reach energy independence in electricity using renewables that would free up countless trillions of cubic feet or meters of natural gas; something that can, in fact, offset oil prices.

All of that could be done. Unfortunately, what we discovered was that the coastline of California would be primarily-visible windmills from the north to the south.

I, for one, consider that that may be a good tradeoff, but with a history of enjoying our sunsets in California, it is clear it would be a difficult and long road.

Today's hearings are about high oil prices and whether gimmicks or short-fixes are going to really do the job versus a sustained policy that might have little effect for the first few weeks or months but likely would begin breaking the back of this persistent rise in oil prices.

Mr. Chairman, I come out of the consumer electronics industry. If there is a shortage of iPods, no matter how severe, the price rise is fairly insignificant.

However, as we have seen in corn, wheat, rice, and yes, oil, a relatively small unanswered demand can lead to a huge, even multiple huge, escalation in prices.

I hope that we bear that in mind that the inelasticity of commodities is part of where we are today. And I look forward to hearing this.

I think it is appropriate for us to look at this in terms of antitrust because we do not have enough competition giving us alternative and varied forms of energy in America today.

With that, I yield back and thank the Chairman.

Mr. CONYERS. Thank you very much.

Tom Feeney, good afternoon.

Mr. FEENEY. Thank you, Mr. Chairman. And thank you for holding this hearing.

I want to associate myself with the remarks of, among others, Mr. Sensenbrenner.

Every American business and every American consumer is now paying a huge price, and it is hurting very badly because of the high cost of energy.

But to the extent that there is an antitrust problem involved here, I think that we need to break up congressional monopoly over new energy supply.

For example, in the United States of America, we haven't built a nuclear power plant in something like 35 years.

We haven't built new refineries since 1976.

We are increasingly, State by State and regulation by regulation, prohibiting the use of clean coal and liquid coal even though America sits on 26 percent of the world's coal supplies.

We have basically prohibited exploration all over the country, including ANWR, where some 80 percent of the Alaskan population wants it.

And I will acknowledge that Floridians are going to need to stop being selfish when it comes time to drilling, far enough off the coast where they are not a distraction to our wonderful tourism industry, in a safe way.

You cannot repeal the laws of supply and demand, as Mr. Sensenbrenner said. But that does not stop the United States Congress from trying to repeal those laws on a regular basis.

We do need to expand into alternative uses of energy, solar and wind, for example. Ethanol, so far, in terms of the policy, while it may have been well-intended, has been a disaster.

But I do believe that Congress has the antitrust problem. We need to break up the monopoly which is basically empowering people like Ahmadinejad and Chavez as we are totally dependent on foreign oil as opposed to alternative energy sources and more domestic supply.

And with that, Mr. Chairman, thank you for the opportunity, and I will yield back.

Mr. CONYERS. Thank you.

Sheila Jackson Lee, the gentle lady from Texas, good afternoon.

Ms. JACKSON LEE. Good afternoon, Mr. Chairman. And, again, this is a vital, vital hearing.

I wear a conflicted hat representing Houston, Texas, which we often and properly call the energy capital of the world.

I am reminded that energy is complex and diverse.

Energy incorporates wind and alternative and bio-fuels and cellulite and, as well, fossil fuel which we have been, effectively, if you will, drilling in the Gulf for a number of years, decades, frankly, safely and securely.

And some years ago, I added to one of the energy bills that may have passed, the idea of doing an inventory of the resources, domestically, that we have in the Gulf that have been able to be drilled or prospectively drilled under a safe and secure manner.

I don't think we have been very effective in that way.

We have closed our minds on the idea of building more refineries, of course.

We have not looked at the idea of pressuring our large conglomerates to effectively develop the latest technology so that the final product that is produced can be produced in a more efficient and cost-savings manner.

But we have to get relief. I, frankly, believe we do have the burden of giving relief to constituents, to truckers, small and large.

Constituents of mine who own small trucking companies or smaller than small, maybe six trucks, ten trucks, are seeing their fuel prices jump exponentially. The airlines have suggested that is the case.

Mr. Chairman, this is a vital, vital hearing to talk about what happens to the public when you have such a dominance by many of my constituents, and I hope they are listening.

There have been a lot of discussions around suggestions that a gas tax holiday is political. I believe that we should not give short shrift to any idea that may give relief.

And it is interesting that, as we look at these items, rather than studying them extensively and finding out what would work, we spend too much time saying what will not work.

I think it is important.

As the Offshore Technology Conference is being held in Houston as we speak, thousands upon thousands of people coming from the various energy countries from Nigeria to Guinea-Bissau to Angola, a number of the OPEC leaders, I don't know what involvement our government has, whether or not we have any advisors on the ground to discuss the increasing per-barrel cost and the reason for the increasing per-barrel cost and why it is being said and why OPEC is outside of our reach.

And I, frankly, believe that is an abdication by this Administration and by this Congress. There are laws in place, but there are also laws that would give us a leeway of discussion.

We need to be creative, adventurous, and we need to take risks on behalf of the American people.

This hearing, I hope, will certainly share with us the pain that is going on, but I think in the long range, as the Chairman has so often tried to do in his legislative initiatives, we have got to find solutions.

I am prepared to do so as one who represents a very vital area in the energy discussion.

I, frankly, believe that calling energy leaders to Washington, to the White House, to come out in the light, not in the darkness of night as the Vice President attempted to do, but in the light, that we can collectively offer solutions, be they partly legislative or by executive order or by volunteerism, is what we need to do.

The price per barrel is excessive, and the questions have to be raised of how we respond to the needs of the American people.

So, Mr. Chairman, I hope to listen, in part, to the testimony. I am back and forth on the floor, but Houston is not going to go away. The energy capital is not going to go away.

How do we make it work for the American people?

And I believe that hard-working Houstonians who work for these companies truly believe that they can be part of the solution. Let us have that be the thrust of this hearing.

And with that, I yield back as I look forward to being part of the solution as well.

I yield back.

Mr. CONYERS. Thank you.

The gentleman from Utah, Chris Cannon.

Mr. CANNON. Thank you, Mr. Chairman. And thank you for holding this hearing.

It is an important hearing. We have got the Wall Street Journal today talking about $150 a barrel for oil here in the summer; I was thinking the fall. Other people are predicting $200 a barrel. This is a lot of money for Americans, and this hearing, I think, is important.

On the other hand—but I would like to congratulate Mrs. Jackson Lee, by the way, for two things. One is acknowledging the need for more oil. And secondly, for pointing out that her area is the energy capital of the world.

We expect to change that soon because my area of the world, Utah, Colorado, and Wyoming, has trillions of barrels of oil in shale. That is essentially, some people are saying, five times as much oil as all the oil in the Middle East combined.

And we have the first test for commercially taking oil out of shale in 30 years, and that should be done by mid-September. Those folks think they can make oil out of shale for less than $30 a barrel.

Having looked at that, I think it is going to be quite a bit less than $30 a barrel. We are sitting here on massive resources.

Our dear colleague, Mr. Bartlett from Maryland, does a presentation in the evening here in Congress and he talks about the limited resources that we have and reasonably raising some concern about where we are going and our domestic, in fact, worldwide, our typical historic traditional sources of fuel are decreasing.

But they are dwarfed—all of the current resources that we are looking at or hoping for are dwarfed by the oil and shale in Utah, Colorado, and Wyoming.

And it is oil that technology has allowed us to actually get much more easily than when we tried it in the late 1970's.

Let me point out that there are other nontraditional sources that are dramatically important. We have walked away, in the Grand Staircase Escalante National Monument, 77 billion tons of coal. That is 150 barrels of oil if you turn coal into liquid.

And, in fact, a lot of people think that coal is too expensive as a source for gas because the last time we had an energy crisis, coal was very expensive.

And so, in fact, in 1977, one of my power plants entered into a series of 30-year contracts. They paid $85 a year for coal.

Now, if that coal had been priced with inflation today, that would be about $300 per ton of coal. The actual price of coal when those contracts lapsed in 2005 was about $15 a ton.

So in 1977, the actual price of a half a ton of coal, which you need to create a barrel of oil, was $45. And then you had the capital cost and the operational cost to gasify it.

Today, the input cost is $7.50. That means your input costs are barely below seven and a half bucks. You can produce oil reasonably—now, it is a little higher than that right now, but not much higher.

You can reasonably produce gas or gasoline or liquid from coal at a price that makes a lot of sense. These are not Area 30 ideas.

This is not turning the whole country on windmills, which I just had a meeting with some folks who were telling me that windmills have a huge cost when they are not operating because you have to keep the machinery warm and in place.

The fact is, Mr. Chairman, we are in a world where we have energy in America.

We just hope that not only when we talk about the high cost and some of the concerns that this Committee, as an antitrust Committee, has but I hope we will also focus on the alternatives that are available today and allow these guys to bring their prices down and get competitive in the world instead of creating an environment where the high cost of gas has created a huge market for innovation.

Let us not ignore that innovation and those opportunities as we look at these fellows today.

Thank you. And I yield back.

Mr. CONYERS. Thanks so much.

David Owen has been known since 1989 as "the voice for small trucking companies."

He co-founded the National Association of Small Trucking Companies, and I think he has got a real message to start us off today.

I thank you very much for being here. All of your statements will be put, in their entirety, in the record and then you can talk with us from there.

TESTIMONY OF DAVID OWEN, PRESIDENT, THE NATIONAL ASSOCIATION OF SMALL TRUCKING COMPANIES

Mr. OWEN. Thank you, sir. It is an honor and privilege to be here, and I hope that some of my comments will have an impact.

It is certainly humbling to be representing our niche market in trucking. We represent small, full truck, long haul, irregular route carriers.

I am not going to give any information about my organization, as that is in the record.

This meeting is about gas prices, and I would respectfully correct that to fuel prices. Everything that we talk about and everything that we burn is diesel fuel.

And there is a difference between the impact of diesel and the impact of gasoline. And I would like to try to connect some of those dots today and maybe say some of the obvious.

But truthfully, I think the driving purpose, and sometimes Congress and regulatory agencies don't connect the dots between diesel fuel and how all the stuff in this room got here.

Everything in this room that you see came on a truck at least once, and maybe two or three times, before it got here.

The high price of fuel, if you are buying gasoline and you are driving a car, you have got several choices. You can buy a smaller car; you can drive less; you can cut back on your trips; you can carpool.

Trucking companies don't have any options because they have to run. And that is something that is unique about our industry. They are between a rock and a hard place.

There has been a lot of talk over the last few months about stoppages and protests and strikes in trucking to try to bring attention to this crippling effect of the cost of diesel fuel.

Quite frankly, a trucking company can't stop running if you think about it. If they stop running a day, they lose their drivers because the driver is paid by the mile. There is a driver shortage. A driver can get a new job in 30 minutes. So he will drive for somebody that will run.

If they stop, they lose their customer. If you don't haul my goods today, I will find somebody else to carry it.

So they lose their drivers first, then they lose their customer. Then the truck is not turning any revenue, and they can't pay for the truck.

So they have got a couple of choices. They can get out of the business and start doing something else, or they can continue to run.

My father, during World War II was frozen on his job with the railroad because it was a critical part of the defense effort. And, quite frankly, the industry, the trucking industry is de facto frozen on their jobs because every day they pick up this country and bring it back to itself.

And if they stop running, guys, our whole distribution system would come to a halt and we would be on our knees in a matter of days, not weeks.

Up until about a year and a half ago, the driver was the biggest cost factor in trucking. And about a year and a half ago, fuel became the biggest cost factor.

And in some cases now, if you go a thousand miles at five miles to the gallon and you pay a driver $.40 a mile, which is pretty high, at $4 a gallon, you are going to burn $800 in fuel costs in a thousand miles.

Here again, we don't have any options about whether to run or not; we have to keep running.

We invented something that is called a fuel surcharge, and that is the only way the trucking industry has survived this onslaught of diesel prices, and I am sure you are familiar with it.

I won't go into detail how a fuel surcharge works, but there is some—I heard yesterday, as a matter of fact, there is some legislation up here that is originating about regulating fuel surcharges.

But this crippling effect starts with the independent one-truck guy, goes to the small trucking company, goes up the supply chain, and eventually gets right back to you and me, the consumer.

I would like to point out, too, that in our industry which represents one in every 11 people that work, the transportation industry, we get the dubious pleasure of paying for it at the pump and then turn around and pay for it again when we buy it at the cash register.

There is plenty of blame to go around, plenty of theories.

You guys are a whole lot smarter than me, but increased demand by China, the move to a global market, the weakness of the dollar, lack of refinery capacity, hedge fund operators manipulating the market, the war in Iraq, the unrest in the Middle East, profiteering by big oil, failure to become less dependent on OPEC, the policies of the Bush Administration, the policies of Clinton Administration, failure to tap the resources in Alaska——

I can tell you one thing, though, we don't need to point the finger at the retailer. Our largest truck stop chain showed losses of $140 million the last two quarters.

In summation, what is worse than $4 diesel fuel? What is worse than $7 diesel fuel? No diesel fuel at all.

Our most sensitive and essential distribution leg is getting that oil from the refineries to the street. And if we ever lose that, guys, if the pipelines quit running and if the trucks that haul the fuel quit running, this country will come to its knees.

Thank you.

[The prepared statement of Mr. Owen follows:]

PREPARED STATEMENT OF DAVID OWEN

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David Owen
President

May 7, 2008

"Retail Gas Prices, Part 1: Consumer Effect."

Good Morning

My name is David Owen and I'm the President of The National Association of Small Trucking Companies (NASTC, Inc.).

I feel privileged and honored to be here today. I am certainly humbled to be representing our niche group of carriers and, to some extent, the entire trucking industry regarding the topic at hand. I hope that some value can come from my testimony.

NASTC, Inc. was founded in 1989 and our mission statement then and today is as follows:

> **"NASTC is dedicated to helping small trucking companies control their costs through managed purchasing, analysis, consultation, and advocacy. Our ultimate mission is to level the competitive playing field, allowing our member-companies to grow, prosper, and remain a significant force in the transportation industry."**

We have stayed focused to that mission over the past eighteen years and have grown to an organization of significant size serving our niche market. We have approximately 2,200 member-carriers in our group and we add between thirty and fifty companies each month. This group at present employs approximately 50,000 drivers and operates approximately 47,000 tractors.

Our niche market is identified with the following characteristics:
- -Small in size (generally from 1 to 100 power units)
- -Full truckload (not LTL)
- -Rural based
- -Family owned
- -Non-union
- -For hire (very few "private" carriers)
- -Long haul (generally averaging over 500 miles from pick-up to delivery)

NASTC has developed a wide array of programs to assist its members in their efforts to be viable, competitive companies. Some of these programs include the following:

Safety Programs
- -Drug & Alcohol Administration
- -PrePass & PrePass Plus
- -Professional Drivers Advantage
- -Time access to motor vehicle records (MVR's) and background checks
- -The Bill Fralic Safety Library
- -Driver Plus Audio Magazine Program
- -Drivers of the Year Program

Compliance Programs
- -Fuel Taxes
- -Driver Qualification file maintenance
- -Log Audits

Educational Programs
- -NASTC's Annual Conference & Expo
- -Drug & Alcohol Training
- -New Entrant Survival Training
- -Quarterly Newsletters

Discount Purchasing Programs
- -J. J. Keller & Associates
- -Office Depot
- -Sprint/Nextel Communications
- -Quality Plus Fuel Program

NASTC used the following logic to appeal to its very fragmented membership base:

-Small companies (under 100 power units) comprise 95% of the carriers and 40% of the capacity of the full truckload segment of our industry.

-Large or small, the basic function of a trucking company remains the same.

-Large companies enjoy discounts, rebates, economies of scale and lower costs generally not available to smaller entities. The difference in price cannot be justified by volume alone.

-Small companies owners wear several hats, performing many different functions. Due to lack of specialization, time, capital, and expertise, attention to detail is often sacrificed.

-Small company owners are dedicated to safety, compliance, employee relations, and profit, and will respond favorably to programs that provide assistance in reaching goals in these areas.

There is background information about who NASTC is and who we represent for the record and this will not be a part of my testimony.

When asked to be here today, my contact referred to this meeting as an investigation into the exorbitant and insistent rise in gas prices. With all dne respect, I would like to point out that the proper title for this meeting should read FUEL prices. I'm going to be addressing diesel fuel prices not gasoline prices, and I think it's important to stress the difference. If I can be so bold, I think there is a wealth of misunderstanding about our industry and the main purpose of my testimony today will be an attempt to help "connect the dots" between perception and reality concerning the driving public's attitudes, beliefs, and understanding of commercial vehicles and the role they and the people who drive them play in our distribution system and our economic well being.

People who purchase gasoline have many options available to them when fuel prices skyrocket. They can:

-Drive less
-Car pool

-Use other means of transportation
-Take less trips
-Buy a hybrid car

Trucking companies have few such options. They must buy fuel daily at the prices put forth because they <u>must run</u>. Our members generally operate a fairly simple business model. They leave on Sunday night or Monday morning and return on Friday afternoon for the football game. The driver recreates, rests, and spends family time while the truck is available for preventive maintenance and readied for the next week's trips. The truck and the driver need to run many miles, to run loaded, and to be as productive as possible during that Monday through Friday work-week. Our drivers and trucks will generally run between 550 to 700 miles a day. They generally get between 5.5 to 6.5 miles per gallon and will buy close to 100 gallons of diesel fuel daily.

Recently there have been movements to "go on strike," slow down, or take trucking holidays to protest the exorbitant price of diesel. These movements bring to the surface the tremendous frustration felt by our industry at all levels because of the perceived malaise of the general public, the government, and their regulatory agencies regarding the "back to the wall," between a rock and a hard place position diesel fuel prices put a truck.

If you're a small trucking company, you have only two choices:

You can close your doors and go do something else

Or,

You can continue to run your truck, often at a <u>loss</u> and if you can't find a way to operate profitably, go broke slowly.

What is not an option is to participate in a stoppage.

Here's why:

If you choose to park trucks to protest fuel costs, your drivers who are paid by the mile will not have a paycheck. There is a driver shortage and a good driver can find a company to drive for in 30 minutes.

So, first you lose your drivers.

Then, if you decide to park trucks, what about your customer who can't get his product delivered—he finds someone else to <u>haul it</u>.

So, then you lose your freight.

Then, your truck isn't producing revenue, so you can't make your truck payment, so you lose your truck.

Trucks must run!

My father during WWII worked for the railroad. He was <u>FROZEN</u> on his job with the railroad for four years because his job was deemed essential to the war effort. Truck drivers and trucking companies are virtually frozen to their jobs because of their essential role in our distribution system. Look around this room. There are thousands of items in view. Every one of them without exception was on one or more trucks before it got here.

Until about a year and a half ago, the driver was the biggest cost factor in trucking. Since then, the cost of fuel has far surpassed the cost of the driver and in some cases is twice that of the driver. Through the collection of fuel surcharges the industry has creatively found a way to survive $4.00 per gallon diesel but the economic pain only begins there. It starts with the independent owner/operator (one guy, one truck & trailer) who can't hedge fuel, who can't enjoy volume discounts, who depends more on brokered freight, and who can't always collect a fuel surcharge. These are the guys who are crippled first with fuel costs. Then come the small trucking companies, our members, who can't stop running without going out of business. And, on up the supply chain the pain goes to the shipper, the manufacturer, and ultimately, to you and me, the consumer.

I would like to point out here that people in the transportation industry (one out of every 11 who work in the U.S.) get the dubious pleasure of feeling the pain twice—once with fuel costs, and then again at the cash register when they purchase the goods they hauled.

It's not just about fuel! The increased price of diesel fuel has a multiplier effect in that it pushes up the price of everything that is transported—which is everything you see in this room.

There are plenty of explanations and plenty of blame to go around. I admit that I've included for the record an explanation of why diesel fuel would be about $1.00 per gallon cheaper today had the EPA not mandated low sulfur diesel and then ultra low sulfur diesel.

A story that is not politically correct at present because it appears to be "anti-green" is the ultimate huge price tag the trucking industry and ultimately, the American public is paying and will continue to pay for cleaner air.

1993—Class 8 trucks ran on DIESEL #2, a by-product of the refinery process. So when a gallon of regular gasoline was refined, Diesel #2 spilled out without much cost much like kerosene and heating oil. This resulted in DIESEL #2 being about 15% cheaper than regular gasoline. DIESEL #2 emitted 5,000 parts per 1,000,000 of sulfur particulate.

1994—The EPA mandated that class 8 trucks begin using LOW SULFUR DIESEL. This was a refined product, not a by-product, and as a result the price of DIESEL moved up to compare with that of regular gasoline—an approximate 15% increase in cost relative to gasoline. This LOW SULFUR DIESEL emitted 500 parts per 1,000,000 of sulfur, so it was 10 times cleaner than DIESEL #2.

2003—The EPA mandated that class 8 trucks operate on ULTRA LOW SULFUR DIESEL that must be refined twice much like higher octane gasoline and the price of diesel increased to about 25% higher than regular gasoline (today's gas in Nashville was $3.50 and diesel was $4.14). ULTRA LOW SULFUR DIESEL emits 15 parts per 1,000,000 of sulfur.

Conclusion: If class 8 trucks were still running on DIESEL #2, the price at the pump for commercial vehicles would be at least $1.00 per gallon lower than it is today.

Now, I'm not saying that cleaner air isn't a worthwhile objective, and I'm not saying that the move to LOW SULFUR by the EPA in 1994 was a bad move. I am saying that the move in 2003 to ULTRA LOW SULFUR DIESEL was OVERKILL and that the full economic impact of this move was not well thought out.

The price of "ULTRA" clean air is huge when the escalated added cost of diesel is passed up through the supply chain from the independent trucker, the small trucking companies, the larger trucking companies, to the shipper, to the manufacturer, and ultimately to the CONSUMER. All of us are paying more for EVERYTHING because of this decision.

Suffice it to say there is no doubt that the EPA who projected $2.75 per gallon diesel through 2008 missed that projection and that they grossly underestimated the economic impact of ultra low sulfur fuel. I think some of this relates back to that lack of understanding of trucking or that failure to "connect the dots" that I alluded to earlier. After all these new café standards were put in place by the same person who supported legislation to limit class 8 truck traffic to only interstate highways in her state while she was governor. I don't have any idea how she thought goods would actually be delivered to market from interstate exit ramps.

We have heard all the political/economic explanations for high fuel prices and I'm sure all of them have some validity. Some that I've heard include the following:

-Increased demand by China, India, and other developing nations
-The move to a global market
-The weakness of the dollar
-Lack of refinery capacity
-The ability of hedge-fund operators to manipulate the market
-The war in Iraq
-Unrest in the Middle East
-Profiteering by "Big Oil"
-Failure to become less dependent on OPEC and foreign oil
-The policies of the Bush Administration
-The policies of the Clinton Administration
-Failure to tap resources in Alaska and other domestic locales

I can pretty well tell you who hasn't been the culprit in the high cost of fuel at the pump, that's the <u>retailer.</u>

Our Quality Plus Network of fuel stops is comprised of 840 truck stops across the country where our companies enjoy the advantages of volume purchasing power for

diesel. Our main network chain, Travel Centers of America (TA) has posted $140,000,000 in losses the past two quarters. It may be difficult to understand or believe, but with diesel fuel, AS PRICES GO UP, MARGINS GO DOWN and, conversely, WHEN PRICES GO DOWN, MARGINS GO UP. The continued upward pressure of fuel prices has seriously threatened the profitability of many truck stops over the past few years.

What's worse than $4.00 diesel?

What's worse than $7.00 diesel?

-Not being able to purchase diesel fuel at all!

Our most vulnerable supply chain in the U.S. today is the supply chain from our refineries to our distribution system. If the pipeline and the trucks that haul fuel were shut down for a week our distribution system would come to a halt and our country would be brought to its knees.

Some hope or help for the future with suggestions.

1. **The SmartWay Program developed by EPA**

2. **The development and implementation of Auxiliary Power Units (APU's) to decrease idling time. In our market, drivers must sleep in their sleeper units which <u>require</u> eight to ten hours of idling time per day. This isn't fuel friendly or ecologically friendly. APU's allow the driver to get his sleeper berth rest without the truck running. I would love to see tax credits for APU's and a national standardization of idling laws.**

3. **The suggested moratorium on fuel taxes, though many argue that it would not necessarily get down to the consumer in <u>GAS</u> prices, it most certainly would get down to the consumer immediately in diesel fuel purchases.**

4. **Some sort of over-sight that prohibits states from selling or leasing interstate highways to the private sector.**

5. **Escalated research and development of hybrid, energy-efficient operating systems for trucks.**

6. **Some semblance of central oversight on interstate commerce that can't be trumped by a hodge-podge of state laws that complicate and restrict the movement of goods and people across state lines.**

Thank you again for the opportunity to speak. I'll be at your service now for any questions you might have.

Mr. CONYERS. Thank you. We notice you have some solutions in your statement. We are going to come back to those.

Mr. OWEN. Okay.

Mr. CONYERS. Mr. Bill Douglass is the member and former director of the Texas Petroleum Convenience Store Association, past chairman of the National Association of Convenience Store and Petroleum Retailers, and is currently chief executive officer of the Douglass Distributing Company.

And we welcome you to this hearing, sir.

TESTIMONY OF BILL DOUGLASS, CHIEF EXECUTIVE OFFICER, DOUGLASS DISTRIBUTING COMPANY

Mr. DOUGLASS. Thank you.

Good afternoon, Mr. Chairman.

As you hear, my name is Bill Douglass and our company is headquartered in Sherman, Texas. We operate 15 retail stores and supply 150 other independent retail facilities.

Understandably, your constituents are concerned about the price of gasoline. And as you continue this issue, I want to share with you how the higher prices are affecting your local retailer.

First, let me explain that the retail petroleum market is the most transparent and competitive market for consumer goods in the nation.

We advertise our prices on large signs along the side of the road. And that empowers the customers to make shopping decisions for the best value while they are driving 45 miles an hour.

Yet, while most consumers can tell you what the price is in their neighborhood, they can't tell you who owns those facilities.

Our industry is dominated by small businesses. Nearly 60 percent of convenience stores are owned by individuals that operate just one store.

Despite common misperceptions, the integrated oil companies own and operate fewer than 3 percent of retail outlets, and this number is declining. Shell, Exxon, BP are all selling off whole retail markets.

When you read the earnings reports released by the major integrated oil companies, remember that your neighborhood convenience store is not sharing in these profits.

In fact, last year the average convenience store made about $23,000 in profit. Most of that profit was generated inside the store on products like coffee and sandwiches.

However, gasoline is essential for us to attract customers. This means our fuel prices must be as competitive as possible.

According to a recent survey, one-third of the customers say they will drive 10 minutes just to save $.03 a gallon. Such competitive pressures have made it very difficult, at this time, to make a profit on gasoline sales.

And this chart that we have over here shows the average retail price for gasoline has increased $1.78 per gallon since 2002.

However, the retailers' gross margin has decreased from 9 percent to a historic low of 3.7 percent. And we refer to this chart as the "misery index." That 3.7 percent is before we pay our biggest expense.

Last week, the Oil Price Information Service reported that the average retail price of gasoline was $3.57 and the average retailer margin was only 8.9 cents. At this price, every time you swipe your credit card to pay for gasoline, the credit card company collects approximately $.09 per gallon. This leaves the retailer with nothing to pay for all the other expenses.

In 2007, our industry paid $7.6 billion in credit card fees while reporting only 3.4 billion in profit. On average, the banks and the card companies are making more than the retailer on every gallon of gasoline, and the card company profits just keep going up with the price.

Many retailers cannot survive on these small margins, and a number of them are on the brink of bankruptcy, and we think it is reaching a dangerous level.

In fact, in the past 4 months, 10 of the dealers whom I supply fuel have offered me the deeds to their business. They are so leveraged that the slim margins they make on their sales can't service their financial obligations.

This is a serious situation. Retailers are being forced out of business because they are unable to pass through the increasing cost of inventory and operating expenses.

So what can Congress do?

First, I think there is two elements that can make a lasting, positive impact on market conditions.

One, we have heard this morning, increase crude supplies. Crude oil now represents 72 percent of the retail price of gasoline, higher than any other time in history.

If substantial supplies of additional crude were brought onto the market, basic economics tell us this would have a deflationary effect on crude oil prices. But perhaps, more importantly, such an increase in supply would send a signal to the noncommercial market traders.

A significant factor influencing crude oil prices has been the entry of the commodity investors seeking a safe haven from the volatility of the real-estate and stock markets.

This huge influx of capital has violated the traditional supply-demand equation and grossly inflated fuel prices.

Additional supplies would help correct this speculation.

And, two, Mr. Chairman, enact your bill that is to give the retailers the ability to negotiate with Visa and Master Card, the Credit Card Fair Fee Act. It is a critical piece of legislation.

And this could help reduce the financial burden on the retailers and provide them with the opportunity to remain competitive in this market.

Many more of my dealer customers would be able to cover their expenses if they were not forced to turn over more than half their gross fuel margins dollars to the credit card companies.

Therefore, I urge you to move forward quickly to enact H.R. 5546.

And thank you for the opportunity to share the perspective of the convenience and petroleum retailers in the nation.

[The prepared statement of Mr. Douglass follows:]

PREPARED STATEMENT OF BILL DOUGLASS

NACS®

Testimony of Bill Douglass

CEO

Douglass Distributing Company

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

The Association for Convenience & Petroleum Retailing

1600 Duke Street • Alexandria, VA 22314-3436 • (703) 684-3600 • FAX (703) 836-4564 • www.nacsonline.com

Chairman Conyers, Representative Chabot, members of the Anti-Trust Task Force, good morning. My name is Bill Douglass and I am CEO of Douglass Distributing Company headquartered in Sherman, Texas. My company owns and operates 15 convenience stores outside the greater Dallas-Fort Worth area. In addition, we supply motor fuels to 150 independent retailers.

I testify today on my behalf as an independent business owner and on behalf of the National Association of Convenience Stores (NACS), of which I served as Chairman of the Board from 2004-2005. NACS is an international trade association that represents the convenience and petroleum retailing industry. In 2007, our industry generated $577.4 billion in sales, sold approximately 80 percent of the gasoline in the United States and employed 1.7 million workers.

I am pleased to be invited to discuss the impact of higher motor fuels prices on the nation's petroleum retailers and their customers. To help the committee better understand the retail petroleum marketplace, my testimony will focus on the composition of the retail market, the criteria influencing retail motor fuel prices, and policy options for Congress to provide price relief to the market.

As you consider the overall impact of higher gasoline prices on your constituents and the economy in general, I want to stress that you should also be very concerned about how our industry is being hurt by higher gasoline prices. These higher prices have lead to reduced – and sometimes negative – gross profit margins, increased inventory costs resulting in extensions of credit lines and associated interest payments, and higher fees assessed by the credit card companies. These have all combined to put an increasing number of retailers on the brink of bankruptcy.

The Retail Petroleum Marketplace

The retail petroleum market is the most transparent and competitive market for consumer goods in the nation. For no other product can consumers comparison shop for the best value while driving down the road at 45 miles per hour. Retailers advertise their motor fuels prices on large signs along the side of the road, empowering consumers to wield an amazing influence on pricing decisions made in a highly competitive market.

Yet, while most consumers can quote the price of gasoline at their neighborhood store, very few understand who owns that neighborhood store.

Our industry is dominated by small, independent businesses. Despite common misperceptions, the major integrated oil companies no longer have a significant presence in the retail marketplace and they are actively reducing their presence even further. This confusion is probably because most fuel retailers are small businesses that lack branding expertise of their own and they have chosen to sell a major refiner's brand of gas. Consequently, customers presume that the canopy signage also indicates ownership of the facility. However, of the more than 115,000 convenience stores that sell motor fuel, the majority – nearly 60% – are owned and operated by individuals that have just one store. By contrast, the major integrated oil companies own and operate fewer than 3% of all retail locations, and this number is declining rapidly.

Below is a snapshot of the composition of the retail market:

Source: NACS, TDLinx, *National Petroleum News*

Petroleum retailers rely on their daily retail sales to generate sufficient revenues to cover their expenses and provide a modest profit. Just as we do not benefit from the corporate revenues generated by the companies that provide snack or drink items sold inside our stores, we do not benefit from the revenues generated by our petroleum suppliers. On average, over the course of a year, we sell about 4,000 gallons of fuel a day. The average net profit per gallon is about 1.5 cents per gallon. This means we generate about $60 in profit per day at the pump. Therefore, when you read about earnings reports released by the major integrated oil companies, remember that those profits were generated from business interests other than retail (primarily crude oil and refining operations) and that your neighborhood convenience store is not sharing in those profits. In fact, on average convenience stores/gas stations in 2007 saw an average pre-tax profit of only $23,335 per store, which includes both profits at the pump and inside the store.

Competition Drives Price

Although motor fuels are the major source of revenues, representing 71 percent of a store's overall sales, they account for only 34 percent of a store's profits. Consequently, it has become essential for retailers to price motor fuels at a level that is sufficiently competitive in the market to generate enough customer traffic to generate sales inside the store, where the majority of profits are generated. Meanwhile, competition for the consumer has become even more intense as retail prices have escalated.

In February 2008, NACS released its 2008 *Consumer Fuels Report,* which examined information obtained through interviews with more than 1,200 consumers nationwide. NACS sought a better understanding of consumers' behavior with regards to the retail marketplace. What we learned helps explain why retailers are unable to generate significant profits at the dispenser:

- 73% of consumers report that price is the most important factor when choosing a retailer from whom to purchase gasoline.
- 45% say that high gas prices have a "very significant" effect on their spending behavior.
- 29% say they will drive 10 minutes out of their way – a 20-minute roundtrip – to save 3 cents per gallon.

The bottom line is consumers feel the pressure of higher gasoline prices; they are shopping for the best-priced gasoline; and they will go out of their way to save as little as a few cents per gallon. In addition, the competitive market has become even more so with the popularity of gasoline pricing websites which enable consumers to plan their routes to seek out lower prices.

As a retailer, I understand that if I price my gasoline higher than my competitors, I will lose customers, compromising my ability to sell items like sandwiches and coffee, which provide me with most of my operating margin dollars.

In my market, I am competing with retail formats that are quite different from my own, which makes my challenge all the greater. About 10 years ago, grocery stores and mass merchandisers began selling motor fuels with the intent to attract additional customers by posting the lowest price in the market. Competition forced the rest of the motor fuel retailers in the market to lower our prices. But our businesses do not have the same economies of scale as these larger operators and we are unable to absorb lower margins on fuel sales as easily as they can. Yet the need to attract customers requires that we try our best to remain competitive with these other retailers. Unfortunately, this increased price competition does not allow us to pass through changes in the wholesale cost of our motor fuel inventories, which reduces our profitability.

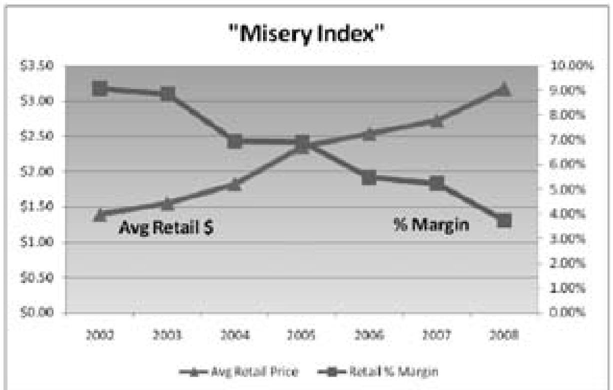
Higher Retail Costs Do Not Mean Higher Retail Profits

The competition isn't the only thing that has changed. So has our supply structure. Only just a few years ago, retailers would receive notification of wholesale price changes once a day. The retail price set in the morning was often sufficient to cover operations for the entire day. More recently, however, due to the dynamic nature of the market and the advent of technology, wholesale prices fluctuate several times throughout the day. Given the slim operating margins on which retailers operate, they must ensure that the gallons they sell will generate sufficient revenues to purchase the replacement gallons at the new wholesale price. In a perfect world, if they learn their next load will cost an additional 10 cents per gallon, they would increase their retail prices 10 cents to cover the next shipment. However, they don't know if and when their competitors receive similar price increases, since each supply arrangement can be different.

This leaves retailers with two choices: increase prices to match the wholesale price increase and know you will lose customers, or try to minimize your price increase to maximize your customers. Most retailers take the second option and profit margins are squeezed or eliminated. According to the U.S. Energy Information Administration, the statistical arm of the U.S. Department of Energy, it may take several weeks before a change in the wholesale price of gasoline may be fully reflected in the retail price. (Source: U.S. Energy Information Administration, "Gasoline Price Pass-through," January 2003)

If competition determines retail prices, wholesale costs determine retailer profitability. According to the Oil Price Information Service (OPIS), which supplies gas price numbers to AAA, the average national retail price for regular unleaded gasoline through April 2008 was $3.178 per gallon, while the average gross margin was 11.9 cents—an historic low margin of 3.74%.

The following chart demonstrates the decline in retailer margins as retail gasoline prices have climbed since 2002:



Source: NACS (2002-2007); Oil Price Information Service (2008)

It is important to remember when considering profitability in the petroleum industry, one must not take a snapshot approach. At any given time throughout the year, a retailer may be losing money per gallon sold or may be making more than the industry averages. However, only by analyzing a complete market cycle can one obtain a clear understanding of a retailer's potential profitability.

Because of the market delay in passing through wholesale price changes, during periods of escalating wholesale prices, retailers typically experience a decline in gross margins. However, the opposite is true when wholesale prices decline – retailers seek to completely pass through costs previously incurred and to recover their lost margins by holding retail prices steady for as long as competition may allow. But at some point, one retailer in a market will begin to drop prices in search of additional customer volume, and others will follow suit to avoid losing in-store sales. This is why it is necessary to look at a retailer's operation from the perspective of a complete market cycle, the duration of which can vary greatly.

The following chart demonstrates the impact of changing wholesale gasoline prices on retailer gross margins:

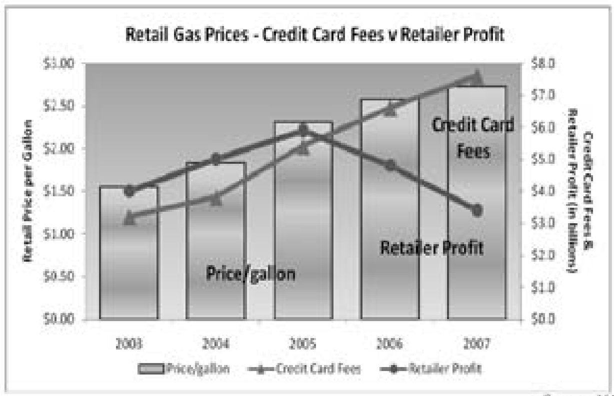
Source: Oil Price Information Service

Credit Card Fees Further Reduce Profitability

A significant cost not represented in the OPIS report of average gross margins is credit card fees. Whenever a consumer uses a credit card to purchase any product or service, the banks that issue the card and that process the transaction collect a set of fees. For petroleum retailers, this typically equates to about 2.5 percent. As gasoline prices have gone up, so have the costs associated with these transactions.

According to OPIS data, the retail price of gasoline has increased from a 2006 annual average of $2.56 to a 2008 annual average of $3.18 and retailer gross margins declined from 13.8 cents per gallon to 11.9 cents. Meanwhile, credit card fees have increased from 6.4 cents to 7.9 cents per gallon. While this increase may not seem significant, to the retailer this automatically reduces potential profitability. Subtracting credit card fees from the OPIS reported margins during that time period, retail gross margins declined from 7.4 cents per gallon to 4.0 cents, and that is before all other operating expenses.

In fact, the convenience and petroleum retailing industry paid $7.6 billion in fees in 2007 while generating only $3.4 billion in pre-tax profit. The net effect is that the industry's credit card fees are now more than double the industry's pretax profits.

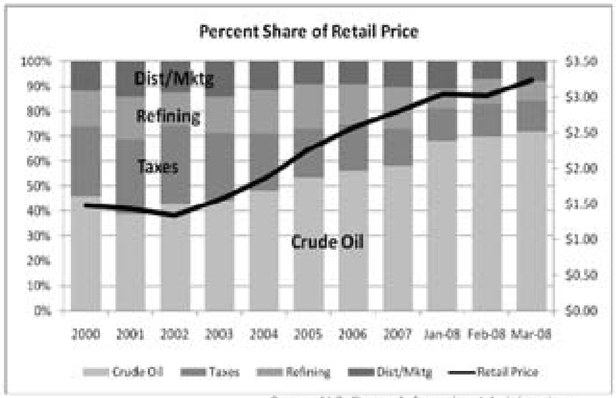


Source: NACS

Compounding the impact of credit card fees is the fact that consumers are increasingly turning to this form of payment as prices increase. Plastic payment has become the default currency. An increasing number of consumers do not have sufficient cash flow to cover increasing fuel expenses, leaving credit as their best option to finance purchases, despite the high interest rates associated with these cards.

Crude Oil Drives Wholesale Costs

The price of crude oil is the largest single factor in the retail price of gasoline. Each month, the U.S. Energy Information Administration reports the breakdown of retail gasoline prices into four sectors: crude oil, taxes, refining, and distribution/marketing. This last category includes all the factors that are incurred after the product leaves the refinery, including pipelines, terminals, distribution and retail. The latest data available is for March 2008 and indicates that crude oil at the time contributed 71.8% to the retail price of gasoline. This is a sharp departure from historic norms. Crude oil's average contribution from 2000 through 2005 was only 45.3%. Meanwhile, the relative contribution of the other components has declined:



Source: U.S. Energy Information Administration

Retailers Struggle with Liquidity

The overall impact on retailers of higher crude oil prices, and the resulting increase in wholesale and retail gasoline prices, is profound. Not only have consumers become more price sensitive, resulting in lower margins, but the overall economics of retail operations have become more challenging. As gross margins have remained static on a cents-per-gallon basis over the past few years, inventory costs have not.

Inventory Costs Outpace Margins

	Avg. Rack Price w/ Tax & Freight	Cost of 9,000 Gal. Delivery	Gross Margin per Delivery	Margin as % of Cost
2006	$2.420	$21,780	$1,242	5.70%
2007	$2.640	$23,760	$1,242	5.22%
Through April 28, 2008	$3.048	$27,432	$1,071	3.90%

Source: Oil Price Information Service

The combination of increased inventory costs with declining profitability has created a liquidity crisis for retailers. Retailers now must pay more for their fuel inventory, reducing cash flow and increasing liabilities. Compounding this increase in costs, many retailers incur additional fuel surcharges for each delivery as their distributors seek to cover the increased expense of the fuel required to power their trucks. (Similar surcharges also apply to the delivery of in-store items.) This has greatly reduced the ability of cash flow from fuel sales to purchase replacement gallons.

Consequently, many retailers are forced to extend their lines of credit to keep fuel in their tanks. This has brought with it additional costs. In addition, terms extended to retailers may have historically required payment within 10 days. Now that creditors are seeking to ensure their own liquidity, these terms may have been reduced to 7 days or even fewer. Many of these creditors are actually wholesale distributors, like me, servicing multiple retailers and they are running into their own credit limits in their efforts to keep their customers supplied with fuel. As more inventory is purchased on credit, the additional payments of interest have further reduced cash flow.

After months of operating on credit, while wholesale costs have continued to increase and gross margins have remained stagnant or declined, many retailers are approaching the limit of their available credit. This is especially true in my market.

The following OPIS data represents average conditions for the Dallas-Fort Worth market in Texas. You can see that in all but three weeks, the credit card companies have made more on each gallon sold than have the retailers. More critically, retailer profit after credit card fees was less than one penny in eight weeks and was actually negative in six weeks. I must remind the Committee that these numbers are averages, which means that some retailers did better than the numbers represented below, while others did worse.

Market Performance in Dallas-Fort Worth

	Retail Price	Gross Margin (cpg)	Credit Card Fees (cpg)	Retailer Profit (cpg)
January 7	$2.925	7.5	7.3	2.0
January 14	$2.929	18.1	7.3	10.8
January 21	$2.867	20.8	7.2	13.6
January 28	$2.827	15.0	7.1	7.9
February 4	$2.816	10.8	7.0	3.8
February 11	$2.798	11.9	7.0	4.9
February 18	$2.850	3.7	7.1	-3.4
February 25	$2.988	5.1	7.5	-2.4
March 3	$3.039	9.5	7.6	1.9
March 10	$3.086	8.2	7.7	0.5
March 17	$3.162	9.8	7.9	1.9
March 24	$3.152	10.8	7.9	2.9
March 31	$3.186	5.9	8.0	-2.1
April 7	$3.242	8.3	8.1	0.2
April 14	$3.286	7.9	8.2	-0.3
April 21	$3.377	3.8	8.4	-4.6
April 28	$3.485	8.0	8.7	-0.7
2008 Average	**$3.060**	**9.7**	**7.6**	**2.1**

Source: Oil Price Information Service

My company not only operates convenience stores, we also distribute motor fuel to 150 stores in Texas. From my perspective, I can assure you that times are tough. Many retailers cannot survive on the margins available in my market. When you layer on top of that the increased cost of inventory, the extension of credit lines and the associated interest payments, and ultimately the fees assessed by the credit card companies, the number of retailers on the brink of bankruptcy is now at a dangerous level.

My comments are not simply gloom-and-doom projections, they are fact. In the past four months, 10 of the dealers to whom I supply motor fuel have relinquished to me the deeds to their business. They are so leveraged with their efforts to maintain adequate motor fuel inventories, so burdened by low margins and high credit card fees, that they simply have reached the point where they can no longer service their financial obligations. This is a serious situation—retailers are being forced out of business because they are unable to charge sufficient prices at retail to cover the increasing costs of inventory and operating expenses.

What Can Be Done?

So what can the government do to help? I do not envy your position. Your constituents are asking you to "do something," to "do anything." Unfortunately, there is no magic potion available to correct the imbalances in the market in the time frame that public sentiment desires. Consequently, I strongly caution you against implementing knee-jerk reactions driven by public uproar. Such actions often carry with them consequences which are much more disruptive than the current market situation. Rather, I encourage you to focus on policy changes that can benefit the long term stability of the marketplace, which will in turn benefit consumers.

I suggest you focus on two areas. First, since the driving force behind retail gasoline prices is clearly the elevated price of crude oil, your attention must be focused on that component of the system. Regardless of external influences, economics dictates that when supplies for any object are greater than the relative demand, prices will decline. There are numerous examples throughout the history of the petroleum market that support this argument. Today's crude oil prices are largely related to the international relationship between supply and demand. If substantial inventories of additional crude oil were brought onto the market, this would have a deflationary effect on crude oil prices.

Perhaps even more importantly, however, an increase in supply would send a signal to the non-commercial market traders. A significant factor influencing crude oil prices has been the entry of investors seeking a safe haven from the volatility of the real estate and stock markets. This huge influx of capital into the crude oil markets has violated the traditional supply-demand equation and grossly inflated prices. However, additional supplies should have a dampening effect on prices. It is therefore conceivable that non-commercial investors would begin to transfer their speculative capital away from the crude oil commodities market and invest in markets with more favorable economic indicators for long-term return. This would help restore crude oil prices to a more rational level.

Second, Congress can take action to help retailers get out of the spin cycle and remain solvent, thereby preserving the competitive nature of the market. More of my dealer customers would be able to cover their expenses if they were not forced to turn over more than half of their gross fuel margin dollars to the credit card companies. Chairman Conyers and Congressman Cannon have introduced H.R. 5546, the Credit Card Fair Fee Act, to give retailers the ability to negotiate with Visa and MasterCard. This is critical legislation that could help reduce the financial burden facing retailers and provide them with the opportunity to remain competitive in the market without sacrificing the future of their business. I urge you to move forward quickly to enact this legislation.

Thank you for the opportunity to share the perspective of the nation's convenience and petroleum retailing industry on the retail motor fuels market. I look forward to your questions and to working with you to create a system that addresses our nation's motor fuels challenges and can affect permanent change to a system that frustrates both consumers and retailers alike.

2006 Average Weekly Prices and Margins[1]

Date	Crude Price	Rack Price	Retail Price	Net Retail[2]	Gross Margin	Credit Cards[3]
January 2, 2006	$59.82	$1.668	$2.197	$1.742	$0.074	$0.055
9-Jan	$63.39	$1.782	$2.292	$1.833	$0.051	$0.057
16-Jan	$63.74	$1.743	$2.323	$1.863	$0.120	$0.058
23-Jan	$66.79	$1.774	$2.323	$1.863	$0.089	$0.058
30-Jan	$66.82	$1.757	$2.332	$1.872	$0.115	$0.058
6-Feb	$66.59	$1.747	$2.342	$1.880	$0.133	$0.059
13-Feb	$63.06	$1.627	$2.296	$1.834	$0.207	$0.057
20-Feb	$59.37	$1.596	$2.241	$1.780	$0.184	$0.056
27-Feb	$59.93	$1.657	$2.238	$1.777	$0.120	$0.056
6-Mar	$62.27	$1.758	$2.281	$1.820	$0.062	$0.057
13-Mar	$60.89	$1.801	$2.381	$1.889	$0.088	$0.060
20-Mar	$62.64	$1.946	$2.472	$2.008	$0.062	$0.062
27-Mar	$61.36	$1.912	$2.500	$2.036	$0.124	$0.063
3-Apr	$65.67	$2.021	$2.558	$2.092	$0.071	$0.064
10-Apr	$66.56	$2.112	$2.650	$2.182	$0.070	$0.066
17-Apr	$68.85	$2.231	$2.769	$2.300	$0.069	$0.069
24-Apr	$71.87	$2.347	$2.891	$2.420	$0.073	$0.072
1-May	$70.38	$2.284	$2.927	$2.458	$0.174	$0.073
8-May	$72.14	$2.291	$2.912	$2.444	$0.153	$0.073
15-May	$71.50	$2.342	$2.917	$2.450	$0.108	$0.073
22-May	$69.07	$2.228	$2.903	$2.437	$0.209	$0.073
29-May	$70.35	$2.238	$2.861	$2.397	$0.159	$0.072
5-Jun	$71.53	$2.305	$2.863	$2.398	$0.093	$0.072
12-Jun	$71.54	$2.319	$2.902	$2.438	$0.119	$0.073
19-Jun	$69.48	$2.243	$2.880	$2.416	$0.173	$0.072
26-Jun	$69.94	$2.262	$2.852	$2.388	$0.126	$0.071
3-Jul	$72.65	$2.372	$2.915	$2.449	$0.077	$0.073
10-Jul	$74.65	$2.399	$2.960	$2.493	$0.094	$0.074
17-Jul	$75.21	$2.400	$2.967	$2.501	$0.101	$0.074
24-Jul	$73.98	$2.429	$2.995	$2.528	$0.099	$0.075
31-Jul	$73.87	$2.428	$3.010	$2.544	$0.116	$0.075
7-Aug	$75.20	$2.444	$3.022	$2.556	$0.112	$0.076
14-Aug	$75.63	$2.325	$3.011	$2.544	$0.219	$0.075
21-Aug	$71.79	$2.211	$2.937	$2.472	$0.261	$0.073
28-Aug	$72.12	$2.114	$2.858	$2.395	$0.281	$0.071
4-Sep	$70.06	$1.983	$2.757	$2.295	$0.312	$0.069
11-Sep	$67.53	$1.859	$2.643	$2.184	$0.325	$0.066
18-Sep	$63.98	$1.760	$2.514	$2.057	$0.297	$0.063
25-Sep	$61.40	$1.665	$2.400	$1.946	$0.281	$0.060
2-Oct	$61.94	$1.668	$2.310	$1.856	$0.188	$0.058
9-Oct	$59.77	$1.643	$2.258	$1.806	$0.163	$0.056
16-Oct	$58.58	$1.614	$2.219	$1.768	$0.154	$0.055
23-Oct	$58.48	$1.615	$2.194	$1.744	$0.129	$0.055
30-Oct	$58.88	$1.636	$2.191	$1.741	$0.105	$0.055
6-Nov	$58.55	$1.618	$2.181	$1.731	$0.113	$0.055
13-Nov	$59.96	$1.675	$2.206	$1.756	$0.081	$0.055
20-Nov	$57.56	$1.662	$2.218	$1.768	$0.106	$0.055
27-Nov	$57.24	$1.686	$2.230	$1.779	$0.093	$0.056
4-Dec	$62.02	$1.744	$2.263	$1.812	$0.068	$0.057
11-Dec	$62.32	$1.708	$2.287	$1.836	$0.128	$0.057
18-Dec	$61.91	$1.725	$2.288	$1.836	$0.111	$0.057
25-Dec	$62.40	$1.762	$2.333	$1.880	$0.118	$0.058
1-Jan	$60.66	$1.722	$2.323	$1.870	$0.148	$0.058
2006 Average	**$65.92**	**$1.960**	**$2.558**	**$2.097**	**$0.138**	**$0.064**

Source: Crude Prices: Energy Information Administration, date is set to date reported by OPIS
Rack, Retail, Margin Data: Oil Price Information Service (OPIS), *Retail Fuel Watch*

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[1] Crude prices are expressed as $/barrel; other prices are $/gallon.
[2] Net Retail: Retail price less local, state and federal taxes and 1.5 cents freight
[3] Estimated at 2.5% of the retail price

2007 Average Weekly Prices and Margins[4]

Date	Crude Price	Rack Price	Retail Price	Net Retail[5]	Gross Margin	Credit Cards[6]
January 8, 2007	$57.76	$1.661	$2.309	$1.856	$0.195	$0.058
15-Jan	$54.11	$1.544	$2.248	$1.796	$0.252	$0.056
22-Jan	$51.51	$1.477	$2.176	$1.726	$0.249	$0.054
29-Jan	$53.57	$1.538	$2.145	$1.695	$0.157	$0.054
5-Feb	$57.11	$1.604	$2.168	$1.715	$0.111	$0.054
12-Feb	$58.99	$1.667	$2.207	$1.754	$0.087	$0.055
19-Feb	$58.41	$1.716	$2.253	$1.798	$0.082	$0.056
26-Feb	$59.57	$1.816	$2.329	$1.874	$0.058	$0.058
5-Mar	$61.64	$1.940	$2.459	$2.000	$0.060	$0.061
12-Mar	$60.85	$1.963	$2.527	$2.067	$0.104	$0.063
19-Mar	$57.94	$1.977	$2.550	$2.090	$0.113	$0.064
26-Mar	$58.26	$2.021	$2.583	$2.121	$0.100	$0.065
2-Apr	$64.18	$2.124	$2.667	$2.203	$0.079	$0.067
9-Apr	$64.82	$2.203	$2.755	$2.289	$0.086	$0.069
16-Apr	$62.85	$2.294	$2.840	$2.373	$0.079	$0.071
23-Apr	$63.06	$2.233	$2.859	$2.392	$0.159	$0.071
30-Apr	$65.26	$2.389	$2.928	$2.459	$0.070	$0.073
7-May	$63.82	$2.444	$3.021	$2.549	$0.105	$0.076
14-May	$61.90	$2.490	$3.055	$2.583	$0.093	$0.076
21-May	$63.61	$2.601	$3.158	$2.683	$0.082	$0.079
28-May	$64.89	$2.541	$3.203	$2.728	$0.187	$0.080
4-Jun	$63.94	$2.471	$3.156	$2.681	$0.210	$0.079
11-Jun	$65.90	$2.357	$3.085	$2.612	$0.255	$0.077
18-Jun	$66.62	$2.319	$3.005	$2.534	$0.215	$0.075
25-Jun	$68.78	$2.356	$2.973	$2.503	$0.147	$0.074
2-Jul	$69.13	$2.331	$2.952	$2.481	$0.150	$0.074
9-Jul	$71.78	$2.384	$2.948	$2.475	$0.091	$0.074
16-Jul	$72.79	$2.426	$3.032	$2.556	$0.130	$0.076
23-Jul	$74.92	$2.250	$2.967	$2.489	$0.239	$0.074
30-Jul	$75.15	$2.168	$2.885	$2.411	$0.243	$0.072
6-Aug	$76.75	$2.162	$2.830	$2.358	$0.196	$0.071
13-Aug	$71.92	$2.084	$2.771	$2.300	$0.216	$0.069
20-Aug	$72.05	$2.157	$2.754	$2.284	$0.127	$0.069
27-Aug	$70.19	$2.105	$2.747	$2.278	$0.173	$0.069
3-Sep	$72.93	$2.204	$2.762	$2.292	$0.088	$0.069
10-Sep	$75.96	$2.218	$2.804	$2.333	$0.115	$0.070
17-Sep	$78.95	$2.185	$2.778	$2.309	$0.124	$0.069
24-Sep	$82.26	$2.228	$2.787	$2.318	$0.090	$0.070
1-Oct	$81.70	$2.186	$2.786	$2.316	$0.130	$0.070
8-Oct	$80.59	$2.143	$2.758	$2.289	$0.146	$0.069
15-Oct	$81.46	$2.161	$2.747	$2.279	$0.118	$0.069
22-Oct	$87.80	$2.251	$2.801	$2.331	$0.080	$0.070
29-Oct	$89.23	$2.273	$2.832	$2.362	$0.089	$0.071
5-Nov	$93.46	$2.418	$2.961	$2.489	$0.071	$0.074
12-Nov	$95.81	$2.510	$3.076	$2.603	$0.093	$0.077
19-Nov	$93.56	$2.456	$3.092	$2.624	$0.168	$0.077
26-Nov	$97.93	2.483	$3.076	$2.607	$0.124	$0.077
3-Dec	$92.47	$2.359	$3.066	$2.598	$0.239	$0.077
10-Dec	$88.71	$2.301	$3.004	$2.538	$0.237	$0.075
17-Dec	$91.18	$2.352	$2.981	$2.514	$0.162	$0.075
24-Dec	$91.16	$2.356	$2.966	$2.500	$0.144	$0.074
31-Dec	$95.64	$2.466	$3.011	$2.545	$0.079	$0.075
2007 Average	**$72.21**	**$2.180**	**$2.785**	**$2.318**	**$0.138**	**$0.070**

Source: Crude Prices: Energy Information Administration, date is set to date reported by OPIS
Rack, Retail, Margin Data: Oil Price Information Service (OPIS), *Retail Fuel Watch*

[4] Crude prices are expressed as $/barrel; other prices are $/gallon.
[5] Net Retail: Retail price less local, state and federal taxes and 1.5 cents freight
[6] Estimated at 2.5% of the retail price

2008 Average Weekly Prices and Margins[7]

Date	Crude Price	Rack Price	Retail Price	Net Retail[8]	Gross Margin	Credit Cards[9]
January 7, 2008	$98.17	$2.514	$3.078	$2.610	$0.096	$0.077
14-Jan	$94.76	$2.417	$3.074	$2.606	$0.189	$0.077
21-Jan	$91.51	$2.327	$3.016	$2.549	$0.222	$0.075
28-Jan	$89.41	$2.340	$2.983	$2.516	$0.176	$0.075
4-Feb	$91.14	$2.383	$2.976	$2.509	$0.126	$0.074
11-Feb	$89.08	$2.341	$2.954	$2.487	$0.146	$0.074
18-Feb	$94.13	$2.444	$2.992	$2.525	$0.081	$0.075
25-Feb	$99.61	$2.560	$3.112	$2.643	$0.083	$0.078
3-Mar	$100.84	$2.573	$3.153	$2.684	$0.111	$0.079
10-Mar	$103.44	$2.613	$3.195	$2.725	$0.112	$0.080
17-Mar	$109.35	$2.682	$3.269	$2.797	$0.115	$0.082
24-Mar	$105.28	$2.629	$3.257	$2.785	$0.156	$0.081
31-Mar	$104.49	$2.708	$3.268	$2.798	$0.090	$0.082
7-Apr	$103..46	$2.739	$3.304	$2.830	$0.092	$0.083
14-Apr	$109.71	$2.800	$3.360	$2.884	$0.084	$0.084
21-Apr	$114.33	$2.924	$3.459	$2.982	$0.057	$0.086
28-Apr	$118.53	$3.009	$3.576	$3.098	$0.089	$0.089
Average	**$97.23**	**$2.588**	**$3.178**	**$2.708**	**$0.119**	**$0.079**

Source: Crude Prices: Energy Information Administration, date is set to date reported by OPIS
Rack, Retail, Margin Data: Oil Price Information Service (OPIS), *Retail Fuel Watch*

[7] Crude prices are expressed as $/barrel; other prices are $/gallon.
[8] Net Retail: Retail price less local, state and federal taxes and 1.5 cents freight
[9] Estimated at 2.5% of the retail price

Mr. CONYERS. Thanks so much, Mr. Douglass.

Our final witness before we vote is Mr. Lou Pugliaresi who has been a White House staffer. He has worked with the EPA, Interior, Energy, and State Department.

He has written extensively for the Oil and Gas Journal, and we are pleased to have you here this afternoon.

TESTIMONY OF LUCIAN PUGLIARESI, PRESIDENT, ENERGY POLICY RESEARCH FOUNDATION, INC.

Mr. PUGLIARESI. Mr. Chairman, thank you so much.

First, we very much appreciate the opportunity to testify today.

I am the president of the Energy Policy Research Foundation. We used to be called the Petroleum Industry Research Foundation. We have been around since 1944.

We have probably looked more at the downstream markets and the petroleum markets, both in the U.S., worldwide, than almost any other institution. We have been doing this a very long time.

And what I would like to do today is just make a couple of basic points pulled from our analysis.

The first is the fundamental issue these gentlemen are talking about is the price of crude.

In fact, you can just do the simple math. At $122 a barrel, with about $.50 of Federal, State, and sales tax, you get to $3.36 a gallon. So 93 percent today of the problem is the feed stock cost, the price of crude oil.

And we have been doing a lot of work on this, looking at this and trying to figure out why our crude price is so high.

I mean, I think that is the sort of fundamental sort of issue I would like to discuss with you. And if you go back to 2001, 2002, the market, the buyers and sellers in the market had a set of expectations on future production.

This is actually not unusual. It is not just what is happening in the prompt period; it is what do the participants in the market think about what is going to happen over time.

We always say the 1973, 1974 Arab Oil Embargo wasn't an embargo; it was a signal to the marketplace that oil and gas was going to be developed at a much lower pace, as a slower pace.

So if you go to 2001, 2002, and you look at expectations on developing ANWR, expectations on leasing developments in Nigeria, Russia, Venezuela, across the entire major-producing regions, we generally had an era of positive expectations.

We thought that production would come on online. And, in fact, if you take EIA's forecast and take it through to 2008, 2009, it wasn't that bad had we not had what we call a "series of unfortunate events."

And virtually everything that could go wrong did go wrong.

We had civil war and strife in Nigeria. We have turmoil in Sudan. We had the Venezuelans begin to expropriate property. We failed to proceed on an aggressive leasing program here in the United States. We passed up a lot of opportunities such as opening up ANWR.

All that gets folded into the market. And, in fact, if you go through our analysis and go through each and every one, we think we are, right now, in the midst of a rather large supply disruption.

Yes, we have had growth in demand from China and India, and that has moved prices up. But the market is probably missing upwards to five million barrels a day. And that is having a big effect on prices.

So that is sort of the main point I want to leave you with.

The other issue on the diesel part that I think is a good one, world diesel demand has grown about twice the rate of gasoline. And world refining capacity was really not set up to meet that demand.

And, in fact, what is happening is—this sounds a bit strange—but it is not that diesel is so expensive; it is that gasoline is so cheap.

Now, of course, both of those products are very expensive, but what is happening is as the European and Asian refining centers are trying to hit their diesel targets—because of the way refineries are built, they produce gasoline components.

Those gasoline components come into the United States, and they come in at a pretty good price.

So I think the question of diesel fuel, that can get fixed over time as more refining capacity comes online, not just here in the U.S., but worldwide.

So I would like to sort of leave you with one last issue, which is if we are now above where we think the long-run price of oil is, than we may be in a position of bringing to market a lot of ideas, a lot of regulatory programs which would impose a very heavy cost.

What we have to ask ourselves is: Do we really want to go forward and proceed in that way? I mean, it may be that trying to specify the fuels of the future, to put together a program that tries to, sort of, almost centrally plan how we ought to transition is not going to be as productive as allowing opportunities for conventional fuels to fill in this gap as these alternative fuels have a greater opportunity to make it to the market.

Thank you.

[The prepared statement of Mr. Pugliaresi follows:]

PREPARED STATEMENT OF LUCIAN PUGLIARESI

Testimony of Lucian Pugliaresi
before the

Task Force on Competition Policy and Antitrust
of the
U.S. House of Representatives Committee on Judiciary
Hearing on Retail Gasoline Prices
May 7, 2008

Chairman Conyers, Ranking Member Chabot, and members of the Task Force on Competition Policy and Antitrust, thank you for the opportunity to testify on such an important topic. The rapid rise in gasoline prices has become a burden on U.S. consumers and the broader economy. Our organization has historically kept on top of the issue, and EPRINC has published a sequence of reports on gasoline supply and demand, resource nationalism, oil prices, role of ethanol fuels, and the structure of the world oil market.

As in institution, we bring historical perspective on developments in these markets. The Energy Policy Research Foundation, Inc. (EPRINC), formerly PIRINC, was incorporated in 1944 and is a not-for-profit organization that studies energy economics with special emphasis on petroleum and the downstream product markets. EPRINC researches and publishes reports on all aspects of the petroleum industry which are made available free of charge to interested organizations and individuals. It is known internationally for providing objective analysis of energy issues.[1]

My testimony today includes an assessment of why petroleum prices have risen so dramatically over the last two years. Today, the cost of crude oil---combined with federal and state taxes---accounts for 93 percent of the price at the pump (crude at $122/bbl plus approximately 50 cents of federal, state, and sales taxes yields a direct cost with no refiner or retailer margin of $3.36/gallon). Although, I will make some brief comments on the refining

[1] Views expressed in publications, interviews and testimony result from the Foundation's own analysis and are not meant in any way to represent a consensus of its member's views. EPRINC's supporters recognize the importance of a credible, authoritative and impartial organization that can help industry and government officials, the media, and the general public better understand the petroleum industry and the markets in which it operates.

and distribution sectors, the fundamental cause of high gasoline prices is the high price of crude oil and this is the focus of my testimony

.

Why Are Crude Prices So High?

Over the last ten years, the world oil market has clearly experienced an unprecedented number of new and sustained impediments to upstream development, including, unilateral contract renegotiation, nationalization, lack of investment by national oil companies, restrictive access to resources, war and civil strife. Many of these factors, along with technical challenges in bringing new oil fields online have also contributed to reductions in excess production capacity among OPEC producers. At the same time, global oil demand has grown robustly. These developments are presented in more detail in the graph and chart, entitled "A Series of Unfortunate Events."

When these "unfortunate events" occur, the world oil market not only loses existing production, but expectations on the availability of future supplies are also revised downward. These ongoing events, which have now resulted in a sustained trend, prompted us to dig through our files to see if we had done some earlier work on the topic. A tattered mimeographed document prepared many years ago by ***EPRINC*** (***PIRINC at that time***), was circulated by the staff to our trustees and clearly shows that if you live long enough history does indeed repeat itself,

> *American petroleum investments abroad are exposed to unprecedented political, social and economic changes. There is the ever present "specter of communism." Socialist and related nationalist movements all over the globe add their share to the ever growing difficulties. No longer can a foreign government investor depend on the protection by his government alone. No longer can a foreign government safeguard investments by guarantees, when political upheaval may remove it overnight. Policy making for petroleum companies today call for statesmanship of the highest order.*
>
> *In the domestic field the petroleum industry is entirely on the defensive. Again and again it has been shocked if not surprised by government and foundation sponsored theoretical publications. The recent Federal Trade Commission Study, 900 pages of complaints against alleged international oil cartel activities, is an example of a trend that can only continue. Many similar studies, such as the Yale*

published "A National Policy for the Oil Industry" (financed by Carnegie and Rockefeller foundations), or the Columbia University publications "Concentration of Economic Power" by David Lynch, and the cartel investigation of the 20th Century Fund are shaping the thinking and actions of legislators which in the end will only lead to lower oil production and higher prices.

Staff Memorandum to Board of Trustees of PIRINC
New York City
February 13, 1952[2]

Resource nationalism can be defined as the recent (or perhaps recurring) trend in the international oil industry wherein host nations change the terms of their contracts with international oil companies (IOCs) developing indigenous oil and gas resources. Encouraged by the rapid escalation of oil prices in recent years, this trend is now spreading rapidly. Rising oil prices have emboldened governments to take a greater share of the revenue of projects which were negotiated when oil prices were substantially lower. A variety of explanations for these actions are brought forward, including existing production contract terms do not adequately permit a fair distribution of the good fortune of rising prices. Even in Canada and the U.S., investors are not totally immune from attempts by their respective legislative bodies to change previously agreed contract terms.

Operating companies, with some notable exceptions, have had little choice but to accept these new terms to protect residual value in their projects as existing legal alternatives are either too cumbersome or present further risks to remaining operations in the host county.

The longer term consequences of these unilateral actions are much more than a redistribution of revenue. These actions are likely to result in further reductions in investment in the exploration and development of petroleum resources, an arena in which there is a growing consensus that the industry is already "effort constrained." Projects which present relatively high technical thresholds, extraordinary project completion risks, and very long lead times to initial production, may now be unable to attract adequate capital to go forward. This trend in unilateral contract changes, combined with growing limitations on access to resource development, and in many cases unrealistic terms for new projects, is all adding to the so-called "Peak

[2] In 1952, gasoline sold for 27 cents/gallon, approximately $2/gallon when adjusted by the CPI deflator.

Oil" problem, which is now more about constraints above the ground than below. In a kind of perfect storm of bad luck, the resurgence in resource nationalism has been supplemented by civil strife and armed conflicts in several important producing regions in the world.

The world oil market has been subject to considerably more turmoil than generated by the recent resurgence in resource nationalism –armed attacks in Nigeria and Sudan are good examples rebel activity and civil strife that have led (and continue to bring to the world oil market) reduced output, and more importantly expectations that new opportunities to expand production must be postponed.

Role of Expectations

Ultimately, prices in the world oil market are set by the fundamentals of supply and demand. However, crude oil prices at any given moment reflect a wide range of considerations that go well beyond immediate conditions in the market, but also include expectations on future events, including world demand, technological advances, availability of highly skilled workers, availability of future supplies, replacement cost of new supplies, technical and political risk, war and terrorism, among others. In many cases, the immediate loss in output from any number of unexpected events has much less effect on the world market, than the resulting shift in expectations on the availability of expanded output over the next 5-10 years.

It is our view that major price shifts in crude oil prices since the early 1970's can be explained in part (perhaps largely) by major shifts in expectations on future output. For example, the important consequence of the 1973-74 Arab oil embargo was the structural shift in the ownership and control of the vast resources of the Gulf. The 1973-74 Arab oil embargo, by changing expectations on future production levels from the major Middle East oil producers, brought about a sustained increase in the value of oil. As Middle East reserves were nationalized and transferred to the control of the host countries, expectations on future production from the region were scaled back and prices responded accordingly.

The so-called second oil price shock in 1979 can be seen in a similar light as the Iranian revolution also sent a signal that the region was in for a period of instability and the prior view that future output from Iran and Iraq would expand substantially was no longer likely. The point here is that in both cases, prices were affected by changing expectations on future production levels. The subsequent fall in oil prices in the mid-1980's can be linked to a fundamental shift in medium term expectations on demand (as consuming countries engaged in fuel substitution and conservation efforts), and Saudi Arabia was no longer willing to engage in highly restrictive output levels to protect the existing price structure.

From the 1980's until the 1999 oil price recovery, OPEC was unable to limit (or had collectively been unwilling to agree to a strategy of limiting) sufficient volumes of oil production to obtain price levels which were substantially above long run replacement costs. Part of the problem with OPEC is that it collectively does not (and cannot) arrive at a consensus on long-term production strategy because of the divergent long term interests of its membership.

Prices Take Off

Since mid-2004 the price of oil has risen dramatically as the world oil market has faced a perfect storm of bad luck. Resource nationalism has run rampant, harming near-term output, and shifting expectations on future production.

World oil prices initially rose from about $10 to $30/barrel. While this was substantially above the levels experienced in the 1990's, it reflected some combination of rising demand and increased difficulty in replacing reserves as producers moved to technically more challenging environments, having produced much of the "easy" oil. The supply outlook was generally positive with output rising to keep pace with growing global demand.

Expectations on rising investment oil and gas development in Nigeria, Russia, Sudan, Venezuela, the U.S. and many other places soon evolved into an environment where projects were postponed, access to resources were denied or postponed, or contract terms were changed. Within a few years, an era of positive expectations between 2000-2004 turned into an era of negative expectations, and the bad news keeps on coming. Superimposed on this supply situation, has been rising incomes in China, India, and other parts of the developing world. These economies are also a major factor in rapidly rising demand for middle distillates, particularly diesel fuel.

Chart I and Graph I shows the forces at play that brought about much of the shift in expectations on new production. Note that by early 2005 historic forecasts by EIA (and others) on production growth were unrealized, and combined with falling OPEC excess capacity helped to drive crude oil prices upward.

CHART ONE

A SERIES OF UNFORTUNATE EVENTS

OIL MARKET MOVES FROM POSITIVE TO NEGATIVE EXPECTATIONS

Country	**Era of Positive Expectations** *Outlook in general (but not always) is positive (1998-2004)*	**Era of Negative Expectations** *Outlook in general (but not always) is negative(after 2004)*	**Lost Production** *Oil market production loses between the two eras, both from base level output and expected new output.*
Iraq	Produced 2.4 mmb/d 1999-2002. The U.S. invasion in 2003 offered promise of rapid investment in Iraqi oil sector as economic sanctions were removed.	Turmoil in Iraq drops output to 1.8 mmb/d, 2003-2006. Investment in field rehabilitation and new fields postponed.	Lost production between eras, 600,000 b/d, plus unrealized additional output from postponed investment and inability to do field rehabilitation work.
Nigeria	Production rose from 2.1 mmb/d to 2.4 mmb/d between 2000-2005, with expectations to achieve up to 4 mmb/d by 2010 commonly accepted prior to 2005.	Civil strife and attacks on oil infrastructure has hurt production and investment. Oil production declined in both 2006 and 2007 (2.11 mmb/d) after 2.4 mmb/d in 2005.	500,000 – 700,000 b/d due to shut in production, political instability and fighting, plus unrealized additional output from postponed investment.
Venezuela	In 2002 oil production surpassed 3 Mm b/d and was showing potential for growth after several years of relatively consistent production.	A strike at the end of 2002 at PDVSA sent production into a nosedive. As of 2007 the country had recovered to slightly less than 2/3's of 2002's peak production. Recent nationalization has hurt investment, furthering Venezuela's production difficulties and growth potential.	Approximately 800,000 b/d decline in output, not restored after 2002-2003 strike, plus loss of previously expected output expansion after nationalizations in 2007, due to likely fall off in investment.

CHART (page 2 of 4)

	Era of Positive Expectations *Outlook in general (but not always) is positive; (1998-2004*	**Era of Negative Expectations** *Outlook in general (but not always) is negative; after 2004*	**Lost Production** *Oil market production loses between the two eras, both from base level output and expected new output.*
Russia	Russian production skyrocketed between 1999 and 2005, from 6.31 Mm b/d to 9.51 mmb/d. Privatization of Russia's energy sector brought in western investment and more efficient production and management methods. Output was projected at 10 Mm b/d by 2006 & expected to grow to 12 mmb/d by 2010.	Re-nationalization of Russian oil companies, most notably Yukos in 2004, scared off investment and slowed production growth. Russia has failed to reach 10 Mm b/d production as of January 2008 but has seen slight growth over the past few years. Russia's major fields in western Siberia remain in decline, eastern Siberia not yet producing oil.	Near term loss of output from re-nationalization approximately 200,000 – 400,000 b/d. Longer term loss unknown, but could be substantial, and loss in annual output over next 10 years may be as much as 1 million b/d.
Sudan	A peace treaty signed in 2005 to end the country's civil war was expected to allow for development of previously inaccessible fields. The Sudanese government said in 2005 production would reach 600,000 b/d by 2006. Oil reserves were acknowledged to be in the billions, as opposed to the previously known 560 Mm barrels of proven reserves.	Fighting has continued and rebel groups have launched several recent attacks against oil infrastructure in Sudan, mostly run by Chinese companies. Production has yet to reach 600,000 b/d and has fallen about 200,000 – 250,000 b/d short of expectations over the past few years, but grew to 570,000 in 2007. New production has been slow come online as many new fields remain inaccessible due to fighting and many western countries have launched divestment initiatives.	200,000-250,000 b/d of additional output not realized, investment outlook remains limited and access to known reserves has declined.
Argentina -	Between 1991 and 1998 Argentina's crude oil production grew by approximately 80% to 917,000 b/d. After 2 years of slight decline, production picked up again in 2001.	During the two years following 2001 production remained constant. In 2004 Argentina nationalized the country's oil sector and created state oil company Ensara. Ensara has been poorly funded by the government.	State company, Ensara controls all oil projects, oil production has been declining since 2004 and dropped below 800,000 b/d in 2007.

CHART (page 3 of 4)

	Era of Positive Expectations *Outlook in general (but not always) is positive; (1998-2004*	**Era of Negative Expectations** *Outlook in general (but not always) is negative; after 2004*	**Lost Production** *Oil market production loses between the two eras, both from base level output and expected new output.*
Kazakhstan	After the fall of the Soviet Union Kazakhstan opened it borders to oil and gas exploration. A major discovery was made in the Caspian Sea of an estimated 13 billion barrels. Production from this field, Kashagan, was expected to begin in 2005 with a consortium of foreign oil companies and Kazakhstan's KazMunaiGaz.	The government has implemented several restrictions against foreign oil companies over the past several years as it seeks to strengthen control of its energy resources. It is currently renegotiating the Kashagan deal it made several years ago with the consortium of foreign oil companies.	Most of the delay in Kashagan oil output is due to technical problems. Difficult to determine future loss from government forced renegotiation of contract, but may result in chill on investment levels for new resources.
U.S.	Opening ANWR to development, which has an estimated 10.4 billion barrels of crude reserves, was a major part of president Bush's energy policy when he took office in 2000.	Legislation that would allow drilling in ANWR (Arctic National Wildlife Refuge) has failed to be passed by Congress. Attempts at new offshore exploration have seen similar fates. In August 2007 Shell's right to drill 3 exploration wells in the Beaufort Sear near ANWR was revoked by U.S. courts	Depending upon when ANWR leasing had occurred, loss in domestic production could be substantial, exact amount is unknowable since the prospect has done been drilled, but could be as much as 1 million b/d had leasing occurred ten years ago
Canada (Alberta)	Canada has the second largest crude oil reserves in the world, 179.2 billion barrels, behind only Saudi Arabia. It is estimated that about 95% of those reserves are located in Alberta's oil sands deposits.	In 2007 the provincial government of Alberta introduced new royalty rates which will increase the government take by an additional 15 percent.. Alberta has already seen a loss of investment which will hinder future production in the region. 2007 oil and gas land sales were down over 50%.	Several companies, including Canada Natural Resources, Nexen, and Imperial Oil have announced reduced investment in the area. Loss of output unknown, but rising royalty rates likely to curtail future output growth.

CHART (page 4 of 4)

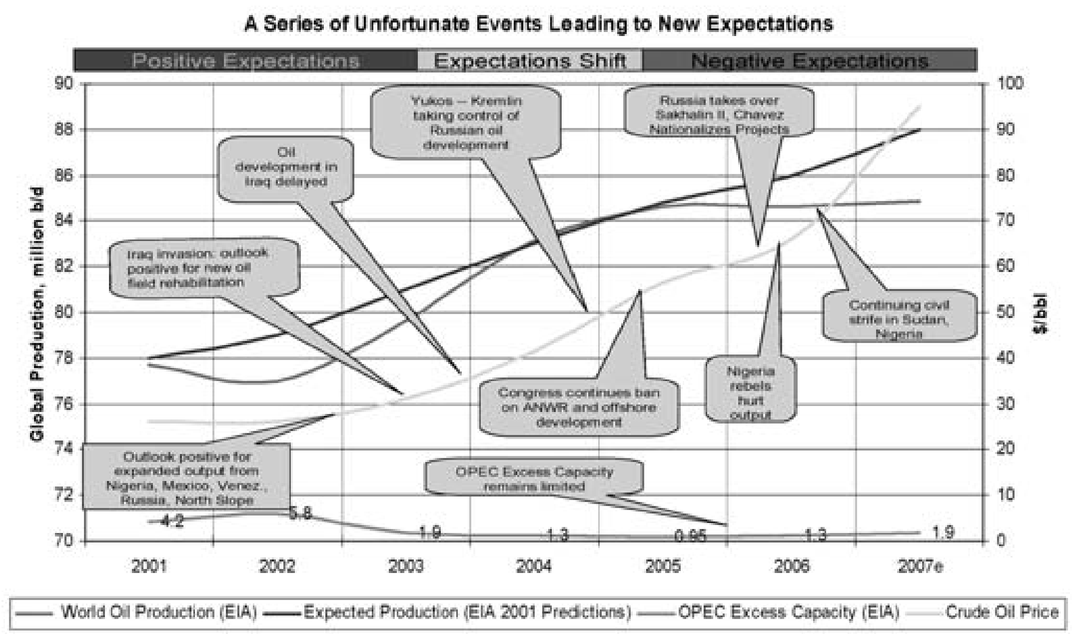
	Era of Positive Expectations *Outlook in general (but not always) is positive; (1998-2004*	Era of Negative Expectations *Outlook in general (but not always) is negative; after 2004*	Lost Production *Oil market production loses between the two eras, both from base level output and expected new output.*
Bolivia	1999-2006 saw natural gas production, a major part of Bolivia's economy, grow by nearly 400% to 466 bcf.	Nationalization of state energy resources in 2006 by president Evo Morales and the subsequent loss of foreign investment and management caused production growth to diminish. The government announced that it will be unable to meet contractual export requirements to Argentina and Brazil in 2008.	Lost production and exploration due to significant decline in investment. Loss of new production unknown, but likely to be substantial over the next 5 years.
Mexico	Between 1995 and 2004 Mexican production increased from 3.08 mmb/d to 3.85 mmb/d. In September 2004, the EIA predicted production of 4 mm/bd in 2005.	Mexico's production has been in decline since 2004. The 4 mmb/d predicted for 2005 never materialized - instead output dropped to 3.78 mmb/d. Only 3.53 mmb/d were produced in 2007 and 3.39 mmb/d are expected to be produced in 2008. Some analyst believe Mexico's oil output has peaked, but the more serious problem is that Pemex, Mexico's state-owned oil monopoly, does not have the funds needed for exploration and development of new fields.	Much of Mexico's lost production comes from lack of funding for Pemex. Pemex's budget is subject to approval by the Mexican Congress. PEMEX operates on a very tight budget, large debt service, and no legal authority to bring in outside investors. We estimate lost of supply to the world market in the 2005-2010 time period at approximately 500,000 b/d, and possibly more.

Estimated Loss of Supplies to the World Market, 2005-2010 **2.5 – 4.5 mmb/d**[3]

Sources: Energy Information Administration, USGS, ***Upstream Online, Oil and Gas Journal***, Institute for Energy Policy (Moscow), EPRINC

[3] In the end the estimate of lost production is just that, an imprecise estimate.. In many respects, the lost opportunities from these unfortunate events may be more significant as producers lose opportunities to evaluate and extend new technology and gain information that can enhance future exploration in the region in question.

Graph One


A Series of Unfortunate Events Leading to New Expectations
Positive Expectations
Expectations Shift
Negative Expectations
Global Production, million b/d
$/bbl
Yukos – Kremlin taking control of Russian oil development
Russia takes over Sakhalin II, Chavez Nationalizes Projects
Oil development in Iraq delayed
Iraq invasion: outlook positive for new oil field rehabilitation
Continuing civil strife in Sudan, Nigeria
Nigeria rebels hurt output
Congress continues ban on ANWR and offshore development
Outlook positive for expanded output from Nigeria, Mexico, Venez., Russia, North Slope
OPEC Excess Capacity remains limited
4.2
5.8
1.9
1.3
0.95
1.3
1.9
90
88
86
84
82
80
78
76
74
72
70
100
90
80
70
60
50
40
30
20
10
0
2001
2002
2003
2004
2005
2006
2007e
World Oil Production (EIA)
Expected Production (EIA 2001 Predictions)
OPEC Excess Capacity (EIA)
Crude Oil Price

The Downstream Sector

Year to date, the U.S. is consuming about 20.5 million barrels/day (mbd) of petroleum and produces about 8.5 mbd (including natural gas liquids and processing gains). Our remaining supply is provided through imports of crude oil and petroleum products plus about 700,000 b/d of ethanol. Ethanol, however, presents some unique challenges to the transportation fuels sector. It is relatively more expensive to transport (it is not petroleum) as it has no access to the U.S. product pipeline network, operates at two-thirds the BTU value of conventional gasoline, and consumes substantial volumes of transportation fuels in the production of its main feedstock, corn.

Rising world demand for transportation fuels, particularly middle distillates, have grown at a much faster rate than additions to refinery capacity. The world refining industry is operating at very low levels of excess capacity, and the existing capacity is not well matched to the recent high growth in demand for middle distillates. This creates an environment where we have can experience periodic spikes in the price of transportation fuels. For example, U.S. refining capacity is 4 mbd below effective available capacity (3 mbd below nameplate capacity). As result, US must import diesel fuel and gasoline components (historically 10% of consumption) from foreign refineries.

Middle distillates (including diesel fuel) have been growing at substantially higher rates than gasoline. Until new world wide refining capacity is added to improve output of middle distillates, we expect to continue to face a market where gasoline remains heavily discounted to diesel fuel. Although both gasoline and diesel prices are very high, the price of gasoline as been attenuated by the large volumes of co-produced gasoline components on the world oil market. What is occurring is that as European and Asian refining centers attempt to maximize output of middle distillates, they have no choice but to also produce gasoline components which are often sold into the U.S. market.

The decline in the value of the U.S. dollar has also increased the cost of imports, but we are reluctant to speculate whether there is any kind of direct causal relationship between the two. This is an extremely complex and esoteric issue involving trade flows and monetary policy which is better addressed by analysts other than EPRINC

Concluding Remarks

The oil market is highly integrated and a disruption somewhere in the market is a disruption everywhere. Today, world oil prices reflect the consequences of rising world demand from major growth centers such as China and India, but more importantly, prices also reflect a substantial disruption in oil supplies. This disruption, however, is not the result of an identifiable single event, but events taking place at several production centers.

Nonetheless, this production is missing from the market and the subsequent higher prices are imposing substantial costs on the U.S. economy and U.S. consumers. In the period we call the "era of positive expectations," buyers and sellers reasonably expected that oil supplies would grow from major producing regions, but these additions to output did not occur largely because of problems above the ground and not below. These problems in the upstream market have been amplified by constraints in refining capacity.

Certainly, we would have expected oil prices to rise in response to demand growth and rising costs of new supplies, but current price increases reflect a failure of the world petroleum market to deliver new supplies from fields that could easily do so within the current (or even a lower) price structure. U.S. policies that have restricted opportunities to expand conventional supplies from Alaska, and prospective offshore and onshore provinces in the lower 48 have contributed to this high price environment along with civil strife in Nigeria, delays in new OPEC capacity, and resource nationalism in Venezuela.

Many observers have argued that these higher prices also provide benefits in demand reduction, new conservation initiatives, and acceleration of incentives for moving the U.S. to the fuels of the future. Whether this is a cost effective approach for the U.S. economy depends on whether current prices are in fact approaching the long run backstop price, i.e., the price where alternative fuels, conservation, unconventional supplies, etc., are so plentiful that the price of oil can only rise modestly if at all. Our perspective is that the current price structure is not sustainable, but our failure to provide access to conventional fuels may mean the transition to a lower and more realistic price level may also involve a lot of unnecessary economic pain.

Mr. CONYERS. Thank you so much.

We will be back very, very shortly.

[Recess.]

Mr. CONYERS. Our final witness this morning is Dr. Mark Cooper, director of research at Consumer Federation of America.

He has been working on this general subject matter for several decades. He has got a Ph.D. from Yale. We are very interested in his perspective because he has testified on this area quite often.

And we are so pleased to have you this afternoon, sir.

TESTIMONY OF MARK COOPER, DIRECTOR OF RESEARCH, CONSUMER FEDERATION OF AMERICA

Mr. COOPER. Thank you, Mr. Chairman.

In my remarks today, I will focus on the aspect of the gasoline price problem that is in the jurisdiction of this Committee and make the case that that is an awfully big part of the problem.

In large part, significant part, current high gas and oil prices are the result of a long-term combination of an international crude oil cartel and a tight domestic refining monopoly, both of which have systematically underinvested in production capacity.

Our failing to expand production capacity to meet demand and provide a reasonable reserve in an industry with very low elasticity to supply and demand, one that is prone to accidents and disruptions, that have created a tight and volatile market and the opportunity to raise prices and profits.

For cartels and oligopolies, supply is a strategic variable.

You learn that in Economics 102 when you study market power.

While crude oil is the largest component of gasoline prices, there have been months over the past 5 years when the domestic spread, the amount of money that domestic refining and market account for in the pump price, have been over $1 a gallon.

That domestic spread creates a tug-of-war between the crude oil cartel and the domestic refining oligopoly.

They fight over the extraction of consumer surplus, and here is why.

The U.S. gasoline market accounts for about one-quarter of all the gasoline consumed in the world and is, by far, the single largest product market in the oil sector.

So as U.S. refiners increase their margins, OPEC receives a signal that markets will support higher prices and pushes for higher crude price to recapture their share of the rent. They are a rent-seeking cartel.

Crude oil pushes gasoline prices up, yes, it does. But U.S. gasoline prices also pull crude oil prices up in a vicious anti-consumer spiral. And, of course, rising crude oil prices pull up the prices across the entire energy complex.

Speculation also has played an increasing role in driving up prices. There has been a huge influx of money; too much money chasing too few goods and money that does nothing but arbitrage.

A barrel of oil may trade 30 times between the well head and the burner tip. It is not clear. All those transactions are free or costless.

Volume, volatility, and risk drive up the price of oil.

The Senate Committee on Oversight Investigations concluded in 2006 that speculation accounted for one-third of the oil price. In today's dollars, that is a big number.

Growing global demand certainly has played a role in triggering this price spiral, but a well-functioning market with growing demand would not cause such a powerful upward surge in prices and huge increases in volatility.

It is the failure on the supply side to invest, mergers that resulted in highly-concentrated refining markets, and barriers to entry that are part of the natural structure of this industry that have allowed the cartel and the oligopoly to profit at the expense of the public and to feed the speculative bubble.

If we did not have an international crude cartel and a domestic refining oligopoly, the price of gasoline would be about $2 a gallon this summer, not heading to $4 a gallon.

So make no mistake about it; the matters that this Committee oversees, the market structural matters that it oversees, are, in fact, at the heart of the problem.

And, frankly, if we had $2 a gallon, we would not be talking about exotic alternatives. The economics of all those alternatives would disappear.

So solve the traditional problem. It will be tough, but don't ignore the traditional problem. Don't be hemmed into a little bubble that says, "Here we are stuck in this situation; how do we produce ourselves out of it within the situation?"

The bubble has been made by anti-competitive, anti-consumer practices and structures, and that is the jurisdiction of this Committee.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Cooper follows:]

PREPARED STATEMENT OF MARK COOPER

Consumer Federation of America
1620 I Street, N.W., Suite 200 * Washington, DC 20006

Statement of Dr. Mark Cooper
Director of Research

On

Consumer Effects of Retail Gas Prices

Before the

Judiciary Committee Antitrust Task Force
United States House of Representative

May 7, 2008

Mr. Chairman and Members of the Committee,

My name is Dr. Mark Cooper. I am Director of Research at the Consumer Federation of America.[1] I greatly appreciate the opportunity to testify yet again on the burden that rising gasoline and energy prices are putting on household budgets.

The Rising Energy Burden on Household Budgets

There is no doubt that rising energy prices are crushing the budgets of American households. We estimate that household spending on gasoline has increased from about $1200 in 2002 to over $3000 in 2008 (see Attachment 1).

Gasoline is only the tip of the energy iceberg for three reasons –

- consumers bear the burden of rising energy prices indirectly in the prices they pay for a wide range of goods and services.
- gasoline prices influence the price of crude oil, and
- crude oil influences the price of fossil fuels across the entire energy complex, and

Gasoline price increases are not the only energy price increases consumers have endured. Direct expenditures for energy by households include natural gas for heating and cooking, heating oil, and electricity. Combining increases in the cost of this residential energy with gasoline into total household energy or "energy at home," I estimate that from 2002 to 2008 household energy expenditures increased from about $2600 to over $5300. This increase of about $1900 represents an increase from 5 percent of household income to 8 percent.

To put this expenditure in perspective, I contrast expenditures at home for energy with expenditures at home for food and health care. Energy at home has shot past these other basic necessities dramatically (see Attachment 2).

Unfortunately, household energy expenditures are not the end of the story. The energy consumed by households accounts for only one-third of the total energy consumed (about 11 percent for gasoline and 22 percent for the residential energy, see Attachment 3). In other words, two thirds of the energy consumed in the country is used to produce goods and services. Tracking how much burden this places on households is a complex task. However, there are some obvious sectors that have attracted attention. The energy consumed in the transportation sector that is not gasoline consumed by households turns up in the cost of the

[1] The Consumer Federation of America is an advocacy, research, education and service organization established in 1968. CFA has as its members some 300 nonprofit organizations from throughout the nation with a combined membership exceeding 50 million people. As an advocacy group, CFA works to advance pro-consumer policy on a variety of issues before Congress, the White House, federal and state regulatory agencies, state legislatures, and the courts.

goods transported by truck and train. Commercial energy, used to light stores and buildings, will turn up in the retail price of good sand services. One example that has recently received a great deal of attention is the food sector. The production, processing and distribution of food consume about 8 percent of all the energy used in the nation, the cost of which turns up in the price of food. In a sense, netting out exports, energy related food costs that are passed on to consumers are over half as large as the direct gasoline costs at the pump.

The burden on household budgets discussed above is for the average household. Needless to say, the burden on lower income households is much greater. Although lower income households spend less on energy and other necessities, energy expenditures take a larger share of their income and household budgets. In 2005, the last year for which we have complete data, home energy expenditures took about 14 percent of the income for households in the bottom fifth of the income distribution (incomes below $17,579), compared to the national average where home energy took about 5 percent of income.

The Energy Price Spiral

The U.S. is afflicted with skyrocketing gasoline prices because of a combination of rising demand and faltering supply both at home and abroad. On the supply-side a combination of an international crude oil cartel and a tight domestic refining oligopoly have systematically under-invested in production capacity. By failing to expand production capacity to meet demand and provide a reasonable reserve in an industry with very low supply and demand elasticities that is prone to accidents and disruptions, the markets became tight and volatile. It is certainly true that tight global crude oil markets push up the price of gasoline, but it is also true that a tight refinery market in the U.S. pushes up the price of gasoline and ultimately pulls up the price of crude. These two domestic effects do not receive a great deal of attention, but they are important.

While crude oil is the largest component of the cost of gasoline, there have been months during the past five years when the domestic spread (the amount the domestic and refining account for at-the-pump price) has been over $1 gallon (see Attachment 4).

Those high domestic margins create a tug of war between OPEC and the domestic refining industry over the extraction of consumer surplus, a wrestling match has become so economically crippling that even the *Wall Street Journal* and the Energy Information administration have commented on it.

The U.S. gasoline market plays a critical role in the energy complex because it accounts for about one quarter of all the gasoline consumed in the world and one-eighth of the entire refined petroleum product. Thus, it is by far the single largest product market in the oil sector. As gasoline prices rise, OPEC receives the signal that the market will support higher prices. As refiner margins rise, OPEC, which is a rent seeking cartel, pushes for higher crude prices to recapture 'its' share of the available rents.

Things have gotten so bad in the U.S. gasoline market that even the Energy Information Administration, in one of its weekly reports, recognized that the tight U.S. gasoline market may be "pulling up" the price of crude. "In other words, if U.S. gasoline markets are tight, they may 'pull up' crude oil prices to a degree, given that tight downstream capacity makes each gallon of product produced that much more valuable, increasing the value of the crude used to produce the refined product."[2]

A *Wall Street Journal* story made a similar point.

> Two years ago when gasoline prices in the U.S. surged to the then-lofty level of $2 a gallon, the Organization of Petroleum Exporting Countries sprang into action, seeking to provide relief by pledging to boost oil production.
>
> Now with gasoline topping an average of $3.20 a gallon nationwide, OPEC officials say they see no reason to open the oil spigot.
>
> OPEC's new attitude reflects a tug of war in the global oil patch over how the profits from a barrel of oil are divided up between the world's producers – which develop oil deposits and pump oil -- and its refiners who process it into fuels like gasoline.
>
> In recent years, the balance in the world's oil-supply system has shifted, giving the refining industry more power and more profit…
>
> Privately, OPEC members are irked that U.S. refining margins – the profit refiners make in turning crude into gasoline and other products – have soared in recent months…
>
> OPEC officials say that if they pump more oil and depress world oil prices, U.S. gasoline prices might remain high, and the result would be even wider refining margins. In essence, OPEC would be putting more money into the pockets of refiners while its own revenue would be hurt by declining crude prices.[3]

OPEC's response to rising crude oil prices continues to be to point the finger back at the consuming nations. "Chakib Kheilil, the president of the global cartel, who is also the Algerian Energy Minister, said: "There are big pressures on OPEC and some consuming nations would like to present OPEC as being behind current high prices. But the truth is the current prices are linked to US economic problems as well as to the value of the dollar."[4]

While the crude cartel and the domestic refinery oligopoly drive up the rents collected from consumers, they have neglected the production side. There is little if any spare capacity in the global crude oil market. Only 3 percent of the world oil reserves are located in the United States, but the U.S. consumes more than 25 percent of the world's petroleum products.

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[2] Energy Information Administration, *This Week in Petroleum*, May 3, 2006, p. 2

[3] Bhusahn Behree and Ana Campoy, "Why OPEC Idles as Gas Prices Reach New Higher: Cartel Balmes Refiners, Cites Flush Oil Supplies, Tug of War Over Profits," *Wall Street Journal*, May 25, 2007.

[4] Suzy Jagger, "Oil Prices Could Stay as High as $110 a Barrel this Year, says OPEC," *Timesonline*, March 24, 2008.

Gasoline accounts for about 40 percent of all petroleum products supplied to U.S. consumers, and when all vehicle fuels are included that share increases to about 50 percent. This consumption drives the demand for imported crude oil and refined products. In fact, in recent years, the import of gasoline has more than doubled. Because the U.S. simply does not have the crude oil resources to keep up with rising gasoline consumption, oil imports have skyrocketed (see Attachment 7).

There is also a disastrous shortfall in domestic refinery capacity (see Attachment 8). The refinery shortfall has doubled to over 3 million barrels per day since the early 1990s. Yet, in spite of our growing dependence on imports and the shortage of refining capacity, our domestic stockpile has decline sharply (see Attachments 9 and 10), leaving us vulnerable to supply shocks and making gasoline and energy markets extremely volatile.

Speculation Increases the Upward Pressure on Prices

Speculation has also played an increasing role in driving up the price of crude oil and gasoline. On April 29, 2006, the *New York Times* ran a front-page article under the headline "Trading Frenzy Adds to Jump in Price of Oil."[5] The *Times* article opens with a brief paragraph on the conditions in the physical market but then devotes about 36 column inches to the proposition that financial markets are adding to the price increase.

> "A global economic boom, sharply higher demand, extraordinarily tight supplies and domestic instability in many of the world's top oil-producing countries – in that environment higher oil prices were inevitable.
>
> But crude oil is not merely a physical commodity . . . . It has also become a valuable financial asset, bought and sold in electronic exchanges by traders around the world. And they, too, have helped push prices higher…
>
> "Gold prices do not go up because jewelers need more gold, they go up because gold is an investment," said Roger Diwan, a partner with PFC Energy, a Washington-based consultant. "The same has happened to oil…"
>
> "It is the case," complained BP's chief executive, Lord Browne, "that the price of oil has gone up while nothing has changed physically."[6]

Three key factors serve to drive the price spiral higher: volume, volatility and risk. The structure and availability of markets plays a role in allowing the volumes to increase.

> Changes in the way oil is traded have contributed their part as well. On Nymex, oil contracts held mostly by hedge funds – essentially private investment vehicles for the wealthy and institutions, run by traders who share risk and reward with their partners – rose above one billion barrels this month, twice the amount held five years ago.

[5] Jad Mouawad & Heather Timmons, *Trading Frenzy Adds to Jump in Price of Oil*, N.Y. TIMES, Apr. 29, 2006, at A-1.
[6] *Id.*

> Beyond that, trading has also increased outside official exchanges, including swaps or over-the-counter trades conducted directly between, say, a bank and an airline. . . .
>
> Such trading is a 24-hour business. And more sophisticated electronic technology allows more money to pour into oil, quicker than ever before, from anywhere in the world. [7]

The influx of new money is sustained by movements of different institutions and individuals into the market. "Everybody is jumping into commodities and there is a log of cash chasing oil," said Philip K. Verleger Jr., a consultant and former senior advisor on energy policy at the Treasury Department."[8] Attachments 5 and 6 show that the amount of trading in commodities has quintupled in the past five years (which is coincident with the explosion of prices) and that energy commodities are driving that increase in trading.

This fundamental observation had been offered a couple of years earlier in a front page *Wall Street Journal* article entitled, "Oil Brings Surge in Speculators Betting on Prices: Large Investors Playing Ongoing Rise is Increasing Demand and Price Itself:"[9]

> Oil has become a speculator's paradise. Surging energy prices have attracted a horde of investors – and their feverish betting on rising prices has itself contributed to the climb.
>
> These investors have driven up volume on commodities' exchanges and prompted a large push among Wall Street banks and brokerage firms . . . . to beef up energy-trading capabilities. As the action has picked up in the past year, those profiting include large, well-known hedge funds, an emerging group of high-rollers, as well as descendants of once-highflying energy-trading shops such as Enron Corp.[10]

The notion is that the continual influx of money represents too much money chasing too few goods. By mid-2006, the Permanent Subcommittee on Investigations of the U.S. Senate had concluded that the estimates of a speculative premium on oil had risen to $25 dollars per barrel, or about one third of the world price.[11]

The most recent run up in crude prices has triggered similar concerns about the impact of financial speculation and trading on prices.

> "Oil is the new gold," said James Burkhard, director of global oil market analysis at the Cambridge Energy Research Associates consulting firm. "Oil has some intrinsic value, and that value remains even if the dollar depreciates."

[7] *Id.*
[8] *Id.*
[9] Gregory Zuckerman & Henry Sender, *Oil Brings in Speculators Betting on Prices – Large Investors Playing Ongoing Rise is Increasing Demand and Price Itself*, WALL ST. J., Aug. 24, 2004, at. A-1.
[10] *Id.*
[11] Permanent subcommittee on Investigations, Committee on Homeland Security and Governmental Affaires, United States Senate, *The Role of Market Speculation in Rising Oil and Gas Prices: A Need to Put the Cop Back on The Beat*, June 27, 2006.

> For weeks now, oil industry analysts have watched in amazement as oil's price kept climbing, even though government statistics showed that the country had ample supplies of oil and gasoline on hand. Gloomy news about the economy should have pulled oil down, because demand for petroleum usually slumps in a recession. But the bull market barely shrugged.
>
> "If you look at the run-up we've had for the last $20 or so, there's no other explanation for it," said Michael Lynch, president of the Strategic Energy & Economic Research consulting firm. "You have days when there's absolutely no news - except the dollar going down - and oil will still go up $3."
>
> *Role of big investors*
>
> The role of big investors in this year's price spike infuriates some consumer advocates. Investors such as hedge funds may view oil as nothing more than a financial asset, but to the rest of the country, it's fuel. The mercantile exchange didn't even start selling crude oil futures - the most common form of oil investment - until 1983.
>
> "We're taking a financial instrument that barely existed 20 years ago and allowing it to drive a stake through the heart of our economy," said Judy Dugan, research director for the Foundation for Taxpayer and Consumer Rights.
>
> Sooner or later, analysts say, the fundamental issues of oil supply and demand should bring down oil prices.[12]

The upward pressure that speculation puts on prices is not limited to crude, but applies to the whole energy complex. Recent months have seen sharp increases in gasoline prices despite weakening fundamentals.

> Nymex gasoline futures have been rising, following oil, despite growing supplies of both commodities. Blame the falling dollar, which has made dollar-denominated oil contracts irresistible to foreign investors and to any investors looking for a safe haven for their money during a turbulent time in the stock market.
>
> This buying by investors has pushed oil futures to a series of records in recent weeks, and the rest of the energy complex -- which includes gasoline futures -- has followed.
>
> Unfortunately, consumers pay for this investment frenzy in the form of higher pump prices. And despite mounting evidence that Americans are cutting back on their gasoline habit -- and may cut back even more drastically as gas gets more expensive -- it may be some time before prices start responding to lower demand.[13]

---

[12] David R. Baker, "Blame the Dollar for High Gas Prices," *San Francisco Chronicle*, Mark 18, 2008.
[13] John Wilen, "If people are driving less, why are gas prices rising?," *South Florida* Sun-Sentinel.com, March 18, 2008.

Growing global demand certainly has played a role in triggering the price spiral of recent years, but in a well-functioning market, steadily growing demand would not cause such a powerful upward surge in prices and a huge increase in volatility (see Attachment 11). It is the failure to invest on the supply-side, mergers resulting in highly concentrated markets, and barriers to entry that have allowed the cartel and the oligopoly to profit at the expense of the public. Speculation magnifies the upward spiral.

Policy Responses

Unfortunately, two decades of policy neglect have created this problem and there are no short-term solutions. We need a policy that is dedicated to reducing our oil consumption and expanding alternative energy sources in a responsible way. Congress took a huge step in that direction last year when it enacted the Energy Independence and Security Act. Now that we have started down that path, it is critical that we stay on it.

One thing we do not need is short-term gimmicks that divert our attention from the long-term goal. One such idea that has received a lot of attention and bipartisan support on the campaign trail is a gasoline tax holiday. We conclude that it is an awful idea. The basis for reaching that conclusion has been described in the above analysis.

First, because of the current supply/demand situation, the oil companies will eat part of the tax cut by simply expanding the domestic spread. It gives them more head-room to raise their share of the price. Any effort to recapture that increase in profit by increasing taxes on oil companies would have to prevent them from putting more profits in their pockets. Even if it did so, the end result would be that consumers just pay the tax through another route. Given the inelasticity of supply and demand, tax incidence analysis tells us the burden will be shifted to the consumer. A windfall profits tax may be a good idea under other circumstances, but coupling it with a gasoline tax holiday makes it too easy for oil companies to shift the burden to consumers.

Second, using the gasoline tax to flow rebates to consumers is a tax cut for the wealthy. As we have seen, lower income households consume substantially less gasoline than the national average. Upper income households consume a lot more, so they would get a disproportionate share of whatever part of the tax cut is passed through to consumers. Based on the 2005 Consumer Expenditure Survey, the wealthiest 20 percent of households (top quintile with incomes above $85,000)) consume 32 percent of all gasoline. The bottom 40 percent of all households (bottom two quintiles with incomes below $33,000) consume only 23 percent of all gasoline. Obviously, because they have lower income, they feel greater relief, but if providing relief to lower and middle income households is the objective, there are much more effective ways to accomplish the goal that do not fill the pockets of the wealthy at the same time.

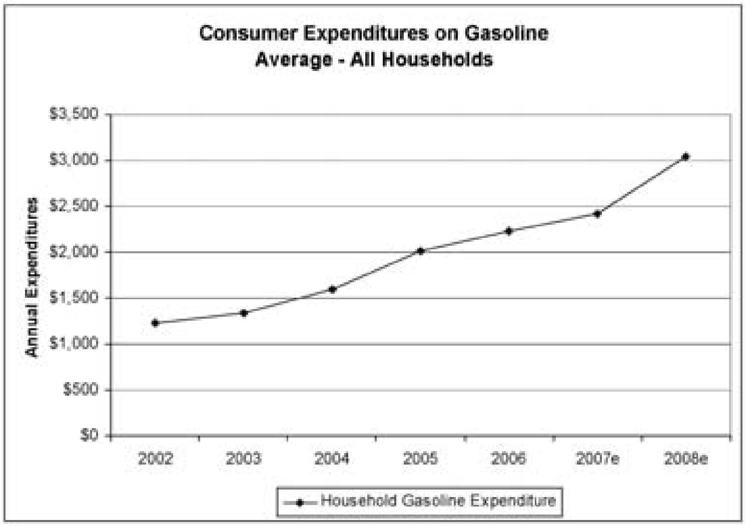
Third, the gasoline tax holiday scrambles the incentives on energy consumption and turns gasoline taxes into a political football. It will induce people to drive more and divert their attention from more efficient vehicles and alternative methods of transportation (at least temporarily), which is not the message we need to send.

Fourth, since gasoline taxes are earmarked for the highway trust fund, it could drain the highway trust fund. Since the national highway system is infrastructure in need of repair, this is one earmark that is in the public interest. With a huge deficit and mounting national debt, engineering replacement revenues will pose a challenge, whatever the source of funds.

Finally, if the idea is to actually lower gasoline prices, then policies that attack the underlying problem in both the short- and long-term are more attractive. If the most recent run-up is seen as a temporary, speculative bubble, then policies that curb speculation and temporarily expand supply could be considered. Ultimately, a long-term solutions will do consumers the most good.

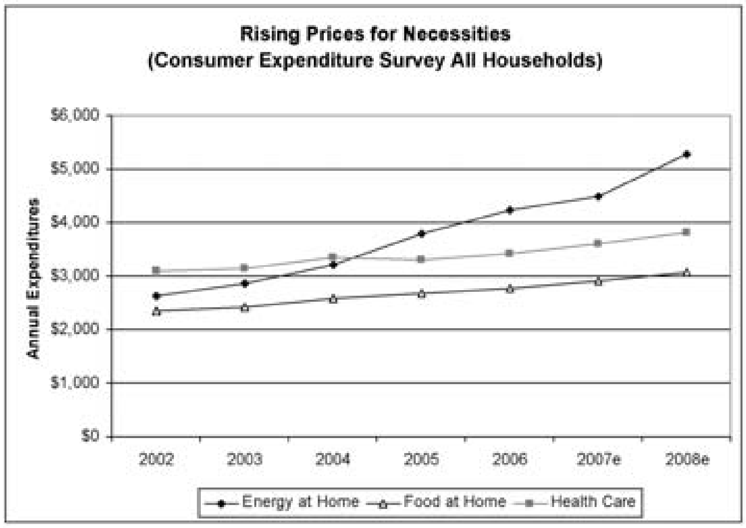
Without the abuse of market power in the crude oil and refining sectors, the summer price of gasoline would be in the vicinity of $2.00 a gallon rather than heading for $4.00 a gallon nationwide. A policy that gives relief of 18 cents a gallon for a few months and does nothing to address the systemic problem, even makes it worse, while allowing the oil companies to eat the tax holiday by raising prices, is at best a diversion and at worst a sham.

Attachment 1



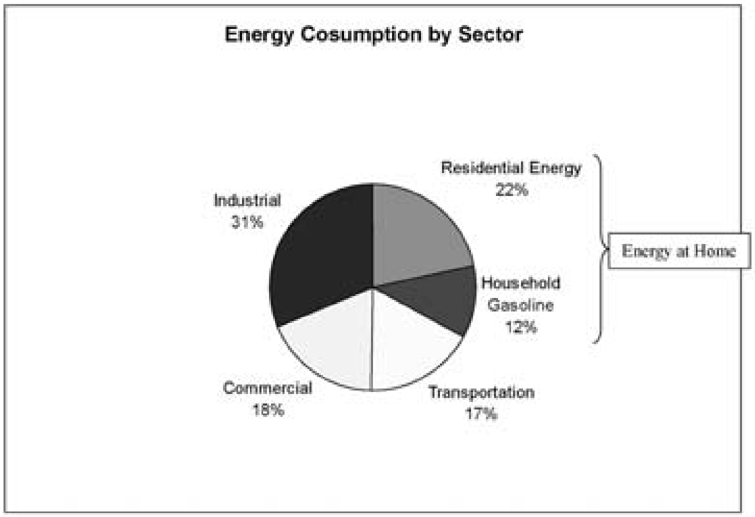
Source: Bureau of Labor Statistics, *Consumer Expenditure Survey*, through 2006, updated with the Consumer Price Index and Energy Information Administration, *Short Term Energy Outlook.* Assumes 5 percent cutback 2006-2008.

Attachment 2



Source: Bureau of Labor Statistics, *Consumer Expenditure Survey*, through 2006, updated with the Consumer Price Index and Energy Information Administration, *Short Term Energy Outlook.* Assumes 5 percent cutback 2006-2008 for energy, but no cutbacks for food at home and health care.

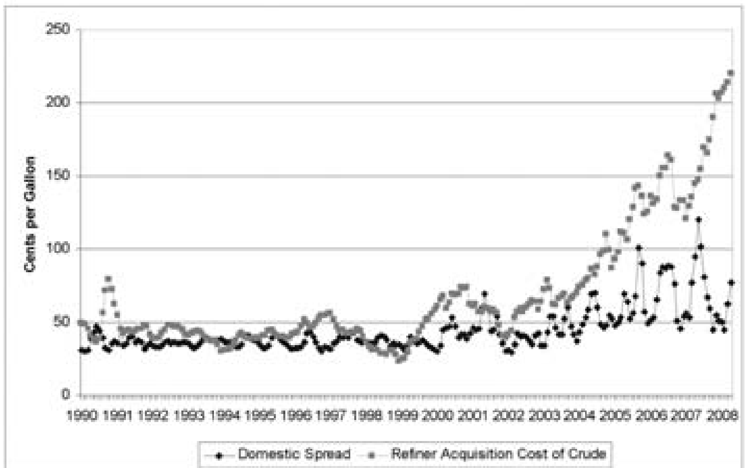
Attachment 3



Sources: Energy Information Administration (EIA), *Monthly Energy Review,* April 2008, Table 2.1 for overall energy consumption. Household gasoline is derived from the Bureau of Labor Statistics, *Consumer Expenditure Survey*, by estimating the number of gallons consumed per households (average expenditure/average price) and converting to Btu. This total is subtracted from the transportation total.

Attachment 4:

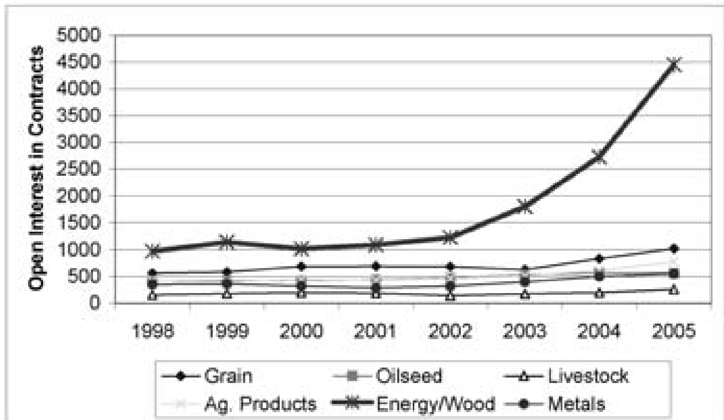
Record Gasoline Prices are the Result of Increases in Crude Oil Prices and the Domestic Spread (pump price minus crude oil and taxes)



Source: Energy Information Administration, Database available at **<u>www.eia.doe.gov</u>**

Attachment 5:

Trading Of Non-Financial Instruments (Average Month-end Open Interest)



Source: Commodity Future Trading Commission, Annual Reports: Futures Statistics by Major Commodity Group.

Attachment 6:

Trading has quintupled Since 2002

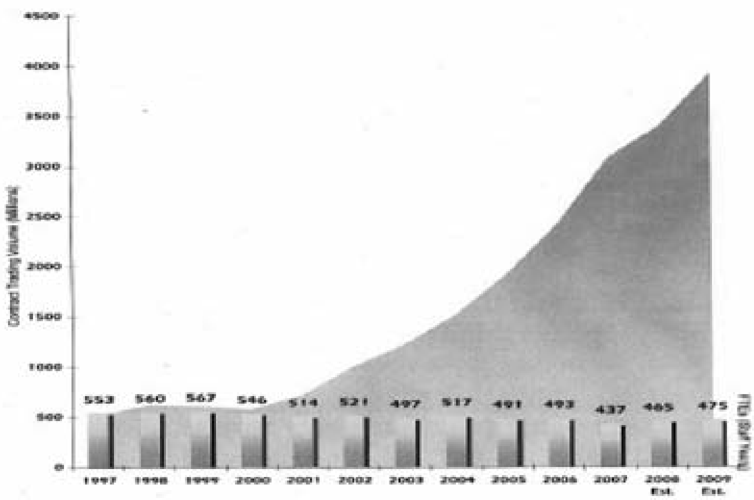


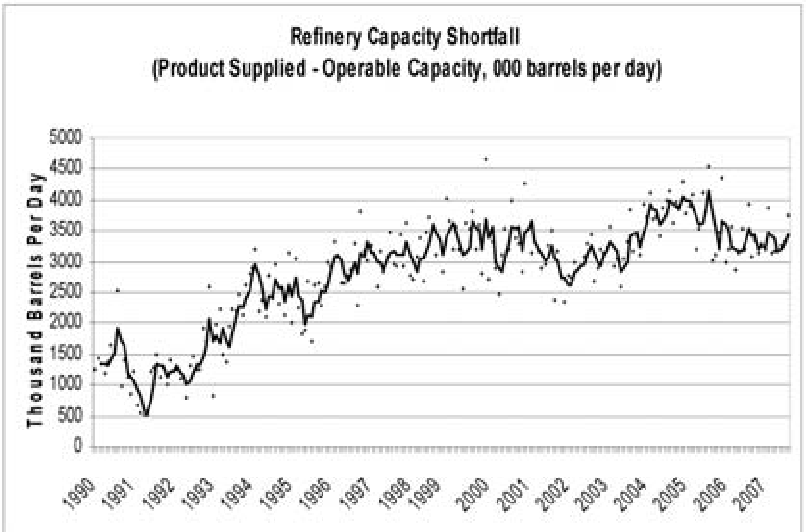
Figure 1: Growth of Volume of Contracts Traded and FTEs

Source: Commodity Futures Trading Commission, FY 2009 President's Budget and Performance Plan, available at
http://www.cftc.gov/stellent/groups/public/@aboutcftc/documents/file/2009budgetperf.pdf

Attachment 7:

Source: Energy Information Administration, Database, www.eia.doe.gov,

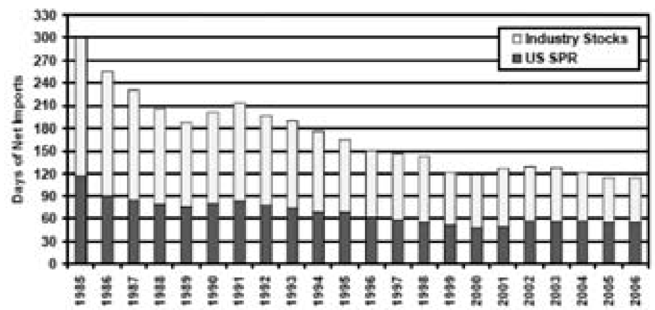
Attachment 8:
The Refinery Shortfall has Doubled Since the Early 1990s



Source: Energy Information Administration, Database available at www.eia.doe.gov

Attachment 9:

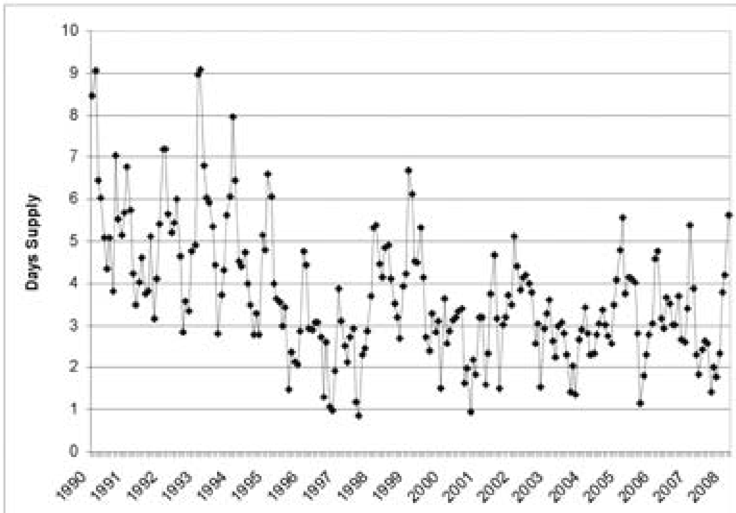
U.S. Crude Oil Stocks



Source: U.S. Department of Energy, *Strategic Petroleum Reserve Annual Report for Calendar Year 2006*, p. 30

Attachment 10:

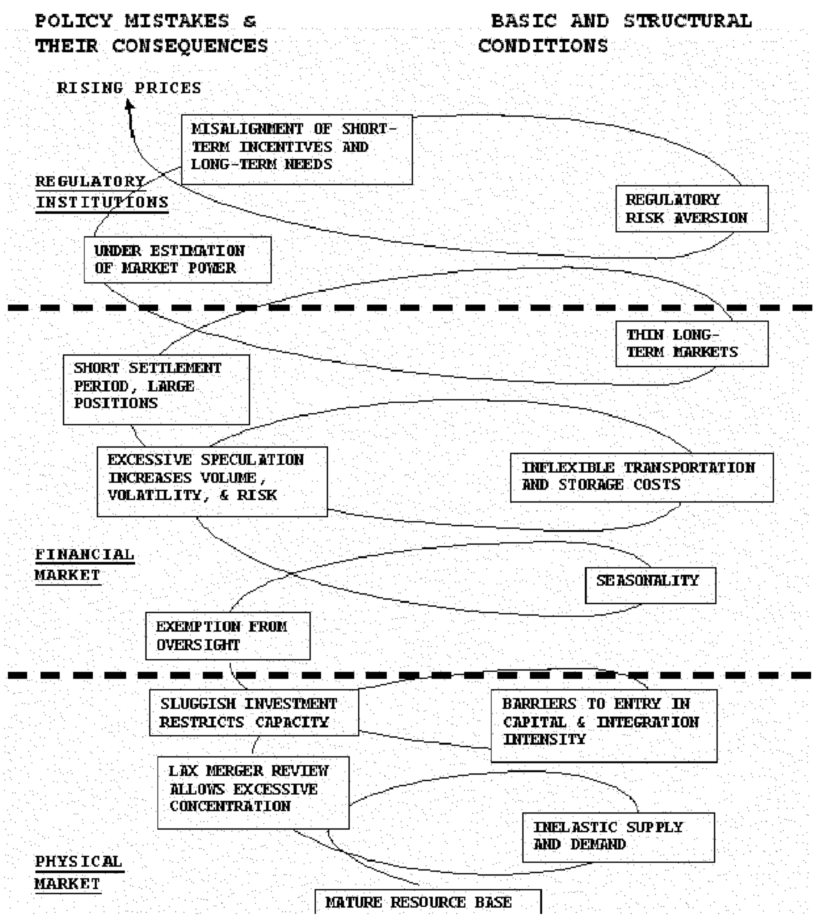
Gasoline Inventories have plummeted compared to Demand
(Das Supply above Minimum Operating Inventories)



Source: Energy Information Administration, Database available at www.eia.doe.gov

Attachment 11

Physical, Financial and Regulatory Factors in the Explosive Spiral of Energy Prices



Mr. CONYERS. Thank you so much.

Ric Keller, would you begin the questioning, please?

Mr. KELLER. Thank you very much, Mr. Chairman.

I will just tell you up front what I am going to be asking you about.

Mr. Pugliaresi, I am going to ask you about refining capacity.

And, Mr. Douglass, I am going to ask you a little bit about interchange fees in your testimony.

But I want to, first, begin with a little straight talk on both sides as to how we got here. And I am going to try to be fair to both sides here.

First, Speaker Pelosi, on April 26, 2006, said, "Democrats have a common-sense plan to help bring down skyrocketing gas prices."

Since she became speaker, gas prices have increased 55 percent. They are $1.29 a gallon more than they were when she took over. For example, today, they are $3.62; when she took over, $2.33.

Did we expand our supply by drilling in ANWR? No.

Did we reduce our demand by building alternative energy sources or nuclear plants? No.

Did we streamline or bottleneck the process with refineries? No.

And that is a little straight-talk on that side.

The promise should have never been made. I think it was political.

In fairness to Speaker Pelosi, let me say the other side.

The one law that she cannot change is the law of supply and demand. And, obviously, the main reason we have skyrocketing gas prices is because crude oil is a commodity which she or I or anyone else doesn't have any control over, and it has gone up dramatically.

She can't, also, help the fact that China and India have come online and are using more crude oil and gasoline than ever. And that is out of her hands as well.

And so let me present where we are in sort of a straight-talk capacity.

Also, I think there is some things this Congress has done to, at least, make an effort. We have increased the CAFE standards, which I voted for, from 25 to 35 miles a gallon. We generally support, on a bipartisan basis, tax incentives to buy hybrids and that sort of thing.

So, with that as a background, let me begin with you, Mr. Pugliaresi, and let us talk about refineries.

And I want to tell you both sides what I hear, and you tell me your opinion.

We haven't built a refinery in 32 years, since 1976. One side says, well, these companies that own the refineries don't want us to build any more refineries and that they are wanting to keep a limited capacity to jack up their profits; and that there has only been one request for a permit to be granted in 32 years and it was granted.

The other side says no, it is very expensive to build a refinery. It takes a lot of red tape in getting it through the State and regulatory processes.

The last refinery permit to be granted was for an Arizona company years ago, and it took that company 19 years to do it. And as a result of it being so expensive and burdensome, these companies find it cheaper just to build refineries elsewhere.

I am not an expert in the field, but I just laid out what I have been told.

Can you give me your opinion, Mr. Pugliaresi, as to what the reason is we are not having more refineries built if everybody seems to think we need more built?

Mr. PUGLIARESI. Yes.

Mr. KELLER. Your mike needs to be on.

Mr. PUGLIARESI. Obviously, none of these have a simple answer. We have been adding capacity. And, unfortunately, that is the one table I didn't bring with me, but we have been adding capacity at existing refineries.

And the capacity has moved up equivalent, I think, of somewhere between 150, 200,000 barrels a day per year. So there is a lot of debottle-necking.

Also, the industry has had to—it is not just installation capacity that we worry about. As the crude gets heavier, as the refined products get cleaner, as the sophistication of the processes change over time, a lot of capital investment goes into treating and beating up the barrel more.

Mr. KELLER. Even our side, you know, Joe Barton says we need five million gallons more capacity. I mean, do you disagree that we need more capacity? More refineries?

Mr. PUGLIARESI. I think if the permitting process were smoother and it were, you know, easier to make additions and the cost structure was—I mean, there is a lot of risks out there if you build a refinery.

You don't know what the Congress is going to do on the climate control. You have the new ozone standards coming along.

So the cost structure is pretty high.

And you also have ethanol moving into the market at pretty high rates.

So total demand for gasoline in the U.S. may be coming down.

Mr. KELLER. I don't want to cut you off, but I sense a no clear-cut answer to that refinery thing, and I have only got a few seconds left to ask Mr. Douglass about the interchange fees.

You are paying, roughly, on average, about 2 percent interchange fees to credit card companies?

Mr. DOUGLASS. It varies between 1 1/2 for a debit card and 4 percent for——

Mr. KELLER. The premium cards.

Mr. DOUGLASS [continuing]. American Express.

Mr. KELLER. And that is really where you get hit, the premium cards, the 4 percent fee versus a 2 percent fee?

Mr. DOUGLASS. Yes.

Mr. KELLER. Mr. Chairman, will you indulge me for another minute to follow up on the interchange fee question?

What were you paying about 10 years ago in interchange fees? Rather than 2 percent, was it about 1 percent?

Mr. DOUGLASS. One percent.

Mr. KELLER. So you have seen an increase. You like Mr. Conyers bill, I take it?

Mr. DOUGLASS. Absolutely.

Mr. KELLER. Okay.

If we were to pass his bill and you were to have some favorable reduction long-term through some market-based approach and your interchange fees went down from an average of 2 percent to 1 percent, would the companies you represent pass those savings along to consumers? Or would they use that to enhance their profits, in your opinion?

Mr. DOUGLASS. In my opinion, it would always go to the consumer because we are in such a transparent industry. We use two-foot letters, numbers, if you will, to advertise what we are selling our product for.

And so you can tell, at any reasonable speed, what that particular location is selling at, and so their margin is compressed by the fact that everybody else has a sign.

It isn't like going into a store and shopping and you have to look at the sales and so on. We can drive by at 50 miles an hour and tell what the neighborhood's price is.

But they have to give it to the customer because the competition demands it. We are in the business of pulling customers in to a convenience store to buy fuel. We use fuel as the attractor.

Mr. KELLER. So your answer is you would pass it on to consumers because you have to because you are in such a competitive environment?

Mr. DOUGLASS. Yes, sir.

Mr. KELLER. Now, let me give you one hard question, if you don't mind, since I gave you——

Mr. DOUGLASS. Okay.

Mr. KELLER [continuing]. A more modest one.

On Mr. Conyers' bill, he is not setting the rate. You would go to this arbitration panel and one side would say to the panel, for example, the electronic payment folks may say, well, we want you to set an interchange fee at 4 percent.

And your side may say we want you to set an interchange fee at 1 percent.

Are you concerned at all that the arbitrator may go with a 4 percent fee which is higher than you are paying now on average? Or are you just willing to take your chances?

Give me your thoughts on that issue.

Mr. DOUGLASS. It is really the opportunity to talk to these folks.

We have a contract that is 1,550 pages, as we understand it, with Visa and Master Card, but they won't let us see it.

So we are virtually shut out of the process. I am not allowed to talk to them.

And, as a group, my association can't get together and talk to them because there is antitrust violations there.

So, essentially, I am controlled by a duopoly that doesn't give me a chance to negotiate. All we ask in the bill is the right to have a discussion with them.

If they choose not to have a discussion, that is the only time it would go to arbitration. And we would take whatever they decided. It has to be better, at least in discussion, than we have today where they won't talk to us.

Mr. KELLER. Thank you, Mr. Chairman. My time is expired, and I will yield back.

Mr. CONYERS. Thank you.

Dr. Cooper is going to have to excuse himself at 2 o'clock. That shouldn't present any problem, but I want everyone to know it in advance.

How do we deal with the biggest problem that you suggest is in structural and we are the only antitrust group on this side of the House——

How do we start off, Mark Cooper?

Mr. COOPER. Well, there has actually been legislation directly addressing some of these issues that have been introduced in the last couple years that would start the process.

It will be a long, slow process. But one is giving the antitrust division the clear right to go to court with OPEC.

Now, I understand people shake in their boots about OPEC, but if you think about it, and there was this article, an opinion piece in the Post today made the point.

When we put a nickel of a tariff on some commodity, we get hauled into world court in the blink of an eye.

And OPEC has been taking $50 billion, $100 billion in monopoly rent for decades and nobody does anything about it.

And so his point is it is time to say this is economic warfare and to stand up. It will take time, but, you know, that threat may actually work.

Instead of holding their hand, maybe we ought to push it away and begin that process.

Mr. CONYERS. But what about some diplomacy? Let us take a middle course.

Mr. COOPER. Well—sometimes works, but, you know, a cartel is tough to run as a general proposition. But when everybody's pockets are full of money, as has happened over the past years, it gets real easy because there is no incentive to cheat anymore.

And so you really now have—and just go back and look over the past few years. What you will see is OPEC was defending $40 a barrel. You had a huge jump in domestic spread in the U.S., and then OPEC is defending $60 a barrel.

Then you get another jump in the domestic spread in the U.S., and OPEC is defending $80 a barrel.

The Saudis now say they are defending $80 a barrel, and they are talking about not investing in more production when, in fact, their costs of production are down in the 20's at most.

Now, that is a massive rate of profit which, in a competitive industry, would attract entry, but it is not a competitive industry.

So the answer is we have to start the process of signaling that we are going to fight back.

The same thing is true in the domestic industry in terms of refining. You know, the Saudis offered to fund these expensive refineries years ago.

Bush offered military bases to get over the nimby problem, and the oil industry said no thanks.

The shortfall in refining capacity in this country has doubled in the past 15 years. Yes, they expanded a little bit, but they haven't tried to build new ones and they don't want to try to build new ones.

Mr. CONYERS. Why?

Mr. CONNER. Because it maximizes their profits.

Mr. CONYERS. Okay.

Mr. CONNER. Now, that may be a different Committee, but you have to look at that as unilateral action.

Senator Specter had a bill in. We have to start to tell the antitrust authorities that in a market that is this concentrated, where market forces are this weak, unilateral actions can, in fact, harm the public and need to be investigated.

Mr. CONYERS. More things than you think are in this Committee.

Mr. CONNER. I know that Committees have that view of the world, sir.

Mr. CONYERS. Shale, nuclear, tax holiday, coal, drilling, drilling, drilling—what are we to do?

Mr. CONNER. Well, let me start with the one that is universally seen as a bad idea.

The tax holiday is not a good idea. And the interesting thing is it is particularly not a good idea for two reasons.

One is it turns out to be a tax cut for the wealthy. The top one-fifth of consumers in this country, 20 percent, with household incomes above $85,000, consume 32 percent of the gasoline. They get the bulk of the tax cut.

The bottom 40 percent of the households in this country consume about 20 percent of the gasoline, so they get a smaller part.

It is a very regressive way to go.

Second of all, when you do that tax cut, as I described, the industry has market power. They will eat a large part of it. It gives them head room to increase their margins.

Ironically, if you combine that with a windfall-profits tax, this is the one circumstance in which they can easily make the public pay for the windfall-profits tax because they will increase their profits. You will try and tax it away, and you will end up paying it at the pump.

So that is a bad idea.

The other issues of shale and those kinds of things, if you could solve that problem in the market structure, we wouldn't be talking about those high-cost alternatives.

So what you have here is an industry structure that has constrained opportunities, and now you look at this very narrow set of very expensive back stop and say, boy, we got to build a back stop someplace. At $120 a barrel, let us do this. When the real solution is to fix the market structure.

Mr. CONYERS. Well, that is why we are here. Should I put these other items, those, Dr. Cooper, on hold? Drilling and nuclear and coal and shale?

Mr. COOPER. Well, I don't believe that drilling in the U.S. will have an impact on the world price in part because the cartel can anticipate and see this takes 10 years. It certainly won't lower my gasoline bills in the near term.

The cartel will see what the supply is and adjust to it.

So I don't know that we get any advantage out of that.

With respect to nuclear, Congress passed legislation that was supposed to expedite the permitting process and the nuclear industry can't come up with a standard design. They are driving the NRC crazy by constantly changing their own designs.

So Congress tried, and now they are going to blame it on the regulator, but, in fact, the industry really can't figure out how to build those.

Coal to liquids, if you solve the market structure problem, it goes away. It is not economic if the price of crude and gasoline were economically set, not politically set.

Mr. CONYERS. Well, that gets us out of the gate anyway.

I would like to continue some of these examinations of the circumstance.

And, Mr. Chabot, I would like to recognize you now.

Mr. CHABOT. Thank you very much, Mr. Chairman.

Mr. Cooper, you had indicated you would not be in favor of drilling in ANWR. Do you include the Outer Continental Shelf in that or not?

Mr. COOPER. Well, in my view, the domestic resource base is not sufficiently large to influence the world price of oil as long as you have this cartel in place, because that cartel can easily offset whatever you want to do.

Mr. CHABOT. So the answer is yes?

I mean, you would keep both ANWR and the Outer Continental Shelf off limits at this point; is that correct?

Mr. COOPER. I am telling you it wouldn't do the consumer any good. And I want you to do stuff that will help the consumer.

Mr. CHABOT. All right. Thank you.

If I could ask the other three members of the panel your opinion on whether or not you believe that part of the solution to the problem that we, as a nation, find ourselves in with fuel costs continuing to rise, if you could tell me your belief relative to ANWR and the Outer Continental Shelf as to whether we ought to go there or not.

I guess I will start with you, Mr. Pugliaresi.

Mr. PUGLIARESI. First, Mr. Cooper's comments are interesting.

But the first question you have to ask yourself is: Why would Congress leave all this money on the table? I was curious about that.

You look at the Norwegians. They are a very socially-advanced country, very environmentally sensitive yet they lease and operate in some of the most harsh, environmentally-sensitive offshore regions.

Our assets, both ANWR—are worth billions of dollars, and they would be collected by the U.S. Government.

Second, I am not sure I agree that—I agree that the scarce resource is crude oil. This is a scarce resource.

I mean, the energy security problem is, to some extent, a concentration of those resources in parts of the world that can be very unstable.

If you want to put some discipline in the cartel, we need to do two things. We need to expand output; really start drilling, as *Newsweek* recently said. And we need to have reductions in net demand.

I refer everyone to the collapse in oil prices that occurred in the mid-1980's. This occurred largely because the high prices brought about so much conservation and so much increase in non-OPEC production that Saudi Arabia lowered its output to the point, in defending that price, to where it could barely produce enough associated gas to run its utilities.

At that point, they said, we are not defending the price any more.

So supply response from non-OPEC countries will have a positive response on OPEC. It may take time.

The other issue is if we don't do it, we are not going to break expectations. And this market is driven a great deal by expectations.

Mr. CHABOT. So, yes, we should drill in ANWR and the Outer Continental Shelf?

Mr. PUGLIARESI. Absolutely.

Mr. CHABOT. Mr. Douglass?

Mr. DOUGLASS. Yes. Absolutely. Yes, we should drill ANWR.

We should be in Colorado with shale oil. And, obviously, off both coasts because if we don't produce our, if you will, our speculators, our commodity traders and so on will be given the signal that this isn't ever going to happen.

They can continue to pile on, and the price continues to escalate both by raw product costs and by the speculators investing in the future that says we aren't going to produce it ourselves; therefore, it is a good hedge against inflation.

Mr. CHABOT. Thank you.

And Mr. Owen?

Mr. OWEN. I would concur. I have heard it all my life, you know, we need to reduce our dependency on foreign oil. And by producing more here, yes, I think that is a good idea.

But I don't feel qualified. I mean, I do understand what the doctor was talking about regarding it being a global commodity now. And I think that the impact of drilling today would be less than it would have been eight or 10 years ago.

Mr. CHABOT. Right. And in my opening statement, that is one of the points that I was trying to make was the fact that this is something we should have done many years ago. We didn't.

Congress was partially responsible for that. President Clinton vetoed drilling up there prior to that.

So, yes, we should have done it back then, but if we did it now, it is my view, that—we talked about the impact that speculation has on the price in the markets.

I think it would have almost an immediate impact on that because they would know that we are serious about this and we are actually doing something about it.

Mr. Owen?

Mr. OWEN. I think that the speculative nature of treating fuel as a commodity by the hedge funds, people with a lot of money that aren't going to take delivery on the product and have no extension of doing that, is probably one of biggest parts of this whole problem.

Mr. CHABOT. Thank you.

Dr. Cooper——

Mr. OWEN. One more important point.

It is true that when you learn a lot about a new technology helps you get more. But what you really learn is you get the knowledge of the geology.

And the Permian Basin and the San Joachin Basins are very interesting. Every forecast made on total recovery from those basins turned out to be wrong even as late at 1982. And they were wrong by an order of magnitude.

So when we don't drill in new regions, we lose the oil. We also lose the knowledge. And that knowledge can have sustaining value for a long period of time.

Mr. CHABOT. Thank you.

Dr. Cooper, our Chairman had asked me to ask you why would we want to leave money on the table, as Mr. Pugliaresi has indicated we shouldn't do.

Mr. COOPER. Well, I am told, and I would have to look, we have a very low tax rate on oil compared to other producing nations in the world.

Clearly, we spend lots of money on lots of things, and, you know, we don't tax everything.

We have made a social choice about where we want to drill and how we want our environment to be managed.

My view of drilling in those places is not about getting money. Someone recommended that we sell the national parks. Why don't we sell the national parks? We could get a lot of money for selling the national parks.

The answer is we make social choices.

The question here is not how much money we left on the table, but whether or not those decisions would have a significant impact on the price and the structure of the world oil industry.

If we had started drilling ANWR 10 years ago, it would be starting on its decline now. It is not that big of a resource.

OCS may be a little bit bigger, but, again, we just don't have the kind of resources here to significantly, in my opinion, effect the market.

With respect to the speculative bubble, sending a signal about expectations—the two most important things we could do about sending a signal about expectations is, one—and fix this bubble—is close the Enron loophole.

We regulate onions more than we do oil. And, frankly, oil is an awful lot more important.

Second of all, we could raise the margin requirement so that people who are playing with this kind of physical commodity do not, in fact, have so much leverage.

We need to chase a lot of that funny money out of this market. That is the way to, in the long term, address the speculative problem which has not afflicted us since we created the Enron loophole.

Remember, the speculation in energy began right after we decided that we were not going to regulate these commodities, and it has grown worse and worse year after year.

So that is the way to fix speculation.

Mr. CHABOT. Thank you, Mr. Chairman.

I would just like the record to reflect that 75 percent of the panel indicated they thought we should drill in ANWR and the Outer Continental Shelf.

Mr. CONYERS. One of the 75 percent disclaimed any expertise.

Mr. CHABOT. But nonetheless, ventured an opinion and we appreciate that opinion and we agree with that opinion.

Mr. CONYERS. He is going to have to live with that, too.

By the way, how are your relationships with the teamsters?

Mr. OWEN. Actually, we have very, very little to do with—most of our companies, sir, are family-owned, privately-held, grass-roots type businesses.

We have 2,200 member companies, and I think maybe one or two that even are union shops.

Mr. CONYERS. Uh-huh. Thank you.

Chris Cannon?

Mr. CANNON. Thank you, Mr. Chairman. I am hoping that our clock will run fast and the clock on the floor will run slow.

I want to reiterate, first of all, Mr. Pugliaresi, your point was profound that not drilling means foregoing knowledge that is profoundly important for the future because there are a lot of things we don't know about the geology.

And then, Dr. Cooper, as I understand it, I think there is only a minor difference between you and Mr. Pugliaresi, but my understanding of our decision is that if we drill in ANWR, then OPEC will lower the amount they produce and, therefore, we will get no net benefit out of ANWR or other marginal sources of production.

Is that, essentially, your position?

Mr. COOPER. My concern is that when you can see it coming, if it is not big, than you can adjust to it. If it were big and you would make someone cheat, that would be different.

Mr. CANNON. Pardon me. Because of the limited time, I think we understand each other and I, largely, agree.

Mr. Pugliaresi is only suggesting, in difference from your opinion, that over time that would have an effect. So that difference is marginal.

So what I really want to focus on is what happens when you get a larger resource that is available. And I hope that is where we will agree that you might see a significant change.

You referred to shale, for instance, as one of the high-cost alternatives. And I think you are probably referring to CTL, coal to liquid, as one of those high-cost alternatives.

As you view the world today, what are the input costs for coal to liquid, and what do you think coal is going to be costing us? I mean, in your calculations, what do you think that cost would be?

Mr. COOPER. Well, my point is that at $40 a barrel, I don't think you will get a lot of coal to liquids.

Mr. CANNON. In other words, if OPEC brings the price of oil down to $40 a barrel, you won't——

Mr. COOPER. The economic, in my opinion—the oil company executives testified a few weeks ago it is $50 a barrel. And I assume that they are inflating it.

So at $40 a barrel, I don't think you will get a lot of coal to liquid.

Mr. CANNON. I think that is about the right price. Frankly, it might be a little less than that, and, especially, if we made coal available like the 77 billion tons in Utah, which is 150 billion tons of oil which is now locked up.

So that is coal, I think, that can be had, at an economic cost, for less than $20, probably about $15 a ton; meaning an input cost of seven and a half dollars per barrel; meaning that you are way under the $40 a barrel.

So it is a matter of resource availability among other things.

But on the other hand, are you aware that we have some serious activity in oil shale right now? Now, not on public lands. DLM is prohibited by the Democrats from developing shale.

But we have a commercial test on school trust lands that has begun, and that should be done by about the middle of September. They are thinking that—they are saying their cost is $30 or less.

I think that is inflated myself. I think the real costs are going to be in the ballpark of just under $20 a barrel.

That is literally trillions of barrels of oil that we have locked up that is available at a cost—and there are five or six or seven companies out there that have particular developed technologies to get that oil out.

Oil shale—what do we have? Maybe three to five trillions barrels available in shale. That changes the dynamic to OPEC; does it not?

Mr. COOPER. Well, the development of those resources, the numbers I have seen, does not make them economic at the market clearing price of oil.

Mr. CANNON. What is that market clearing price in your mind?

Mr. COOPER. And the environmental cost has to be factored in.

Mr. CANNON. Granted. Although, I think that the environmental costs are going to be much less than what most people are thinking.

What do you think the clearing cost of oil is?

Is that the $40 a barrel we talked about a moment ago?

Mr. COOPER. $40 a barrel is—for today's prices, if there were no political constraints, if we had had good investment over the——

Mr. CANNON. What I want to know is——

Mr. COOPER [continuing]. It would be—the marginal cost of lifting a barrel of oil in Saudi Arabia is $10.

Mr. CANNON. Right.

Mr. COOPER. Or $15.

Mr. CANNON. So what is the clearing cost in America that is low enough so that Saudi Arabia and the rest of OPEC does not drop its price below some point where we can't compete? Or it doesn't make sense to get oil in America?

Mr. COOPER. Well, the oil companies say that their costs are $50 a barrel at the margin. I think the number is a lot lower than that if there were not a cartel which was manipulating and refusing to invest.

The Saudis just said they are not going to expand more than 11 percent.

Mr. CANNON. You said $50. When you talk about $15 in Saudi Arabia, there is some point between $15 and $50 where OPEC can't constrain the market. Is that $30, do you think?

Mr. COOPER. Well, OPEC constrains the market as long as they can control cheating, which is real easy at $120 a barrel.

Mr. CANNON. Right.

Mr. COOPER. You heard the description of what happened when they were backed down. We can't back them down——

Mr. CANNON. If the Chair would indulge me——

If we had $30 a barrel oil in virtually unlimited amounts in America, would that break the cartel?

Mr. COOPER. That would certainly help, as would the Canadians. The Canadians are not producing much of their shale either.

There is not a lot of shale all over the world being produced, and it may well be that people don't believe the $120 price, but the economics suggest that where they can, they haven't produced it.

Mr. CANNON. Well——

Mr. COOPER. Where they can, they haven't produced it.

Mr. CANNON. Technology has changed the world, and people are going to catch up with that.

Mr. Chairman, I have a million more questions. I appreciate the hearing.

The time has passed, and I hope some time is left on the clock on the floor.

Thank you, and I yield back.

Mr. CONYERS. Ric Keller?

Mr. KELLER. Thank you, Mr. Chairman.

My final question, I will just direct to my fellow Tennessean there, Mr. Owen.

I believe you testified that your truckers buy, on average, about a hundred gallons of diesel fuel a day. Is that right?

Mr. OWEN. Yes, sir.

Mr. KELLER. According to the Department of Energy, diesel fuel, this week, is about $4.15 a gallon. Does that sound about right?

Mr. OWEN. I believe that is a national average. It is higher in California and lower in Georgia. But, yes, that is about right.

Mr. KELLER. Even as a national average, that means your truckers are paying about $4.15 end of day in diesel fuel costs. Is that right?

Mr. OWEN. That is correct.

Mr. KELLER. Okay.

What is the number one thing you would like to see Congress do in the short term to provide relief to your truckers who are struck with the skyrocketing cost of $4.15 a day in fuel costs?

Mr. OWEN. I believe number two on my list there—in our part of the industry, our drivers sleep in their trucks. They sleep in the sleeper unit, and they are required to rest 10 hours uninterrupted a day.

Mr. KELLER. Right.

Mr. OWEN. And in order to do that, they sleep in their sleeper units. And in order to secure the load, secure themselves, they have to lock themselves in the truck, basically, and take their rest.

And you have to have air-conditioning in the summer time and heat in the winter time to do that. And so they idle their truck.

And there is a thing called an APU, which is the auxiliary power unit that a lot of companies are already putting on trucks. They range in price from $6,000 to $10,000.

But they cut that cost of idling by, you know, 65, 70 percent.

It is a big winner for everybody.

Mr. KELLER. Do you want a tax incentive for the APU?

Mr. OWEN. I would love to see a tax credit for APUs. Yes, sir.

And I would like to also see some kind of standardization for idling laws.

The EPA is working on that, but every law is different. It is different in California. It is different in New York. And we go everywhere.

Mr. KELLER. And, right now, there is no tax incentive to buy the APU?

Mr. OWEN. Not that I am aware.

Mr. KELLER. Okay.

And the final question deals with the proposed gas tax increase. And I want to be fair to both sides here on this issue.

But I want to get your opinion on what impact the gas-tax increase would have on truckers.

A very well-respected Democrat, Mr. Dingell, Chairman of Energy and Commerce, has called for a $.50 gas-tax increase. Don Young, a senior respected, powerful Republican, called for a dollar tax increase on gas.

These are senior respected, knowledgeable guys, far more powerful than me. The other side—and I will tell you my view.

At a time when people are hurting in this country and paying higher costs for gasoline, mortgages, and food, I think it is flat-out wrong to take their taxes only to see Congress spend it on things like hippie museums and bridges to nowhere.

What impact do you think an increase in the gas tax of $.50 or a dollar would have on your truckers? And is that something you favor or oppose?

Mr. OWEN. Thank you for asking that question.

We are taxed federally at the rate of 24.4 cents a gallon. This gentleman over here will average making about $0.08 or $0.09 a gallon before the exchange fees.

So the government is making more off of fuel, by far, than anybody else. That doesn't include the State taxes nor the local taxes.

I think we are an overtaxed industry. I think we are overregulated and overtaxed and unappreciated, quite frankly.

So my first take is no, we can't. But everybody else in the industry but me and you think it is a good idea.

And I think the reason being that the infrastructure is in such horrible shape and the bridges and the roads and the amounts of money that are needed to do that, and a lot of the States who are required to keep the interstates viable are turning to alternative way of financing.

I don't want more fuel taxes. I would like less. But I don't want our States selling our interstate system off to a private enterprise either.

Mr. KELLER. So the summary of your position, you are against a gas tax increase, but you don't think it is necessarily a good idea to suspend the existing tax because we still have got to build roads and bridges. Is that a fair summary?

Mr. OWEN. I think so. And that would run contrary to the ATA and other organizations who have, in my opinion, copped out for higher fuel taxes.

Mr. KELLER. Okay. Thank you.

And, Mr. Chairman, thank you very much for letting me ask those additional questions.

Mr. CONYERS. Well, I was very happy to get the responses, as you were.

Thank you, gentlemen.

We have invited, at our next hearing, the secretary general of the Organization of Petroleum Exporting Countries or his representative.

We believe in the discussion being very important to what our attitudes are going to be in the near future toward each other. And for that reason, we are asking them to come and join us in this discussion so that we make sure that we have their perspective.

Do you have any recommendations about this approach, Mr. Pugliaresi?

Mr. PUGLIARESI. Mr. Chairman, first, we do need a counter-OPEC strategy. I agree.

I just don't think using the legal side of the ledger is likely to yield any results that we are going to like. These are sovereign countries making decisions on how much to produce.

Part of the problem is, in this particular market, when Venezuela misbehaves or if countries engage in resource nationalism in this type market, prices go up. And it tends to sort of mask their bad behavior.

So I think Dr. Cooper is wrong about the supply response.

If we have a concerted supply response on this side, OPEC behavior will change. It might not change right away, but it will change.

Some of these OPEC countries are doing things that are actually making the problem a lot worse on the demand side, I believe.

Almost the entire Middle East has highly-subsidized gasoline prices. I mean, we are talking Iran is charging $.07 a gallon. Parts of China and India still have subsidized a lot of subsidies in their fuel sectors.

That would, clearly, be an area where they ought to be doing a lot more.

Mr. CONYERS. What about the discussion part of it? Is there any room for diplomacy at this stage of our relationships?

Mr. PUGLIARESI. I presume you are talking about some sort of consumer-producer dialogue.

Mr. CONYERS. Well, I haven't shaped the dialogue yet. That is what I am asking you.

Mr. PUGLIARESI. Some of this is very perplexing to me because I do not believe that, for example, these existing price structures are in the interests of some of the OPEC producers.

Some of the OPEC producers with very large reserves are going to end up seeing too much demand with destruction over time. And, for whatever reason, they did not expand capacity fast enough to keep up with it.

Others may benefit directly, those are smaller reserves.

So, once again, I think we need to find out whatever trade negotiations we have, sort of explain to them, yes, you should probably be worried about demand destruction and the response from the West because it is likely to be cumulative and be substantial over time.

Mr. CONYERS. I was hoping to edge you toward more support for the diplomatic approach.

Mr. PUGLIARESI. You know, I understand you are sort of having the President ask them to produce more. I think we are in a kind of difficult position.

I mean, I don't see a problem with that necessarily, but we are not willing to produce more. It is kind of a problem.

I mean, we are sitting here with a very bad example of resource nationalism in a way, and we are so restrictive on our ability to produce more.

It is going to be hard to argue you ought to produce more. I think it is in their interest to produce more.

Mr. CONYERS. Well, I didn't mean that particular point. But I mean to begin to have extended discussions.

There are other issues.

I see I am not very successful this afternoon. [Laughter.]

But, look, that is what diplomacy itself is all about. You have to keep talking. So I will have to keep talking with you. [Laughter.]

Thank you very much. This was a very important beginning of our re-examination of our responsibility in terms of the antitrust question which is where the Sherman Antitrust Laws first came from, wasn't it? From oil?

And here we are back again looking at them.

Thank you so much.

[Whereupon, at 2:09 p.m., the Task Force was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

MAY 0 5 2008

The Honorable Nancy Pelosi
Speaker of the House of Representatives
Washington, D.C. 20515

Dear Madam Speaker:

Thank you for your letter to President Bush of April 22, 2008. The Bush Administration shares your concerns regarding the effects of high fuel prices on individual Americans, especially low income families who devote a greater share of their income to energy expenses. The President has repeatedly addressed the broader issue of our degree of national dependence on oil, and what this dependence means to our prosperity and our security. We were pleased to work with you to enact the Energy Independence and Security Act of 2007, increasing fuel economy standards, and mandating increased use of alternative fuels. As you are well aware, this legislation followed the President's call to establish even more aggressive alternative fuel standards than were ultimately enacted by the Congress.

The price of fuel, like that of any commodity, is governed by the fundamental laws of supply and demand. President Bush has called for several actions to address both the supply side and the demand side of the oil market. Increasing fuel economy while encouraging greater use of alternative fuels, as required by the recent bipartisan legislation, will help dampen the effects from oil demand pressures that drive up prices. Increasing domestic energy production to help dampen the effects from supply pressures is equally important.

The President again calls upon Congress to take legislative action to expand domestic production. According to the Department of the Interior, of the 31 billion barrels of oil on Federal onshore lands, 92 percent is subject to some restriction with 62 percent not accessible at all. In addition, 85 percent of the Outer Continental Shelf in the lower 48 States, which is likely to be energy rich, is off limits to exploration and production. Providing more access to Outer Continental Shelf resources, opening a small portion of the Arctic National Wildlife Refuge, and streamlining the siting and expansion of oil refineries, would each help to relieve Americans from further upward pressure on the prices they pay for fuel. We call upon Congress to pass legislation to accomplish these goals.

The Administration will continue to oppose Congressional initiatives that would increase the price that consumers pay at the pumps, including recent proposals to increase the gas tax. Earlier this month, the President laid out his principles for addressing climate change. Among those principles was the Administration's opposition to any measure that would sharply increase gasoline prices and the cost of energy. Unfortunately, most of the legislative proposals in

Congress do not meet this test. To the contrary, several of these provisions would have counterproductive effects.

The Administration strongly opposes and has threatened to veto H.R. 2264, the "NOPEC" Bill. This Bill would result in a targeting of foreign direct investment in the United States as a source of damage awards and would likely spur retaliatory action against American interests in those countries and lead to a reduction in oil available to United States refiners. The net effect would be to harm United States interests abroad, discourage investment in the United States economy, potentially limit the availability of gasoline, and possibly to further increase the price of fuel.

The Administration strongly opposes and has threatened to veto so called "price gouging" legislation as well. Such legislation would do nothing to alleviate the supply/demand balance that drives fuel prices in our competitive markets. Such provisions could result in gasoline price controls and in some cases bring back long gas lines reminiscent of the 1970s. Gasoline price controls are an old – and failed – policy choice that would exacerbate shortages and increase fuel hoarding after natural disasters, denying fuel to people when they need it most. Moreover, it is already illegal for companies to collude to raise gas prices or for a single firm with market power to engage in anti-competitive behavior to exploit consumers. The Department of Justice and the Federal Trade Commission remain vigilant in monitoring the markets and stand ready to prosecute any such behavior.

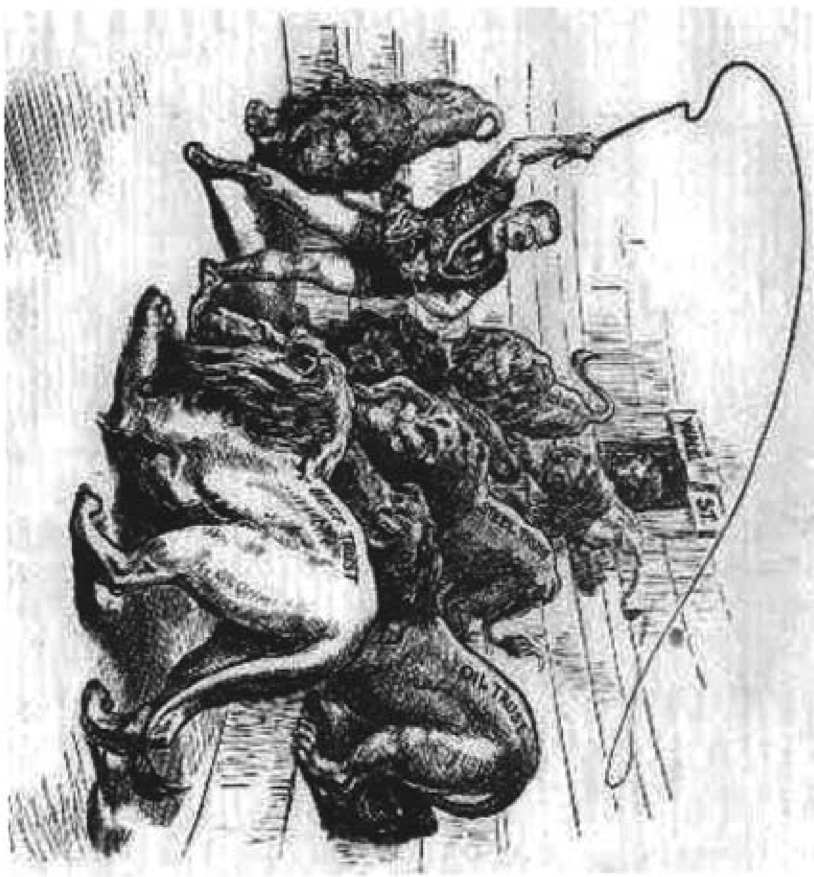
The Administration also strongly opposes and has threatened to veto legislation that would use the Federal tax code to single out specific industries for punitive treatment. Repealing the manufacturing deduction specifically for certain oil and gas companies is a targeted tax increase that would put United States firms at a disadvantage relative to their foreign competitors. Changes to the foreign tax credit rules related to foreign oil and gas extraction income and foreign oil-related income would also disadvantage United States-based companies by reducing their ability to compete for investments in foreign energy-related projects. When Americans are suffering from high gas prices, Congress needs to heed economic realities rather than political temptations; singling out and denying a specific industry the tax advantages broadly provided to others can only result in still higher prices for their products. In short, this is no time to drive the price of fuel still higher by imposing a tax increase on its production.

We appreciate the bipartisan process by which the energy legislation of 2007 was enacted, and believe that a similar bipartisan approach should guide any future legislative efforts.

Sincerely,

DIRK KEMPTHORNE
Secretary of the Interior

Samuel W. Bodman
Secretary of Energy



The Lion Tamer

ONE HUNDRED TENTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON THE JUDICIARY

2138 RAYBURN HOUSE OFFICE BUILDING

WASHINGTON, DC 20515–6216

(202) 225–3951
http://www.house.gov/judiciary

April 29, 2008

HE Abdalla Salem El-Badri
Secretary General
Organization of the Petroleum Exporting Countries
Obere Donaustrasse 93
A-1020 Vienna
Austria

Dear Secretary General El-Badri:

The Antitrust Task Force of the House Committee on the Judiciary will hold a hearing on Thursday, May 22, 2008, at 10:00 a.m. in room 2141 Rayburn House Office Building. The title of the hearing is: Retail Price of Gas and Competition in the Oil Industry.

I would like to invite you to testify at this hearing. Understanding that a personal appearance would require you to travel a considerable distance, we would be happy to teleconference you into the hearing. In addition, should you have an unalterable scheduling conflict, you are welcome to send some other OPEC representative in your stead. Please prepare a written statement for submission to the Committee prior to your appearance. The written statement may be as extensive as you wish and will be included in the hearing record. To allow sufficient time for questions at the hearing, please briefly highlight the most significant points of the written statement in an oral presentation lasting five minutes or less. Oral testimony during the hearing, including answers to questions, will be printed as part of the verbatim record of the hearing. Only transcription errors may be edited subsequent to the hearing.

To facilitate preparation for the hearing, please send an electronic copy of your written statement and curriculum vitae to the Committee 48 hours in advance of the hearing. The Committee will publish the statement on our website and, therefore, requests that you provide the documents in Word Perfect, Microsoft Word, or Adobe Acrobat. Please number all pages of the written statement, and attach a cover page with your name, position, date, and the title of the hearing. These documents may be e-mailed to Anant Raut on my staff at

HE Abdalla Salem El-Badri
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April 29, 2008

In addition, the Committee requests that you provide 50 copies of your written statement to Mr. Raut, 2138 Rayburn House Office Building, Washington, DC, 20515, by 12:00 p.m. the day of the hearing. Due to delays with our current mail delivery system, the copies should be hand delivered in an unsealed package. If this is not possible, please bring the copies with you the day of the hearing. If you intend to teleconference, alternate arrangements can be made. Should you intend to introduce a published document or report as part of your written statement, I ask that you provide 50 copies for the hearing. Should such material be available on the Internet, please prepare a page containing citations to such material and provide the Committee with 50 copies.

Section 210 of the Congressional Accountability Act of 1995 applies the rights and protections covered under the Americans with Disabilities Act of 1990. Accordingly, the Committee on the Judiciary strives to accommodate/meet the needs of those requiring special assistance. If you need special accommodation, please contact the Committee on the Judiciary in advance of the scheduled event (3 days requested) at 202-225-3951.

Additionally, the Rules of the House require a disclosure of the amount and source (by agency and program) of any Federal grant (or subgrant thereof) or contract (or subcontract thereof) which is relevant to your testimony and was received, by you or by an entity which you represent, during the current fiscal year or either of the two preceding fiscal years. Therefore, please fill out the enclosed "Truth in Testimony" Disclosure Form and fax it to the Committee at 202-225-7680 prior to the hearing.

If you have any questions or concerns, please contact Mr. Raut on my staff at 202-225-3951.

I look forward to your participation in the hearing.

Sincerely,

John Conyers, Jr.

John Conyers, Jr.
Chairman

Enclosures