



Red Cavaney
President and Chief Executive Officer

1220 L Street, NW
Washington, DC 20005-4070
USA
Telephone 202-682-8100
Fax 202-682-8110
Email rcavaney@api.org
www.api.org

May 23, 2007

The Honorable Charles Schumer
Chairman
Joint Economic Committee
Washington, DC

Dear Chairman Schumer:

While I welcomed the opportunity to provide the oil and natural gas industry's perspective during today's hearing of the Joint Economic Committee, the session did not allow time for adequate response to the numerous, unfounded accusations against the industry that we believe should be corrected. Therefore, even though I will offer a more detailed response for the record, I believe the seriousness of the charges requires that I offer these immediate observations to set the record straight:

- The evidence is overwhelming that there is healthy competition among the nation's oil and natural gas companies. As noted in today's hearing by Dr. Michael Salinger of the FTC, consolidation is not a major factor contributing to higher gasoline prices. The Federal Trade Commission has determined, over the years, that there is absolutely no evidence of any collusion – formal or informal – among the numerous companies to control fuel prices. For a lack of competition to exist, there has to be corresponding evidence of market concentration. According to 2006 data from the Department of Commerce, the percentage of the market of the eight largest refining companies is about 66 percent. Compare that to more than 95 percent for auto makers and more than 85 percent for seven other industries. There is overpowering evidence that market forces, and market forces alone, are responsible for the volatility in gasoline prices. Over the past couple of decades, there have been more than 30 state and federal investigations of the industry and all have come to the same conclusions: it's the market at work.

In this country, those market forces are affected by the price of crude oil (which is influenced by interruptions of supply, or even the threats of interruptions of supply, resulting from geopolitical conflicts, extreme weather and other factors); how much fuel we can import; necessary refinery maintenance for safety, and demand fluctuations. Imports have been key to this year's statistics. In years past, imports from Europe and elsewhere have been used to augment supply in this country, particularly during refinery curtailment periods. The United States typically imports about 1.2 million barrels per day of gasoline, or about 12 percent of daily consumption. This spring, however, maintenance at European refineries, a prolonged dockworkers strike in France prevented oil shipments, and refinery problems in Nigeria and Venezuela curtailed available foreign supplies.



As we all know, demand has been markedly high, worldwide. In the United States, record-high first quarter gasoline demand of 380 million gallons per day represented a 1.9 percent increase over the first quarter of 2006, according to the Energy Information Administration.

- Accusations that the industry is holding back on production to raise prices must be reconciled with one glaring and irrefutable fact: the industry has been very busy. So busy, in fact, that, through April of this year, the amount of finished gasoline produced in the United States, at 8.73 million barrels per day, is the highest it has ever been. If refiners were truly intent on keeping supplies down to drive up prices, why would they work so hard and invest so much – nearly \$50 billion from 1996 to 2005 – to meet clean fuel and other environmental requirements while still expanding capacity?

That 8.73 million-barrel milestone did not just happen. It is a result of the oil and natural gas industry's determination to increase its refining capacity through state-of-the art technology, despite numerous obstacles. In the last year alone, this increased capacity enabled the industry to refine some 200,000 additional barrels of crude oil per day above what was refined during the same period of 2006. The industry capacity expansions have added the equivalent of 10 new refineries over the past decade. Furthermore, it is expected to bring the equivalent of an additional eight new refineries into operation in the United States by 2011.

In short, our industry's commitment to providing Americans with the energy they need can be summarized in a simple phrase: record investments to produce record supplies to meet record demand.

- U.S. oil companies are not blocking the sale of E-85 at their branded stations. Currently, there are more than 1,200 retail outlets nationwide, located principally in the upper Midwest, that are equipped to distribute E-85. The number appears to be growing rapidly on its own, without any government mandate. Contrary to the false claims by some industry critics, oil companies are not preventing the installation and use of E-85 pumps and storage tanks. Given that only 3 percent of the nation's cars and trucks can safely run on E-85, and that when operated on E-85 these vehicles get 26 percent less fuel economy than when operated on gasoline, it is not surprising there is virtually no demand for this product. Moreover, many API member companies allow E-85 to be sold under the same canopy as gasoline and also allow the gas station owner to list the price of E-85 on signs outside the station.

However, it is not surprising that some companies would choose to keep E-85 pumps under a different canopy at gas stations. Should the owners of the 97 percent of the cars and trucks in this country that cannot use E-85 accidentally fill up with the fuel, their vehicles could be damaged or release higher emissions. Ultimately, it is up to the small business owners, who own and operate the majority of our nation's gasoline stations, to decide whether the demand for E-85 was large enough to cover the costs of installing E-85 pumps. Installing a tank system, including the pump, to handle E-85 can cost as much as \$200,000. Station owners, like any business owner, need to see a greater demand for E-85 in order to realize a return on their investment. Finally, if ethanol producers and their promoters are convinced as to consumer demand for their product, there are no barriers to the opening of their own retail outlets.

- Refiners do not set prices at franchised service stations. Refiners only set the wholesale price, the franchised dealers then set the retail price at their station. Further, this franchisor-franchisee

arrangement is not unique to the oil industry. Long-term service station supply agreements ensure that such dealers have a reliable supply during periods of tight markets.

- Company-owned stations are not a strong deterrent to a thriving independent station sector. In fact, over the past few years, the trend of major oil refiners is to reduce the number of company owned-and-operated service stations.
- Zone pricing does not stymie competition and, in fact, has been found by the federal courts to be a perfectly legitimate business practice and is not unique to the gasoline industry. A 2005 study by economics professors Cary A. Deck (University of Arkansas) and Bart J. Wilson (George Mason University) concluded that legislation to ban zone pricing does little to affect prices and in some cases, actually raises prices. In a 2007 study examining gasoline "zone pricing" in Connecticut, Quinnipiac University economists have determined that banning the practice would raise prices at the pump in most areas of the state. Zone pricing is practiced by motels, restaurants, airlines and grocery stores. Research has shown that the elimination of zone pricing would result in higher average prices for consumers. It would also force many refiners to exit from more competitive retail markets.

In closing, we remind the Committee that our industry, of necessity, operates in a global environment with enormous entities that dwarf even the largest U.S. companies. We must compete with these entities – many of them state-owned companies – for resources around the world. One of the principal reasons for this is the official U.S. policy blocking access to the vast American resources off our coasts, in Alaska and in large sections of the Rocky Mountain West. It is imperative, if we are to continue supplying Americans with the fuel they need, for this policy to be reversed. I look forward to providing your Committee with more information so that you can get a more accurate picture of our industry and its value to our nation.

Sincerely,

