Presentation by API President and CEO Red Cavaney to the USEA Energy Supply Forum

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I am honored to be your keynote speaker at this Energy Supply Forum, being held at such a critical time for our nation and its energy needs. I want to begin my remarks by thanking Barry Worthington and USEA for their continued strong energy leadership.

As much as anything, energy is the lifeblood of our economy and a prerequisite for our nation's future sustainability. It is not just about one region or another. It is not just about one political party or another. It is not just about one energy source or another. It's about our country, in particular, and its place among the hundred-plus neighbor nations in an increasingly globalized, competitive world.

Energy is omnipresent. If we, in the United States, do not get our energy house in order in meeting our energy needs here at home and enhancing our energy relationships throughout the world, we will have abdicated our leadership role in global energy. Rather than being one of the drivers of global energy developments, we will be increasingly driven by those developments.

Today's energy debate should be of concern not just to energy producers, but to all Americans. It has particular impact on our nation's breadwinners, who work hard to support their families and who rely so heavily on energy to get to their jobs, to power their businesses, and to provide comfort for their families. We understand and recognize the heavy burden imposed by high fuel prices. It does not have to be so painful. It is within the reach of our elected and appointed government officials to help mitigate these negative impacts.

In the ongoing energy debate, far too much time is being wasted in discussing what form of energy should be favored and which disadvantaged in meeting our country's needs. Every respected energy study on future demand comes to a similar conclusion about the next several decades - we need *all* the energy that is economically viable to produce in an environmentally sensitive manner – as well as energy efficiency at levels heretofore unrealized.

To some, that may seem a bit of a stretch at a time when demand in our country is being reduced. However, increasingly – and this is certainly the case for oil – what happens globally impacts what happens in the United States in terms of price and availability of supply.

Moreover, the current concern about crude oil and gasoline prices underscores the link between energy and the economy. Recent forecasts by the U.S. Energy Information Administration (EIA) estimate that sustaining a 3 percent rate of annual growth in the global economy to 2030 will require an expansion of crude oil the equivalent of the current combined consumption of the U.S. and China. The growth in demand for natural gas worldwide is expected to be even larger, increasing by 53 percent by 2030. Despite significant growth of alternatives and improvements in energy efficiency, more than half of the world's energy demand will be met by oil and natural gas in 2030, as is the case today.

These realities were underscored by the Department of Energy's National Petroleum Council (NPC) in a report last year. It points out that, as prosperity and incomes rise, so too does demand for energy. It notes that, in the years to 2030, global GDP is projected to double, with the greatest growth occurring in developing countries, particularly in the Asia-Pacific region. The NPC cites projections of a 50-to-60 percent increase in world energy demand from 2005 to 2030. Very soon, and for the first time in history, energy demand in the emerging economies will exceed that of the developed countries of Europe and North America. China, alone, will account for nearly a third of the world's annual demand increase between now and 2013.

Ironically, Chinese, Indians, and others in emerging economies understand these energy realities better than do many Americans. Energy is fueling their mushrooming growth, which, in turn, is driving world demand and spurring the record-high prices of recent months. Unfortunately, many people in this country still fail to understand or appreciate the role of energy in giving vibrancy to the U.S. economy and in supporting the continued growth in the American standard of living.

The energy we produce here at home is at the very heart of our nation's effort to respond to a changing energy world. Forty years ago, world oil reserves were largely the domain of the investor-owned, international oil companies, based principally in the United States. Most people today assume that international oil companies are little changed from decades ago, still holding the bulk of world oil reserves. However, that's no longer the case. Today, world oil reserves are 80 percent owned by the national oil companies of foreign governments, many formed during the past 30 years. Only 6 percent of worldwide oil reserves are now held by the investor-owned, international oil companies.

What is also not generally understood is that crude oil is a global commodity and its cost is determined in global market exchanges like the NYMEX. Rapid growth and development in the emerging economies is responsible for significant upward pressures on demand for a full range of commodities, such as steel, copper, cement, grains, coal, rubber, and oil – all up triple-digits this decade.

This commodity price cycle is a global phenomenon and not unique to oil and natural gas, nor to the United States. The current cycle, however, is particularly problematic for our country. This is due, in part, to the fall in the value of the dollar and to the unusual rush of investments into commodities, as a result of poor returns in the equity and bond markets and in real estate. These factors have contributed to higher commodity prices, particularly for those whose purchase power is in dollars.

The U.S. oil and natural gas industry is doing its part to address the current energy challenges facing our nation. Let me cite some examples:

- Baker-Hughes reported that, as of July 2, there were 1,921 drilling rigs active in the United States, the highest level in 20 years;
- Refiners are producing record amounts of ULSD, low-sulfur diesel and other distillates. And, despite reduced demand, refiners are producing near-record amounts of gasoline;
- With diesel demand increasing, U.S. refiners are making huge investments to increase diesel production. A dozen domestic refiners have announced refinery expansion and/or adjustment plans to increase the amount of diesel fuel produced;
- According to EIA, domestic refiners plan to add approximately 800,000 barrels per day in refining capacity of gasoline, diesel and other fuels over the three years, 2008 to 2010. That is the equivalent to adding four, new medium-sized refineries through the expansion of existing refineries;
- Oil companies are the leading user of ethanol and a key player in increasing the use of ethanol and other biofuels. Nearly two-thirds of all gasoline now consumed in the U.S. includes ethanol. Almost 7 billion gallons of ethanol were used last year – significantly exceeding the required 4.7 billion gallon level for 2007;
- To meet growing demand, our industry has continued to invest heavily. New investment for U.S. projects in 2008 is expected to reach $197 billion – a more than 12 percent increase over 2007; and
- Our industry invested an estimated $98 billion in North America alone, between 2000 and 2005, in emerging energy technologies, including renewables, frontier hydrocarbons -- such as shale and oil sands -- and end-use technologies -- such as fuel cells. That investment represents nearly 75 percent of the total spent by all of

industry and the federal government combined on emerging energy technologies during the period.

Recently, we’ve encountered misleading reports about U.S. exports of petroleum products putting upward pressure on gasoline prices. According to EIA data, nearly half of what we exported in the first four months of this year was petroleum coke and residual fuel oil -- products for which there is little additional U.S. market. No ULSD was exported. U.S. *exports* of gasoline and blending components equaled 2 percent of the U.S. market. U.S. *imports* of gasoline and blending components were roughly five times as large.

Much more needs to be done to meet U.S. energy needs. Many people fail to recognize that the United States is the third largest oil producer in the world. What we do – or fail to do – impacts not just our country, but the global energy marketplace as well. We are the world’s only oil and natural gas producer whose government restricts access to its domestic energy resources. As a result, American consumers are being asked to bear a costly and unnecessary burden, as world energy demand skyrockets,

While there have been some important legislative steps taken in the past several years, our government leaders have yet to formulate a national energy policy framework, through which issues can be viewed in the context of future energy demand. No longer can we afford to pick energy winners and losers, trying to ensure the success of one source at the expense of others. We need energy from all reasonable sources. And, we need them to compete in as free a marketplace as possible.

The continued demand for oil and natural gas should underscore the reality that these are resources that need to be replaced when they have been used. However, current federal policy significantly constrains the domestic development of the abundant oil and natural gas reserves beneath non-park federal lands and coastal waters. Let me give you two examples:

- Eighty-five percent of the Outer Continental Shelf (OCS), out to 200 miles off the lower 48 states, is off limits to development. These inaccessible lands contain an estimated 18 billion barrels of oil and 76 trillion cubic feet of natural gas, according to the U.S. Minerals Management Service; and
- Only 17 percent of non-park, non-wilderness federal lands administered by the federal government is open to energy development under standard lease terms. Lands unavailable for development hold an estimated 19 billion barrels of oil and 94 trillion cubic feet of natural gas, according to the U.S. Bureau of Land Management.

All too often, we hear the argument that "we cannot drill our way out of our current energy problems." It is said that opening ANWR would produce only a six month supply of oil – even though the USGS' mean estimate is that it holds 7.7 billion barrels of technically recoverable oil. Such a claim uses faulty logic, like telling a farmer: "You cannot plant your 400 acres because the crops you grow would not meet the total food crop needs of our nation this year." Oil, like a food crop or any other commodity, helps meet future demand through the incremental addition of new volumes from multiple sources.

Similarly, it is said that the OCS contains only a two and a half year supply of crude oil. In fact, the OCS could provide an additional one million barrels-per-day in crude oil production for 50 years. What's missed here is that energy supply is *cumulative*. Seemingly marginal increments add to that supply – and, taken together, can add up to the supply needed to meet demand. So *all* additions to supply are important.

We also hear some in Congress advocating legislation to "compel" companies to produce oil and natural gas from the federal lands they have leased, before they are permitted to bid on additional leases. Since most leases end up not containing commercially producible quantities of crude oil and natural gas, why would some demand that a lease unlikely to hold oil or natural gas be drilled? How does this help the American consumer? It doesn't.

A company bids for and buys a lease because it believes it may yield enough oil or natural gas to make the cost of the lease, and the costs of exploration and production, commercially viable. However, until the actual exploration is complete, a company does not know whether the lease will be productive. If, through exploration, it finds there is no oil or natural gas underneath the lease – or that there is not enough to justify the tremendous investment required to bring it to the surface – the company cuts its losses by moving on to more promising leases. Yet, the company continues to pay the federal government rent on the now abandoned lease, atop its original leasing bonus fee. In addition, if the company does not develop the lease within a certain period of time, it must return it to the federal government, forfeiting all its costs.

All during this active exploration, evaluation and government permitting phase, however, the lease is listed as “non-producing.” Because a lease is not producing, critics tag it as “idle” when, in reality, it is typically being actively explored and developed.

As I’ve often said, the first step in our business is called “exploration” for a reason. Exploration is time consuming, very costly and involves a great deal of risk. Importantly, you see neither a drop of usable oil nor a cubic foot of natural gas, while it is going on. But it is absolutely essential, and there is nothing “idle” about it. Without the exploration that took place years ago, less domestic oil and natural gas would be available today to meet consumer demand.

A key factor about our industry that is frequently overlooked is its reliance on state-of-the-art technology. In recent years, revolutionary advances in technology have dramatically increased the ability of companies to recover more oil from existing reservoirs. Advanced technology has also enabled the industry to find and develop resources in remote and previously inaccessible areas. One such area is the ultra-deepwater Gulf of Mexico, where highly advanced technology made possible the 2006

Jack discovery in 7,000 feet of water and another 20,000 feet below the earth's surface, 175 miles off New Orleans.

Breakthroughs in advanced technology also enables us to develop other prospects offering vast potential. A U.S. Geological Survey report released in April revised its 1995 estimate of the Bakken formation reserves of North Dakota, Montana and Saskatchewan from 165 million barrels to almost 4.3 billion barrels of recoverable oil, making it the second largest technically recoverable hydrocarbon deposit in the United States, behind only Alaska.

In addition, Canadian oil sands are a major factor in U.S. energy security; for the North American continent supplies almost two-thirds of U.S. oil needs. Oil sands are a rising resource for the U.S. and will provide greater fuel supply reliability for the Midwest. Oil companies are investing huge sums to expand and upgrade refineries in the Midwest and elsewhere to make more gasoline, diesel and other refined products from the Canadian oil derived from oil sands, while remaining in full compliance with strict federal, state and local environmental regulations.

Canadian and U.S. companies are also making the necessary investments to meet stringent environmental and other regulatory requirements to offset the impacts of increased oil sands production and processing. Technological advances have already cut per-barrel GHG emissions from oil sands production by 32 percent compared to 1990 levels, according to Canadian government data.

Several recent polls show that many Americans have a growing recognition that our nation must do more to find and develop the domestic oil and natural gas resources we need, both onshore and offshore. For example, a CNN/Opinion Research Corporation poll in June found that 73 percent of those sampled favored “increased drilling for oil and natural gas offshore in U.S. waters.” And a FOX News/Opinion Dynamics poll, also in June, found 76 percent favored “increasing drilling for oil in the United States immediately.”

We cannot afford to repeat the mistakes of the 1970s – we face far tougher energy competition today as a result of those mistakes. The years since have been replete with short-term energy “fixes” and searches for “silver bullets” to solve our nation’s energy problems. Price controls, allocation schemes, limitations on natural gas, picking winners and losers among fuels, and punitive taxes have all been tried by government – and none have worked to benefit the consumer.

What our nation needs is a national energy policy framework that learns from our past mistakes and works to ensure a secure energy future for our nation. We need all the energy that is economically viable and a greater commitment to increased energy efficiency. We need to diversify our energy resources, drawing upon the full range of energy sources, including alternatives. We also need to increase and diversify our oil and natural gas supplies, both within this country and abroad. We also need a greater emphasis on emerging energy technologies in order to remain on the cutting edge of advanced technology. And, we need to continue making a maximum effort to safeguard our environment. To do less than all of the aforementioned is to risk our nation losing ground in the global race for economic, energy and national security.

It is no longer the energy world of our parents. A global paradigm shift is underway, involving and impacting energy. It is <u>our</u> responsibility to act. We can, and must, do better than the record of the past several decades. It is imperative that we all work together – industry, government and consumers – to secure our nation's energy future. Time is of the essence!