Hearing of the Senate Committee on the Judiciary
"Exploring the Skyrocketing Price of Oil"
May 21, 2008

Questions for the Record
Senator Dianne Feinstein

Questions for all witnesses:

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

> *As a commercial participant in the energy markets with daily needs to buy and sell energy products in order to meet it customers' requirements, BP buys and sells crude oil futures contracts as part of its energy trading activity. It is a normal function of the market for commercial traders such as oil companies to react to new information by adjusting futures positions as necessary.*
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> *The CFTC has not stated that the oil companies are driving up prices in futures markets. In fact, in his April 3, 2008 testimony before the Senate Committee on Energy and Natural Resources, CFTC Chief Economist Jeffrey Harris stated:*
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> > *Given the relative stability of the makeup of participants and their positions in the markets and the absence of evidence that speculation has caused oil price changes, it appears that fundamentals provide the best explanation for crude oil price increases. These fundamentals can be either broad factors that affect many markets—like the value of the dollar or general inflation fears—or factors particular to a market—such as strong demand from China and India for crude oil and other commodities. In addition, geopolitical events, such as tensions involving Venezuela, Nigeria, Iran, Iraq, Turkey and the Kurds have affected commodity markets, especially the energy and precious metals markets.*

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

Over the last 5 years, BP has invested $31.5 billion in development of US energy supply – almost dollar for dollar of our US profits. Thus, for every dollar of increased tax on our operations, there is one fewer dollar to invest in projects that will deliver increased energy to US consumers – whether it is oil, gas, solar, wind, biofuels or other alternatives. Taxing one form of energy to fund development of another doesn't ensure greater supplies of energy to the consumer. This should be the primary criteria of any energy policy adopted by Congress.

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

Finding and producing oil and gas today requires greater scale to meet the challenges posed by greater technical, logistical, financial and permitting hurdles. BP's merger with Amoco and subsequent acquisition of Arco has increased our ability to compete. Nevertheless, BP remains a small player in this global business. Foreign national oil companies control more than 50 percent of global oil and gas production and almost 80 percent of the world's oil and gas reserves. By comparison, BP represents roughly 3 percent of global oil and gas production, and less than one percent of global oil and gas reserves.

BP has recently announced a partnership with ConocoPhillips to build the Denali Natural Gas pipeline project. At a cost of nearly $40 billion, this project will be the largest private sector construction project ever built in North America, and the first major commercialization of Alaska North Slope gas. BP is also investing in its refining capability, investing $4 billion to upgrade our Whiting, IN refinery and entering into a joint venture with Canada's Husky Energy to invest more than $4 billion to develop its Sunrise oil sands field and upgrade our Toledo, OH refinery.

BP is also using investment to find new oil and gas reserves in the deep water Gulf of Mexico; this exploration would most likely have overwhelmed a smaller company. These projects are extreme in every way – extremely risky, extremely large, extremely deep and extremely costly – and present unprecedented technical challenges.

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

BP's refineries are geared towards maximizing output primarily to meet BP's marketing and supply needs. Maintenance occurs on a day-to-day activity and on a large scale in the form of a turnaround, where entire units are brought down for refurbishment. Turnarounds are scheduled and planned usually years ahead of time in order to secure available resources including labor. In a tight and highly specialized labor market required for refinery turnaround, deferring it is very costly. For these reasons, BP refineries are not in the practice of deferring this kind of large scale planned maintenance. BP refineries at times have deferred turnarounds to level labor and engineering demands, but have not deferred maintenance to meet tight marketplace demand. During turnarounds, our supply group obtains alternative resources to make sure BP's demands are met.

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

> *BP estimates that legislation such as the CAFÉ standards, Renewable Fuel Standard and Low Carbon Fuels Standard will all serve to reduce the demand for gasoline in California in the future and at the same time increase demand for diesel. BP also estimates that increases in population and GDP will increase demand for gasoline and diesel. We estimate that the net impact of these changes is that total refined product demand in California will remain constant with today albeit with a reduction in gasoline demand and increase in diesel demand. BP generally seeks to match its production capability in its two West Coast refineries to its own marketing demand, with the minor imbalances sourced from/sold to local markets or imports as appropriate. This approach has seen numerous minor modifications to increase production capacity over the history of the refinery as demand has grown. Even as recently as this spring, our fluid catalytic cracking unit was modified to increase its capability to make gasoline. With little overall growth in total oil demand now expected, we expect to continue to implement minor modifications to match production to demand. In this environment, BP will most likely try to increase our flexibility to respond to a change in the mix of transport fuels by implementing modifications which increase our ability to switch production between gasoline, jet fuel and diesel.*

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

> *BP does not own or operate any refineries in the Bay Area and so it will not speculate about this issue. The price of gasoline has been primarily affected by price of supplies, including crude oil, electrical power, and organic and inorganic materials used to make gasoline. In fact, the American Petroleum Association ("API") recently reported that the FTC has found that concentration in the industry remains low to moderate and vertical integration has been decreasing.*[1]

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

> *BP strives to adequately supply fuel to its customers. BP supplies fuel to its customers via various proprietary and 3rd party pipelines and terminals. BP has invested significantly in its port, pipeline and terminal assets in recent years and delivers a high degree of supply reliability to its customers and is not facing any material issues in meeting its contractual demand as a result of port or logistical constraints.*

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

> *As a general rule, BP supports free markets. The new renewable fuels mandate established large biofuel blending levels and a very aggressive implementation timetable. There are questions*

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[1] "America's Oil and Natural Gas Industry: The Facts About Oil Industry Mergers, Market Power and Fuel Prices: An API Primer," May 12, 2008, page 5.

regarding the ability of US biofuels manufacturers to meet these production targets. The presence of a tariff directionally discourages investment worldwide to supply biofuels to the US market. It also maintains higher consumer price levels than would otherwise exist in the marketplace. BP supports the elimination of the ethanol import tariff or its equalization with the current blenders tax credit as a means of minimizing potential market dislocations.

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

As a commercial operation BP does not take positions on specific national boundary issues. However in the interest of enhancing world energy security we do hope that, in cases where countries disagree on territorial claims, peaceful resolutions can be found that allow exploration for and production of needed natural resources.

10. Over half, and in some cases, roughly 75% of the proven reserves of a number of American oil companies are located abroad. Looking at, say, Venezuela as an example, it seems possible that we are beginning to see a new wave of energy resource nationalizations. How is your company working to protect shareholders from the adverse consequences of such actions?

This is a known risk in the energy sector which impacts all companies operating in that host country. While a company cannot prevent nationalization, we can remain relevant and aligned with the resource holder. Prevention is partly by holding deep relationships with host governments where we operate and where we hope to operate. BP has a track record of developing resources responsibly - some of which are in OPEC nations and some are not. Therefore, each side brings something to the table - we bring one of the best proven track records, technology, experience, and knowledge. Similarly, BP maintains a diverse portfolio of energy options in many different geographic locations to manage risk and pursue unique development opportunities.

Questions for British Petroleum

1. In late 2007, BP settled a case in which the CFTC and the Department of Justice accused BP of manipulating and cornering propane prices in the United States. BP had to pay more than $300 million in fines to settle this case. One of your traders was also convicted on his own accord. In California, we don't have much sympathy for energy market manipulators. What has BP done that can reassure the people of California that BP has cleaned up its act?

We are ashamed that traders working for us manipulated the TET propane market in 2004 and attempted to do so in 2003. We've apologized for what occurred. The traders involved have been disciplined and no longer work for the company.

Our goal is to be an industry leader when it comes to assuring our participation in the nation's energy markets is appropriate. BP has invested heavily over the past several years in building a world class compliance framework to support our trading activities in the U.S. and globally. In North America, we have almost 40 compliance professionals dedicated to supporting our trading businesses. The Compliance organization is independent from the business and reports through the Compliance and Ethics organization. These compliance professionals independently monitor and investigate our trading activity and provide advice on an ongoing basis.

We have extensive annual training requirements to ensure awareness of the laws, regulations, policies, and guidelines related to our trading and market facing activity, including BP's code of conduct. We are working diligently with regulators and an independent monitor to ensure that we are addressing the appropriate compliance issues and to ensure that we are building a deep *compliance culture.*