Testimony of

# Mr. Bill Klesse

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TESTIMONY OF BILL KLESSE
CEO, VALERO ENERGY CORPORATION
SAN ANTONIO, TEXAS

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Chairman Specter and members of the Committee, my name is Bill Klesse, and I am the Vice Chairman and Chief Executive Officer of Valero Energy Corporation, an independent refiner based in San Antonio, Texas. Valero has 22,000 employees, 5,000 branded retail outlets and 18 refineries in the United States, Canada and the Caribbean with a combined throughput capacity of 3.3 million barrels per day (BPD).

We entered the refining industry in 1981 when we bought a 33,000 BPD refining operation in Corpus Christi, Texas. Today, that refinery has a throughput capacity of 340,000 BPD. During the 80's and most of the 90's, refining was at a cyclical low. Other companies were exiting the business because of continuing low profit margins and escalating environmental compliance costs, but Valero believed that the move toward cleaner fuels would tighten supplies and as demand grew, margins would improve. Valero was able to buy many refineries for as little as 10 to 20 percent of replacement costs. Since 1997, Valero has acquired 17 more refineries, improving and expanding each one.

And, while much is made of the fact that no new refineries have been built in this country in more than 30 years because of poor returns, siting issues and permitting, Valero has increased the capacity of its 18 refineries by almost 20 percent since acquiring them, adding 533,000 barrels per day of refining capacity. That's the equivalent of building three world-scale grassroots refineries. We have also added and expanded existing units that allow us to process a wider variety of crudes.

It's fair to say that if Valero had not acquired these refineries, much of this capacity expansion would not have occurred, and some facilities might have closed.

Improving refineries takes expertise and capital and Valero has more in-house expertise and greater access to capital than many of the companies from which we have purchased refineries. In the past this has made expansion easier while meeting costly regulatory requirements.

Valero has invested approximately $8.2 billion to improve its refineries. Since 1997, we have spent $2.4 billion on regulatory and environmental compliance. To comply with probable regulatory and fuel specifications, we will need to spend another $3.5 billion over the next several years. And new regulations continue to be drafted and adopted. Given the magnitude of investment required to meet new requirements, agencies must consider and mitigate their impact on supply and cost as well as on the refining industry's ability to remain profitable.

Each of Valero's acquisitions was thoroughly reviewed by the Federal Trade Commission and state attorneys general. In fact, the FTC holds oil industry mergers to the highest standard and subjects industry operations to constant scrutiny. In some cases, Valero has been required to divest assets in a transaction. But in all cases, Valero's purchases have resulted in more refining capacity and higher annual production. And, we have also dramatically increased the safety and reliability of our acquired refineries.

Of the 20 refineries in the U.S. that have earned the OSHA Voluntary Protection Program "Star Site" status, Valero currently owns and operates 10, and we are working toward the "Star Site" designation for all 18 of our refineries, even those outside the United States. Safe operation benefits consumers because it improves reliability and increases production.

Valero also was recently ranked No. 3 on Fortune magazine's list of the "100 Best Companies to Work For." Our dedicated employees enhance Valero's production levels and reliability. This was particularly apparent during the back-to-back Gulf Coast hurricanes last year. In the wake of Hurricane Katrina, our refinery just outside of New Orleans, Louisiana was back up and running within nine days. Our refinery in Port Arthur, Texas had extensive damage as a result of Hurricane Rita, yet our employees worked tirelessly to get it up and running in less than three weeks.

Aside from supply disruptions like hurricanes, the largest single factor in rising fuel prices was the cost of crude oil, which averaged $1.20 per gallon last year, or about 53% of the average cost of a gallon of gasoline. Valero is not in exploration & production, so we do not benefit from high crude prices. We purchase all of our crude oil and feedstocks on the open market.

And, while much has been said about refining profits, it is important to note that the average gasoline margin for U.S. Gulf Coast refiners in 2005 - the best year ever - was $10.57 per barrel, or about 25 cents per gallon of gasoline. Even in a good profit year like 2005, our overall net profit margin was still less than 4.4 percent of sales. The return on investment for Valero is good, but if these refineries were on our books at full replacement cost, returns even last year, would have been low. Refining is a world business with thin margins and high capital costs. We must be careful about passing laws and regulations that negatively impact the domestic refining industry.

In summary, Valero has been saying since 1997 that worldwide demand for clean refined products would grow faster than the available supply, and we have been investing and growing steadily. Our substantial investments have significantly increased U.S. gasoline and diesel production. Valero's acquisitions have provided increased gasoline and diesel production for the American consumers.

Thank you. I look forward to your questions.