Testimony of

Mr. James Mulva

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TESTIMONY OF JAMES J. MULVA

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

CONOCOPHILLIPS

BEFORE THE

UNITED STATES SENATE COMMITTEE ON THE JUDICIARY

ON

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Good morning, Mr. Chairman and Members of the Committee on the Judiciary. My name is James Mulva, and I serve as Chairman and Chief Executive Officer of ConocoPhillips, headquartered in Houston, Texas.

ConocoPhillips fully appreciates the concerns that you and your constituents have about energy prices. We think it is important to address the underlying causes of the recent increases in energy prices, and we thank you for giving us an opportunity to do so today.

The Committee specifically asked us to address the impact that consolidations in the energy industry have had on prices. We will share with the Committee the experience we have gained from our mergers and acquisitions and the roles they have played in forming ConocoPhillips as it operates today. We will demonstrate how these transactions were necessary responses to a very challenging and ever-changing business environment. Our mergers and acquisitions have enabled ConocoPhillips to compete more effectively by achieving the scale to undertake additional capital-intensive long-term projects, spreading political risk from global exploration, lowering costs and improving efficiency, all of which increase the short-term and long-term supply of petroleum products to U.S. consumers. We believe that this has led to lower energy prices than those that would have prevailed without the merger transactions.

Each of our significant transactions was extensively reviewed by the Federal Trade Commission (FTC). Where the FTC had any concerns about the effects of the transaction on prices to consumers, the Commission mandated significant divestitures of assets or other actions. The FTC has documented that it has pursued divestitures or challenged mergers in the oil industry at lower levels of consolidation than in any other industry and that "despite some increases over time, concentration for most levels of the United States petroleum industry has remained low to moderate".

The FTC also has continued to monitor retail gasoline and diesel prices quite vigorously, tracking these prices in some 360 cities across the nation. And they have monitored wholesale prices in 20 major urban areas. The Commission has stated that the vast majority of its investigations and studies on gasoline pricing have revealed that market factors are the primary drivers of both price increases and price spikes. States also have investigated gasoline and diesel prices. ConocoPhillips cooperates fully - both on a voluntary and a formal basis - with authorities

and expends significant resources in providing information and other assistance to the authorities monitoring the petroleum industry.

In this testimony and when answering your questions to the best of my ability, I will from time to time express my opinions, beliefs and predictions about future events. As I am sure you appreciate, these future events are subject to risks and uncertainties. I refer Members of the Committee and other interested parties to our public filings, where we provide a more extensive description of our risk factors.

Reasons for Petroleum Industry Consolidation

Before describing ConocoPhillips' specific experience with mergers, we would like to share our general views on why the petroleum industry has been consolidating. As you know, there have been a significant number of mergers in the petroleum industry in the last decade, just as there have been in many other industries during this timeframe.

To some degree, the trend toward consolidation is being driven by globalization, with mergers giving companies from all industries sufficient scale and a lower cost structure to enable them to compete in a global arena. For petroleum companies, the global business environment has become particularly challenging as government-owned enterprises from both oil-producing and consuming nations have emerged as new global petroleum players, adding to competition in the marketplace. In fact, the chart below shows that the emergence of national oil companies competing outside their borders has more than offset the decline in the number of international oil companies due to mergers. Thus, the number of international competitors has increased since the 1980s.

The upstream segment of the petroleum business consists of exploration for and development and production (E&P) of crude oil and natural gas supplies. Access to crude oil and natural gas reserves is the principal challenge in the upstream segment of the petroleum industry today. In the United States, oil and gas production is declining, and the areas with the best prospects for exploration and development are off limits. These access restrictions extend well beyond the most environmentally sensitive areas. Constrained access increases the requirement for the U.S. energy industry to look for resources abroad, where resources often are controlled by national oil companies. Resource access has been steadily eroding since the 1960s. As shown in the pie charts below, today international oil companies can directly access only 7 percent of the world's oil and gas reserves, with an additional 12 percent accessible through joint ventures with national oil companies.

Competition for the limited resources available - combined with rising foreign government taxes - make it difficult for publicly traded and private oil companies to access resources with acceptable returns to our shareholders. This has led to declining organic reserve replacement rates for many international oil companies. Meanwhile, national oil companies from oil-producing and consuming nations, along with privately held Russian companies, are now competing globally and adding to the reserves access challenge.

The most significant opportunities that are available to privately held international oil companies today are projects that host-country national oil companies decide should be undertaken with foreign participation. These projects often are very large, complex and risky. They require financial strength, proven technologies, highly trained personnel and reliable access to markets. Many of them are in developing countries and have substantial political and economic risks.

A typical ConocoPhillips exploration and development project costs several billion dollars of up-front investment and does not generate production or revenues for seven to eight years. For example, a project to produce and deliver liquefied natural gas (LNG) currently costs between $5 and $10 billion; similarly the Alaskan gas pipeline is expected to cost more than $20 billion. Only large companies have the financial capacity and technical resources to effectively develop these projects and have sufficient diversification to manage the risk. For U.S. companies to compete in today's environment of mega projects, they've grown in size commensurate with the growing magnitude, complexity and risk of available opportunities. The forces demanding larger and more diverse oil and gas companies will continue to grow in intensity in the years ahead.

Moving to the downstream segment, which includes the refining and marketing businesses (R&M), there has been a reduction in the number of refineries being operated in the United States over the last 25 years, but this is not a result of mergers. Between 1973 and 1981, there were federal government incentives for companies to own and operate small, and often inefficient, refineries. The elimination of these incentives in 1981 spurred the eventual exit of many inefficient refineries. The number of operable domestic refineries declined from 319 in 1980 to 149 in 2004. According to the FTC, refinery closures overwhelmingly have involved small, relatively unsophisticated facilities. The large capital expenditures required for mandated specifications, such as clean fuels and emissions reductions, also were a likely factor in the closure of smaller, less efficient refineries.

The oil industry has done a commendable job of expanding capacity and increasing utilization rates at existing refineries. Thus, while the number of refineries has declined since 1980, expansions and improved efficiency have allowed the industry to actually increase refinery production volumes by 14 percent.

Efficiency improvements over the last two decades also have resulted in substantial cost savings for consumers. The graph below shows the difference between refiners' crude acquisition cost and the pre-tax retail price of gasoline (which is the combination of the cost and profits from refining, distributing and marketing retail gasoline). The graph shows that the difference between cost and price fell from about 99 cents per gallon (real 2005 dollars) in 1980 to 49 cents per gallon in 2002. It subsequently increased to 66 cents per gallon in 2005 (real 2005 dollars) due to the impact of the hurricanes and tighter market conditions. However, even at 2005 prices, this difference was still one-third lower than it was 25 years ago in real terms. This decline has occurred despite the increase in manufacturing cost for cleaner fuels.

ConocoPhillips' Merger Experience

Let me begin the discussion about ConocoPhillips' merger and acquisition experience with a brief description of our company. ConocoPhillips is an international, integrated energy company, headquartered in Houston, Texas, and operating in 40 different countries with 2005 annual revenues of $179 billion and assets of $107 billion as of December 31, 2005. We are the third-largest integrated energy company in the United States, based on market capitalization and oil and gas proved reserves and production. We are the eighth-largest non-government controlled energy company globally based on market capitalization. We are the second-largest refiner in the United States, and the fourth-largest refiner in the world. But a company is more than its revenues and assets - it is its employees, shareholders and the communities it touches. We have approximately 35,600 employees, who own about five percent of our shares through company-sponsored benefit plans. Approximately 83 percent of ConocoPhillips stock is owned by more than 2,000 different institutional funds, representing investments by a wide array of individuals and businesses, as well as numerous private and public pension plans.

The descriptions and rationales for and cost and efficiency improvements resulting from the following transactions are described below:

? Conoco-Phillips merger
? Phillips-Tosco acquisition
? Conoco-Gulf Canada acquisition
? Purchase of equity interest in and joint ventures with LUKOIL
? ConocoPhillips-Burlington Resources pending acquisition
? Other transactions

I think you will see that these mergers, acquisitions and joint ventures have benefited consumers by reducing cost and improving the efficiency of our business, resulting in increased supplies of petroleum products for American consumers. Fundamentally, the supply of petroleum products depends on the ability of U.S. companies to access crude oil and natural gas and the ability of those companies to refine that crude oil into petroleum products for American consumers. Developing supplies of crude oil and natural gas requires petroleum companies to undertake ever larger and riskier projects, both domestically and abroad.

The transactions undertaken by ConocoPhillips have been motivated by and have subsequently achieved increased access to crude oil and natural gas, and increased refining capacity to turn that crude oil into petroleum products.

This increased supply has benefited - and can be expected to continue to benefit - American consumers through lower prices and greater energy security. These mergers and acquisitions also have strengthened the sustainability of the company's competitive position and long-term viability.

Conoco-Phillips Merger

Given the size and importance of the merger of Conoco and Phillips to our company's history, I would like to review this transaction in greater depth than the other transactions. This $36 billion merger of equals was completed on August 30, 2002. The rationale for this merger was to form a company of sufficient size and scale to address opportunities that could not be achieved by either company on a stand-alone basis. The merger was intended to develop a diversified growth portfolio and benefit from the intellectual capital of the two companies. It also was intended to strengthen our financial position through diversifying earnings and cash flow, developing a stronger balance sheet and improving capital efficiency and the cost structure.

By the end of 2004, we documented $1.9 billion in cumulative cost and efficiency savings resulting from this merger. These synergies have benefited American consumers by increasing volumes and by enabling ConocoPhillips to increase investments and compete vigorously for international supplies of natural gas and crude oil.

In the E&P segment of the business, our increased scale, financial strength and diversification have allowed ConocoPhillips to expand our investments in traditional core areas as well as in developing new legacy assets. The E&P business segment also benefited from the combination of the companies' complementary technologies. For example, Phillips possessed natural gas liquefaction technology and Conoco had a natural gas-to-liquids technology. Possessing both of these technologies has allowed the company to become a more effective global gas player. There were also substantial integration benefits associated with utilizing complementary competencies. For example, by combining Phillips' liquefied natural gas (LNG) technical expertise with Conoco's extensive gas marketing experience, ConocoPhillips has become a successful player in the global LNG business in the space of just three years. This puts our company in a strong position to help expand the supply of natural gas to American consumers over the coming years as the domestic supply of natural gas declines. Our increased size also gives us more leverage in procurement, which is an extremely important benefit in this highly capital-intensive business.

In the R&M business segment, we benefited from lowering our cost structure, which was made possible by sharing technology and best practices, optimizing crude supply and improving management of intermediate refining feedstock across our entire refining system. Unit cost reductions have resulted from initiatives in the areas of energy efficiency, maintenance and procurement of goods and services. Additional benefits of technology and best-practice sharing have reduced the capital costs of projects.

The merger also resulted in increased efficiency in R&M operations. We have been able to improve the reliability and increase clean refined product yields at our refineries by sharing technology and best practices across our refinery network. These include initiatives in preventative maintenance, reduced turnaround time, improved tuning and control of operating units, and installation of improved technologies. Conoco and Phillips both brought expertise in key technologies to the table. Conoco's strong petroleum coking technology skills were applied to Phillips' refineries and Phillips' alkylation technology to increase feed and improve octane, along with Phillips' sulfur removal technology, were applied to Conoco's refineries.

Since the merger, refinery utilization has improved from the low 90 percent range to the mid 90 percent range, which is equivalent to adding a 100 thousand barrel per day refinery. In addition to increased capacity utilization, we also have increased the nameplate capacity of our U.S. refineries by approximately 1 percent per year over the last two years.

Having additional U.S. refineries to upgrade is allowing us to bring additional crude oil from Canadian oil sands production into the United States. For example, we currently are expanding the capabilities of our Wood River refinery in Illinois to add both crude capacity and a large coker so it can handle additional volumes of Canadian oil sands crude oil. We are also partnering with a Canadian company to build the Keystone Pipeline to bring an additional 435 thousand barrels per day of Canadian crude into the Midwestern United States. The combined

ownership of Conoco's Canadian crude oil supply and Phillips' Wood River refinery facilitated this major investment. Again, our size and financial strength allow us to undertake major projects of this nature.

All across our post-merger refining system, we can point to numerous examples of higher crude throughputs stemming from our ability to balance crude oil supplies among our refineries. For example, crude oil throughput at our Sweeny, Texas refinery was maintained at higher levels during the Venezuelan supply disruption in 2003 due to our ability to divert the specialized crude from three of our other refineries to Sweeny, because the others could easily adapt to alternative supplies. In several instances, we have been able to maximize our refining system throughput during Gulf of Mexico storms that delayed crude oil deliveries. We have greater balancing options among waterborne cargoes, pipeline receipts and inventories. We also have greater volumes of clean products since the merger because of our ability to balance intermediate and blendstock inventories among refineries. For example, we increased the supply of imported gasoline and gasoline blendstocks from Conoco's Humber refinery in England through Phillips' Bayway and Trainer refineries on the U.S. East Coast. We also move premium gasoline blendstocks (e.g., alkylate, toluene) from our East Coast to West Coast refineries to increase the supply of CARB gasoline and to enhance octane. In addition, when we plan turnarounds, we can process intermediate products (not yet upgraded to a finished product due to capacity in turnaround) at other plants. With unplanned downtime, we can utilize stocks from other facilities to maintain supply to consumers.

We also have realized significant efficiency gains in pipelines and terminals in the United States since the merger. For example, we improved Canadian crude access on the Spearhead pipeline and improved crude import capability on the West Coast.

Divestitures stemming from the merger also moved refining capacity into the hands of new industry participants. While we did not believe it was warranted, in response to an FTC mandate before the merger was closed, our Woods Cross refinery in Utah was sold to Holly Corporation, and our Denver refinery in Colorado was sold to Suncor. In both cases, the new owners have invested to maintain output and to make new clean fuels at these refineries.

Phillips - Tosco Acquisition

This acquisition, which involved the exchange of $7 billion of Phillips stock for Tosco shares, was completed on September 14, 2001. The rationale for the transaction was to build critical mass, capture economies of scale and to reduce the unit costs of R&M operations in the United States. We identified $280 million in pre-tax synergies from this transaction.

Sources of synergies for refining included increasing the ability to use lower cost crude oils, increasing operating reliability, increasing clean product yields, lowering operating costs, and utilizing Tosco's commercial expertise to maximize asset values (e.g., use lower cost feedstock). The acquisition also increased transportation volumes without a commensurate increase in costs through sharing best practices and centralizing services.

Perhaps the most important benefit in terms of volume expansion relates to the fact that ConocoPhillips is able to invest significantly more in the refining business than Tosco, as a smaller independent, was able to invest. Tosco invested about 70 to 80 cents per barrel of capacity during the late 1990s, while ConocoPhillips' investments have averaged about $1.25 per barrel over the last three years. Moreover, additional investments are expected.

ConocoPhillips also is upgrading Tosco's former refineries. As described above, these upgrades include expanding the processing capability of a significant portion of the Wood River refinery to increase crude capacity and access more Canadian unconventional heavy crude oil. The integration of Tosco's business, which was all in the R&M segment, with ConocoPhillips' production of these crude oils facilitates these investments, in part by reducing the risk associated with the investments.

Conoco-Gulf Canada Acquisition

Conoco acquired Gulf Canada on July 16, 2001, in a transaction valued at $9.4 billion. One rationale for the acquisition was to increase Conoco's access to North American natural gas reserves, and thereby improve supply to American consumers. This goal is being realized as ConocoPhillips has utilized its greater financial strength and U.S.

gas marketing position to increase the supply of Canadian natural gas to the United States from Gulf Canada production. ConocoPhillips expects that its financial strength and commercial skills also will enhance development of the supply of natural gas from the Mackenzie Delta gas-producing region in Arctic Canada. Since the acquisition, ConocoPhillips has applied its expertise in heavy-oil production and upgrading to the development of Gulf Canada's Canadian oil sands reserves. Crude oil from these reserves is increasingly being supplied to U.S. refineries as far south as ConocoPhillips' refineries in Illinois, Oklahoma and, in the near future, Texas. ConocoPhillips' investment in Gulf Canada also has ensured that the crude oil production resulting from these E&P investments has a home in refineries capable of processing these crude oils.

ConocoPhillips' Acquisition of Stock Interest in LUKOIL and Subsequent Formation of Upstream Joint Ventures with LUKOIL in Russia

On September 29, 2004, ConocoPhillips announced a broad-based strategic alliance with LUKOIL, an international integrated oil and gas company headquartered in Russia. ConocoPhillips initially acquired 7.6 percent of LUKOIL ordinary shares for $1.99 billion through a government privatization process and began pursuing a near-term target of 10 percent equity ownership soon thereafter via tender or open market purchases, which the company achieved by year-end 2004. At year-end 2005, ConocoPhillips had increased its ownership in LUKOIL to 16.1 percent. ConocoPhillips has the right to purchase up to 20 percent interest in LUKOIL, which it plans to reach by year-end 2006. Simultaneously, ConocoPhillips and LUKOIL formed joint ventures to manage the exploration, development and production of crude oil fields in Russia and potentially in Iraq.

In addition to investment capital, ConocoPhillips provides these joint ventures with its experience in the international energy business and exposure to global best practices and technology, including Arctic and offshore operations, gas commercialization, refining, and information systems and reporting. This joint venture in Russia expands ConocoPhillips' opportunities to develop new supplies of crude oil in resource rich areas. As noted above, long-term access to crude oil for U.S. consumers must include increased access to international supplies of crude as oil production in the United States declines. ConocoPhillips' investments in the development of Russian crude with LUKOIL add an important new source of crude supply for American consumers. According to the U.S. Department of Energy, the United States presently imports about 12 million barrels per day or 60 percent of its oil supplies. It is projected to grow to 17 million barrels per day by 2030 or 63 percent of projected supplies. Diversification of supply sources for imported oil will enhance energy security.

ConocoPhillips' Pending Acquisition of Burlington Resources

On December 12, 2005, ConocoPhillips announced its intent to acquire Burlington Resources Inc. for $33.9 billion. All required regulatory clearances have been obtained. Completion of the transaction is subject to approval by Burlington Resources shareholders, and other customary closing conditions.

The rationale for this transaction is to increase ConocoPhillips' ability to supply North American gas and obtain high-quality, long-lived, low-risk gas reserves. This acquisition also provides near-term production growth, which complements the numerous long-term projects in our portfolio. This production growth is expected to come, in part, through ConocoPhillips' access to Burlington's technical capabilities, particularly its expertise in commercializing unconventional gas projects in coal bed methane and so-called "tight" gas. ConocoPhillips brings to the table better health, safety and environmental processes and operating capabilities. ConocoPhillips also has a lower cost structure than Burlington. Increased natural gas production in the United States will benefit U.S. consumers in a time of ongoing recovery of natural gas production in the Gulf of Mexico from last year's hurricanes. We expect to achieve pre-tax annual synergies of $375 million, through portfolio optimization and operating expense reductions.

This acquisition also enhances the geographic diversity of projects within the United States and strengthens our supply position in Western Canada. The transaction also increases ConocoPhillips' weighting of its portfolio toward E&P. This transaction also has significantly lower risk than mega projects in developing countries with uncertain development costs and fiscal regimes.

Other Transactions

ConocoPhillips also has used mergers and acquisitions as a means to refocus our core business investments on

increasing the supply of natural gas, crude oil and refined petroleum products to American consumers. For example, ConocoPhillips sold most of its retail marketing operations over the last five years. Circle K assets were sold at the end of 2003 to Alimentation Couche-Tard Inc. Other retail assets were sold in 2004 to Sunoco and Getty Petroleum Marketing Inc. ConocoPhillips also formed the Duke Energy Field Services (or DEFS) Joint Venture with Duke Energy in 2000. DEFS is an integrated gas gathering, processing and marketing business. The formation of DEFS enabled the better provision of gas gathering and processing services to third-party producers in the United States using the existing Phillips (and, subsequently, ConocoPhillips) assets. Another example of refocusing was the completion of the ChevronPhillips Chemical joint venture on July 1, 2000. This joint venture reduced the cost structure and made ConocoPhillips' chemicals business more competitive on a global scale.

ConocoPhillips' Investment Plans

As described above, mergers and acquisitions have allowed ConocoPhillips to create a global petroleum company that is more capable of deploying significant investments to increase the supply of crude oil, natural gas and refined products to U.S. consumers. ConocoPhillips invested about $6 billion back into our business in 2003. This amount grew to $9.5 billion in 2004 and $11.6 billion in 2005, which is nearly double the 2003 level.

ConocoPhillips has been investing its earnings back into maintaining and expanding supplies. We had 2005 earnings of $13.5 billion - about $1 billion a month, but our capital investments also were close to $1 billion a month. In fact, over the last three years, ConocoPhillips' earnings were about $26 billion while investments were just over $27 billion. ConocoPhillips expects to grow its base with continued high levels of investment. In 2006, we intend to maintain our higher investment rate to increase supply of crude oil, natural gas and refined products.

ConocoPhillips has been investing aggressively in refining, and in developing new natural gas and crude supplies for the United States. A few of our principal investment projects are described below. All are very large projects and will require significant capital expenditures well into the future.

? ConocoPhillips has been at the forefront in recent years in growing the company's refining business at a rate that was among the highest in the industry. Over the past three years, ConocoPhillips spent $4.2 billion worldwide, of which $3.4 billion was spent domestically, to expand and modernize our refineries and upgrade marketing operations. This includes environmental spending, including clean fuels, over the last three years of nearly $1.7 billion in our U.S. refining and marketing business.

? Going forward in refining, we are planning an expanded investment program, whereby we expect to invest $4-5 billion on top of our maintenance and other refinery investments of $1-2 billion per year. This investment program is aimed at growing our U.S. refining capacity by about 11 percent and improving our capability of handling lower quality crude oils in order to make 15 percent more clean fuels such as gasoline, diesel and heating oil by 2011. These expansions will add enough clean fuels products to be the equivalent of adding one world-scale refinery to our domestic refining system. We are accomplishing it by growing output at nine of our refineries rather than adding a grassroots refinery. Even our international refinery investments benefit U.S. consumers. For example, our planned investment in our newly acquired refinery in Germany is expected to allow us to significantly increase imports of gasoline to the United States.

? ConocoPhillips is making major investments in North American Arctic natural gas through the Mackenzie Delta and Alaska North Slope pipelines. The initial development of the Mackenzie Delta will access 6 trillion cubic feet of gas, which is expected to begin production in 2011 at approximately 1 billion cubic feet per day. As other fields are added, the pipeline capacity can be expanded to 1.8 billion cubic feet per day. The total cost of this pipeline is estimated to be at least $6 billion.

? The Alaska North Slope currently has an estimated 35 trillion cubic feet of natural gas, which, if commercialized, would increase total U.S. gas proven reserves by approximately 20 percent. Undiscovered gas reserves in that State are estimated to be much higher. When the pipeline connecting this gas with the lower 48 market is completed, about 4.0 - 4.5 billion cubic feet per day of new natural gas will be flowing to American consumers. This equates to about 8 percent of present U.S. natural gas production. The Alaska pipeline alone, using 2001 cost estimates, is expected to cost about $20 billion and take 10 years before the first cubic foot of gas is sold on the market. Producers on the

North Slope reached agreement in principle with the Governor of Alaska on terms and conditions that would move the Alaska natural gas pipeline closer to reality. These agreements are now or should be soon pending before the Alaska legislature. Natural gas from Alaska will, eventually, make a sizable contribution in meeting the demand of U.S. consumers.

? ConocoPhillips is also investing to increase the supply of natural gas to U.S. consumers by bringing liquefied natural gas (LNG) to the United States. For LNG supply, we are moving forward with projects in Qatar and Nigeria and aggressively pursuing projects in Russia, Venezuela and Australia. These are all multi-billion dollar projects. We are scheduled to bring our first cargo of Qatari gas to the United States in 2009. For delivery of natural gas from LNG, we are participating in the construction of an LNG regasification facility at Freeport, Texas. We are pursuing two other LNG regasification terminals in Compass Port, offshore Alabama, and in Beacon Port, offshore Louisiana. These are currently in the permitting process. We are committed to making the investments in these facilities. We also are pursuing permitting a regasification facility on the West Coast of the United States, and are open to adding other terminals on all Coasts if we believe they will add value.

? To bolster U.S. and global oil supplies, ConocoPhillips is expanding conventional crude production in Venezuela, Russia and the Far East. There likely will be a bridge of unconventional heavy oil and natural gas before the world transitions to alternative fuels in a major way. ConocoPhillips has invested and continues to invest heavily in unconventional heavy oil production in Venezuela and Canada. We also are partnering with a Canadian company to develop the $2.1 billion Keystone Pipeline, which will bring 435 thousand barrels per day of much needed Canadian heavy oil production to our U.S. Midwestern refineries.

Reasons for Elevated Oil and Gas Prices

While ConocoPhillips does not assume that the high oil prices in the last year will be sustained, we do want to give you an appreciation of the challenges that lie ahead in supplying U.S. and world energy needs. Government policies play an important role in either facilitating or detracting from the petroleum industry's ability to expand output sufficiently to meet consumer needs.

We believe that strong global energy prices today have been caused by a period of extraordinary demand growth in the face of little excess production capacity and frequent supply disruptions. Crude oil prices are the main driver of gasoline and other product prices, as noted in a recent FTC report. The report indicated that over the last 20 years, changes in crude oil prices have explained 85 percent of the changes in the price of gasoline in the United States. Crude oil prices are determined in highly liquid and transparent U.S. and international markets by thousands of traders and other business entities based on the market conditions that exist on a given day.

Global crude prices have been rising since 2002 as a result of the U.S.-led global economic recovery, leading to exceptional oil demand growth and rapid industrial growth in the developing economies of Asia. Over the last decade, oil demand in China and India doubled, and is expected to double again by 2020. Strong U.S. and global economic growth are certainly desirable but the consequence of strong growth is a rise in the demand for commodities, including oil. Higher prices inevitably will justify and encourage new investments to increase the supply of energy, whether in the form of oil and gas or alternative sources.

This exceptional growth in demand over the last few years has left little surplus crude oil production capacity available in the world today. Concern about geopolitical risk in various oil-producing countries in the face of limited spare production capacity has helped drive oil prices higher. The two large hurricanes experienced in the United States last year also disrupted most of Gulf Coast oil and natural gas production and refining capacity.

The refining industry has been challenged by a number of Congressional and State mandates, over the years, focused on significant spending on clean fuels and emissions reductions. This has diverted capital from capacity expansion. Federal and State regulatory processes also have discouraged the building of grass roots refineries and expansions of existing refineries. The process for siting and securing the many permits necessary for a refinery are lengthy and difficult. We have found this to be the case in our on-going efforts to expand refinery capacity at existing locations. The need to develop about 100 different "boutique" grades of gasoline in the United States in various

localities also has increased the cost of manufacturing gasoline and reduced short-term product fungibility. The U.S. Department of Energy has reported that boutique fuels exacerbate price volatility and that reducing the number of fuel types likely will reduce the frequency and magnitude of price surges. Our company would support moving away from "boutique" fuels to more standardized refined products. This will make it easier to redistribute products during times of shortage and should reduce price volatility in normal market conditions.

Another key factor in the price rise we have seen in recent years is the increase in the cost of finding, developing and producing a barrel of oil. Steel prices doubled between the end of 2002 and end of 2004, and they are a large cost component for our industry. In the last three years, onshore drilling costs in the U.S. rose 52 percent and the cost of tubular goods rose by 125 percent. These components represent about half the cost of onshore wells. Costs have been rising in part because the oil services industry has not been able to keep pace with the rapid spending increases by our industry. Shipping rates for large crude carriers also tripled between 2002 and 2004, raising the cost of imported crude. However, there also is a longer term trend of costs increasing because our industry does not have access to the lowest cost reserves, including in the United States. Thus, our industry is going after more remote, deeper water, more complex and lower quality reserves that inherently cost more than what we were developing a decade ago. Both Goldman Sachs and Sanford Bernstein recently estimated that oil replacement costs are currently around $50 per barrel, while they were closer to $35 per barrel in the early 2000s and $20 per barrel in the 1990s. While some of this increase is, we believe, transitory, the cost increase relating to reduced resource access likely will remain.

Resource access is a particular problem for natural gas in the United States because the most highly prospective areas are off limits for drilling or the permitting requirements are so onerous that prospects become uneconomic. Given industry decline rates of 30 percent per year in existing Lower 48 natural gas wells and the long lead times for LNG projects and Arctic gas pipelines, gas supplies in the United States could well be tight over the next few years. The only short-term and long-term solution is to make more acreage available, especially in the Eastern Gulf of Mexico and the Rocky Mountain regions. We would encourage the reinstatement of lease sale 181 in the Eastern Gulf of Mexico. We also would encourage the Department of the Interior to ensure that the Bureau of Land Management has sufficient staffing to expedite permitting in the Rockies. Such measures can increase the supply to U.S. consumers in the near term. Outside the United States, we believe that the federal government should use diplomacy to encourage foreign producing nations to allow greater resource access at reasonable terms.

Another challenge is the difficulty in permitting key energy infrastructure such as refineries, LNG regasification (receiving) terminals and pipelines in consuming countries like the United States. In the United States, regulation and NIMBY (not-in-my-back-yard) sentiments have caused costly delays and even the abandonment of some important infrastructure projects. In order to facilitate sufficient investment in key energy infrastructure the industry needs governments at all levels to be thorough, but at the same time, to streamline permitting and environmental review processes.

Our company is particularly concerned about permitting and the NIMBY issues associated with building new LNG receiving terminals. LNG offers the most promising option for meeting the growing natural gas needs of American consumers in the medium term. But, the permitting and approval of new regasification terminals is occurring significantly slower than we expected. Many are being delayed and face being cancelled altogether, due to challenges at the local level. As noted above, LNG is an important component of natural gas supply to U.S. consumers, particularly in light of the rapid production decline in existing U.S. natural gas wells.

The siting of LNG terminals was addressed in earlier energy policy legislation. However, the federal government, states and the individual localities where these facilities are planned need to have continued dialogue and cooperation on siting issues. There also needs to be better cooperation among the various federal agencies charged with evaluating and permitting these facilities.

Finally, what we do not need from the government are additional taxes that will reduce the industry's ability to invest and provide additional energy supplies. According to a 1990 report by the Congressional Research Service, the windfall profits tax that was signed into law in 1980 and repealed in 1988 drained $79 billion in industry revenues during the 1980s that could have been used to invest in new oil production - leading to 1.6 billion fewer barrels of oil being produced in the U.S. from 1980-1988. The tax reduced domestic oil production by as much as 6 percent, and increased oil imports by as much as 16 percent. Current proposals to increase the taxes of a selected few taxpayers

by taxing LIFO inventories and imposing double taxation on foreign earnings are little more than "stealth" windfall profits taxes and will detract from investment and harm the competitiveness of U.S. versus foreign energy companies.

The key to improving energy security and reducing prices is increased investment by the energy industry across a diverse set of energy projects in both the upstream and downstream business segments. Our industry is a global, highly competitive industry. ConocoPhillips could not make the investments we are making today to increase the supply of crude oil, refined products and natural gas to American consumers without the company we have built, in part through mergers and acquisitions, over the last decade. We would not have had the financial strength, the ability to handle large and complex projects, the technologies, commercial skills or resource prospects without the transactions we have completed over the years. We expect to continue our high rates of efficient investment to expand the supply of crude oil, refined products and natural gas to U.S. consumers.

Mr. Chairman and Members of the Committee, the mergers and acquisitions described to you today have been instrumental in making ConocoPhillips a world class competitor for oil and gas projects around the world. These consolidations have allowed us to become more efficient in developing these projects- projects that we would not have been able to compete for without the benefits brought by consolidations. Since much of our global market is focused on the United States and the American consumer, we believe these consolidations have had a positive impact by giving consumers a stronger American voice in competing for precious world resources and obtaining them at a lower cost. Americans have a stake in keeping the U.S. energy industry competitive, and we believe ConocoPhillips has been an important contributor to sustaining U.S. competitiveness internationally.

Thank you, Mr. Chairman and Members of the Committee for this opportunity to appear before you.