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The Honorable Arlen Specter
Chairman, Committee on the Judiciary
224 Dirksen Senate Office Building
Washington, DC 20510

Attn: Mr. Barr Huefner

Dear Mr. Chairman:

On behalf of Shell Oil Company, I am forwarding our answers to written questions from Committee members regarding the Judiciary Committee hearing on March 14, 2006 styled "Consolidation in the Oil and Gas Industry: Raising Prices?". As directed we are sending this material electronically as well.

If you have additional questions, please contact Jim Rich of my staff at 202-466-1425.

With kind regards.

Sincerely,

B. Malnak

Brian P. Malnak

Questions posed by Senator Specter

To John Hofmeister:

1.) Please provide an analysis of the draft bill, the "Petroleum Industry Antitrust Act of 2006," which was submitted to the Congressional Record earlier this month.

A: Analysis of Draft Bill, the "Petroleum Industry Antitrust Act of 2006"

Section 2 would make it unlawful for any person to "refuse to sell, or to export or divert" crude oil, refined oil products or natural gas, with the "primary intention" of affecting prices or supply in a particular market.

Comment: This provision could create a significant disincentive for suppliers of crude oil, refined oil products or natural gas to respond to different supply and demand conditions in different markets. Such restrictions on suppliers' economic responses to market conditions would likely have the unintended effects of increasing prices and reducing supply in affected markets.

Section 3 would amend Section 7 of the Clayton Act to establish a standard for evaluating the legality of proposed acquisitions of oil or gas companies that is different from the standard applicable to other industries. Acquisitions of oil or gas companies, or their assets, would be prohibited "if the effect of such acquisition may be to appreciably diminish competition."

Comment: This provision would create a unique and vague standard for a single industry that would differ in two important respects from the standard applicable to most other industries. The current standard allows companies in most industries to combine to achieve efficiencies, unless the combination would be likely to cause substantial economic harm. Section 7 of the Clayton Act currently requires proof that

- the effect of the acquisition "may be substantially to lessen competition, or to tend to create a monopoly"
- in a properly defined economic market ("in any line of commerce . . . in any section of the country").

The proposed amendment would substitute a vague standard, "appreciably diminish", for the current "substantially lessen" standard, which has been the subject of extensive interpretation by courts and regulatory agencies over the course of a half-century of enforcement. Worse still, the proposed standard appears not to have any economic foundation. Unlike the current standard, it would apparently not be applied in the context of a properly defined economic market. Thus, the proposed amendment would likely make it more difficult and costly for oil and gas companies to achieve the same kinds of

efficiencies of scale that companies in other industries are not only permitted, but expected, to achieve so that they can compete aggressively with their rivals.

Section 4 would require the GAO to conduct a study, within six months, of the effectiveness of divestitures by oil and gas companies pursuant to consent decrees entered by federal courts in antitrust cases brought by the federal antitrust enforcement agencies during the past ten years.

Comment: Among the many problems with this provision are:

- FTC consent orders involving divestitures are issued by the Commission, not by a court
- It is not clear that the GAO has, or could acquire within the specified time limit, sufficient expertise to study the effectiveness of oil and gas company divestitures required by federal court-ordered consent decrees as well as expertise in antitrust law and industrial organization economics to conduct such a study
- There is no apparent need for GAO to perform such a study, since
    - FTC consent orders and DOJ consent decrees are preceded by a public comment period, which affords affected parties an opportunity to raise any issues as to the likely effectiveness of a divestiture before it is ordered, and
    - After divestitures, affected parties have every incentive to bring to the attention of the enforcement agencies any problems with the effectiveness of the divestitures and to seek additional enforcement action.

Section 5 would create a joint federal-state task force to investigate "information sharing practices" among oil and gas companies.

Comment: This provision is unnecessary because oil and gas companies are continually subjected to antitrust investigations by federal and state antitrust agencies. Most recently, for example, the Florida Attorney General conducted an antitrust investigation and concluded, in August 2005, that gasoline price changes were attributable to supply and demand factors, not to anticompetitive conduct.

Section 6, the so-called "NOPEC" provision, would amend the Sherman Act to make it illegal for foreign states to enter into anticompetitive agreements to limit the supply, or maintain the price, of oil, natural gas, or any petroleum product, where such agreements have a reasonably foreseeable effect on market conditions in the US. The proposed amendment would authorize the Attorney General to bring legal actions against foreign states in US courts, and would deprive those states of the defenses of sovereign immunity and the act of state doctrine.

Comment: Aside from the significant issues of foreign policy, international law, jurisdiction and comity implicated by this provision, it appears likely to reduce OPEC members' incentives to supply oil to the US. If so, the provision would be likely to lead to higher, rather than lower, gasoline prices in the US.

2.) What steps can be taken to decrease consumption of oil and natural gas?

A: Let markets work and encourage fuel conservation and efficiency. During last year's hurricanes, Shell posted to its Web site easy tips on how to conserve fuel, and presently we have a "Fuel Stretch" campaign aimed at showing consumers how to get the most out of every fuel purchase they make. Shell has found significant cost savings in our own facilities from energy conservation.

3.) Please provide an analysis of the incentives offered to petroleum companies by the federal government that explains what the incentives are intended to do, which incentives are important to you, and why they should be maintained.

A: From time to time the Congress has passed a number of federal tax incentives to encourage domestic production of energy. A good example of this is HR 6, the Energy Policy Act of 2005(PL109-58). Among other things, PL109-58 contains various incentives designed to encourage domestic production of oil and gas and renewable fuels, and to increase domestic refining capacity.
In many cases, significant capital investment is required for energy projects with no return for many years. For example, in the OCS, it could take 10 years from the time a property is leased to initial production. Significant additional time is needed to recoup the capital invested. And such a facility could cost over $1 billion. Consequently, Shell supports and relies upon stable regulatory and fiscal policies that enable companies to develop energy projects and secure energy supplies. Furthermore, Shell supports reasonable incentives Congress deems in the national interest to encourage domestic production. In this regard, Shell supported PL 109-58, overwhelmingly approved by the Congress, which contains incentives for fossil and renewable fuels. Such incentives can help augment US security and promote emerging technologies.

4.) In the two weeks prior to March 14, 2006, the price of oil decreased seven cents per gallon, while the price of gasoline increased by eleven cents per gallon. Why would gasoline become more expensive during this period, despite a decrease in the cost of crude oil?

A: Prices in markets will vary as every market is subject to unique conditions. Fuel prices are affected by a number of factors including the cost of crude, formulation requirements, state taxes, refinery utilization, supply and distribution logistics, local market conditions, environmental regulations and operating costs. These factors vary in each market. Also, retail gasoline prices tend to move more slowly than the underlying cost of product. This "lag" effect is evident during periods when prices are rising as well as those times when prices are falling.

5.) With respect to the large mergers that your companies have engaged in over the past decade, what efficiencies have they produced that have benefited consumers, particularly in downstream markets?

A: Over the past five years, Shell has invested virtually all of our U.S. earnings into finding new supply, increasing production, improving refining capabilities and developing new technologies. It takes an extraordinary level of financial strength to deploy large amounts of capital in risky environments and a cyclical industry.

Efficiencies related to transactions Shell has undertaken help us to make significant investments in order to meet the growing consumer demand for energy. Our acquisition of Pennzoil-Quaker State Company helped Shell lower cost structures in manufacturing and distribution of lubricant products while achieving broader distribution. The resulting efficiencies allow our lubricant products to be competitively priced and distributed across multiple channels such as retail, fast lubes, fleets, and re-sellers.

Question's Posed by Senator DeWine

To Tillerson, Mulva, O'Reilly, Klesse, Hofmeister, Pillari, Borenstein:

1.) At our last hearing, we heard testimony that some of the gasoline price spikes can be attributed to regulations that create multiple grades of gasoline to comply with different environmental standards – so called "boutique fuels." What can we do to reduce the number of boutique fuels? What would be the effect of just requiring everyone in the industry to comply with the highest standard, and have just one fuel available?

A: Boutique fuels generally cost more to produce because they require special production and handling, which can cause inefficiencies in the distribution system. In the event that supply or transportation is disrupted, boutique fuels create the potential for significant price volatility because supplies cannot be readily shifted between areas.

Refiners now produce numerous, different fuels to satisfy state and federal requirements. There are several factors to consider when evaluating whether or not to reduce the number of boutique fuels such as ensuring air quality needs, the impact on supply, cost issues and distribution compatibility. After weighing those factors, we recommend reducing the number of gasoline formulations to approximately 5 in order to streamline and simplify this complex system. There is a proposal by API to consolidate fuel requirements to five standardized fuels, which Shell supports. The proposal would provide states with fuel options that ensure continued progress toward attaining air quality standards. The fuel options available to states would depend on air quality need, cost-effectiveness, the availability of other, more cost-effective emissions controls, and compatibility with the nation's gasoline manufacturing and distribution system.

To Tillerson, Mulva, O'Reilly, Klesse, Hofmeister, Pillari:

2.) In the last couple of months most of the oil industry has announced record-breaking profits for the last fiscal year. How much is your company investing annually in exploration, production and refining, and when will we see those investments pay off? And perhaps most important, what are you investing in alternative energy sources so we can help reduce domestic dependence on foreign oil?

A: The following table shows global capital investment by Shell for its Exploration and Production and Oil Products segments. The Refining amounts are a portion of the Oil Products total. Shell does not break out Renewables spending.

RDS totals ($B USD)		Capital Investment Total	EP	OP	Refining
	2000	8.537	4.979	1.571	0.290
	2001	11.781	8.191	1.527	0.360
	2002	24.648	14.151	7.968	3.318
	2003	14.294	9.337	2.405	0.943
	2004	15.275	9.708	2.823	1.275
	2005	17.436	12.046	2.844	1.379
Avg		15.329	9.735	3.190	1.261

OP amounts include Refining

When will investments pay off:
Shell makes strategic investments in the U.S. in order to help meet the energy demand here and to provide satisfactory returns for its investors. For competitive reasons, we do not provide details of assumptions we make relative to our investments. However, because of the size and variety of the investments, and the volatile nature of market conditions, it can sometimes take decades for the company to see a return on many of its investments.

Alternative energy sources:
Shell strongly believes in its investment in renewable energies is in the best interest of its shareholders. Investments to-date have delivered tangible results, making Shell a leader in many of these new technologies, such as biofuels, wind development and hydrogen fueling. Shell remains committed to increasing the world's supply of energy, by broadening its portfolio through the development of renewable energy sources. Shell has invested about $1 billion over the last five years in the solar, wind, and hydrogen businesses and is dedicated to continuing this commitment in the future to develop at least one of these as a commercial business. As with other businesses, the level of investment in the future will depend on our business development progress, the projects' profitability, and affordability.

Question's Posed by Senator Feingold

To All of Panel II:

1.) The President mentioned in his state of the union address that America is "addicted to oil", and outlined several steps - including increasing investments in alternative fuels - to end the addiction. What percentage of your R&D is dedicated to alternatives? In your response, please indicate how your company defines alternatives. In addition to

your R&D, what are your companies doing, as corporate citizens, to move away from fossil fuels?

A: As an energy provider for over 100 years, Shell is committed to increasing the world's supply of energy by broadening its portfolio through the development of renewable and alternative energy sources (biofuels, solar, wind, and hydrogen). In the last five years Shell has invested about $1 billion into these energies, and Shell is dedicated to continuing this commitment in the future to develop at least one of these as a major commercial business.

As a corporate citizen, Shell has made the commitment to develop renewable energies through sustainable investment in technology research and development and increase public awareness of the coming issues. Through its behavior as a responsible corporate citizen, Shell provides access to modern energy technologies, shifts towards low-carbon energy systems and meets growing demand while reducing environmental and social impacts.

Question's Posed by Senator Kohl

To John Hofmeister:

1.) An independent study by the consumers group Public Citizen found that from 1999 to 2004 U.S. oil refiners increased their profits they made on each gallon of gas refined by 79%. Don't these statistics show that it is not merely the rising worldwide cost of crude oil that accounts for high prices and other petroleum products? And does the success of your industry in passing along rising crude oil prices to consumers demonstrate that your companies have gained market power and that there is a failure of competition in this market?

A: Oil and gas industry earnings per dollar of sales are in line with all U.S. industry. During the second quarter of 2005, for example, the energy industry overall earned 7.6 cents for every dollar of sales, compared to an average of 7.9 cents for all U.S. industry. The total dollar numbers may be large, but so are the billions of dollars that petroleum companies have invested to supply energy to U.S. consumers – and will need to re-invest -- to meet future demand in a safe and environmentally sustainable way.

Despite the apparent size of the major investor-owned energy companies, this remains a highly competitive industry. Consider the structure of our retail gasoline business where the Shell brand has a 12 percent market share nationwide. Roughly 90 percent of Shell branded stations are owned by independent retailers and "jobbers." We are seeing healthy new retail competition emerging with brands such as WaWa, Sheetz, and Turkey Hill.

2.) In most competitive industries, when there are high prices, high profits to be made, and soaring consumer demand, we would expect to see an expansion of capacity to meet this demand. Yet in the

oil industry this has not happened. Instead of opening new refineries, the industry has closed more than half of all that existed 25 years ago. In 1981, there were 324 refineries operating in the United States – today there are 149. According the Department of Energy, in the period from 1981 to 2004 overall national refining capacity has declined by more than 9% while demand for gasoline rose by 37%. Oil industry critics suggest that this decline in refining capacity is no accident – that oil companies actually prefer to keep supplies tight in order to be able to gain market power to raise price. Indeed, many economists believe this is a central reason why gas prices are so high.

So why hasn't your industry opened new refineries while closing so many existing ones? Does the failure of the oil industry to open new refineries suggest an effort to keep supplies tight?

A: According to information compiled by API, the number of U.S. refineries peaked in 1981, when there were 315 operating refineries. We believe that some owed their existence largely to government subsidies to small refiners that ended in 1981 and that many closed because they were small and inefficient. As the industry faced increasing requirements for cleaner fuels and improved environmental performance, the number of refineries continued to shrink-from 194 in 1990 to 144 at the end of 2004. However, growth in capacity at existing refineries has largely offset the effect of refinery closures-particularly in the later part of the last decade, with the result that total refinery capacity in the US has grown from 15.5 to 17 million barrels per day since 1990.

Shell has invested in new refining capacity in order to help satisfy demand.
From 1994 to 2004 Shell refineries in the US increased overall capacity by about 30 percent and invested significant capital expenditures to do so. Shell will continue to consider optimizing its refining assets in all markets to take advantage of existing site infrastructure for expansion and debottlenecking. Motiva recently announced that several options are being considered to increase production of gasoline, diesel and aviation fuels at its Gulf Coast refining network. Capacity expansion projects being considered range from 100,000 barrels per day to 325,000 barrels per day.

3.) In the last 15 years there has been a tremendous amount of consolidation in the oil industry – the GAO counts 2600 mergers and acquisitions in this industry since the 1990s alone. Indeed, almost all the companies represented here today are a product of these mergers. During this time, the FTC has approved most of the oil industry mergers it has reviewed, including the gigantic ones like Exxon/Mobil, Chevron/Texaco, and Conoco/Phillips. While each one of these mergers may not have seemed problematic when reviewed, taken as a whole these mergers have greatly increased concentration in the industry. And the GAO has concluded that these mergers have raised gasoline prices.

(a) What is your view of the effects of these mergers on competition in your industry and the price of petroleum products?

A: From the perspective of Shell's transactions experience, in markets of concern to both federal and state antitrust law enforcement agencies, mandatory divestitures were designed to prevent declines in the number of competitors or increases in concentration. We fully complied with such divestitures.

Prices are set on a competitive global market. The biggest component of the retail price of gasoline -- about 60 cents out of every dollar – is the price of crude oil. Crude oil prices are set on competitive global markets where the large number of participants ensures the deepest and most liquid commodity market in the world.

(b) Are we likely to see even more consolidation in the years ahead? If so, what will this mean for competition in this industry?

A: We cannot predict the future of consolidation in our industry.

Question's Posed by Senator Charles E. Schumer

To All Panel II Witnesses:

1.) Would you please clarify which income figures your company reported to the internal revenue service last year for tax purposes, as well as the basis for those figures? Are these the same income figures reported to your shareholders? If different figures were used, what were they, what was their basis, and what is the rationale for this decision?

A: With respect to its US tax returns, Shell reports its taxable income to the Internal Revenue Service by making adjustments to its book income, as required by the US tax laws.

2.) Based on your written testimony, it appears that your company has put at most 5% of annual investment toward developing alternative energy technologies like hydrogen fuel cells, wind, solar, and others. What is the rationale for this investment strategy? Have you decided that investment in these energy sources is not in the interest of your shareholders?

A: Shell strongly believes in its investment in renewable energies is in the best interest of its shareholders. Investments to-date have delivered tangible results, making Shell a leader in many of these new technologies, such as biofuels, wind development and hydrogen fueling. Shell remains committed to increasing the world's supply of energy, by broadening its portfolio through the development of renewable energy sources. Shell has invested about $1 billion over the last five years in the solar, wind, and hydrogen businesses and is dedicated to continuing this commitment in the future to develop at least one of these as a commercial business. As with other businesses, the level of investment in the future will depend on our business development progress, the projects' profitability, and affordability.

3.) How much royalty relief have you received from the Department of Interior for exploration on public lands? Which public lands specifically? At what price threshold have you predicted internally that you would not need royalty relief to make exploration viable?

A: Shell would have received about $29 MM under DWRR from 2000 through 2005. However, because prices thresholds were exceeded at certain times, Shell paid $12.6 million in royalty due the government on certain leases during that period.

In total, from 2000 through 2005, Shell received $16.46 MM in royalty relief. Breakdown by year is:

2000	$.150 MM
2001	$.119 MM
2002	$2.11 MM
2003	$4.68 MM
2004	$2.97 MM
2005	$6.40 MM

The purpose of royalty relief is to provide incentives to explore for oil and gas in low priced and technologically challenging environments. Under the current commodity price environment, Shell does not need deepwater royalty relief. However, if prices fell back significantly the economics of deepwater projects would change and we might need deepwater royalty relief again.

Shell supports the price thresholds that have been set by the government. Shell does not set internal thresholds for the need for royalty relief. Royalty relief is regarded as an incentive that is weighed with all of the economics and risks of a project in making a decision on whether or not to develop.