

**Statement of Red Cavaney
President and CEO, American Petroleum Institute
before the House Energy and Commerce
Subcommittee on Energy and Air Quality**

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I am Red Cavaney, President and CEO of the American Petroleum Institute. API is a national trade association representing more than 400 companies engaged in all sectors of the U.S. oil and natural gas industry.

API welcomes this opportunity to present the views of its member companies on national energy legislation. We support passage of comprehensive energy legislation consistent with the H.R. 6 conference report passed by the House of Representatives in the last Congress. We are pleased that the Subcommittee and the full Committee are moving aggressively to pass it. Your swift action will send a powerful signal that the new Congress recognizes the need to address the serious energy problems facing our nation. We also very much appreciate the House's action in passing national energy legislation several times over the past four years.

The Need for National Energy Legislation

The sad fact is that the current policy framework has failed U.S. consumers. The net effect of current oil and natural gas policy is to decrease reliance on U.S. production and increase dependence on foreign imports. Moreover, while crude oil imports have been

growing for some time, product imports have also started to grow due to constraints on U.S. refining capacity.

Four years ago, when Congress began debating national energy policy, we recognized the steadily growing U.S. demand for energy of all types. Today, that growth in demand continues to increase. Recently, the DOE Energy Information Administration issued forecasts of increased energy demand from 2003 to 2025. EIA projects that:

- Real GDP will increase by 95 percent;
- Population will increase by 20 percent;
- Total energy consumption will increase by 36 percent;
- Petroleum demand will increase by 39 percent;
- Natural gas demand will increase by 40 percent;
- Coal demand will increase by 34 percent; and
- Electricity consumption will increase by 50 percent.

Global Energy Situation

We cannot discuss the challenge of meeting the growing U.S. energy demand without first understanding the global energy situation. In the world of energy, the U.S. must operate in a global market. What others do in that market matters greatly.

Look at what happened just last year. World demand for crude oil typically grows annually a bit more than 1 million barrels per day. In 2004, it grew 2.7 million barrels per day – to a point too closely approaching total worldwide production capacity.

Not surprisingly, China has played a big role in the increase in world oil demand, and India will not be too far behind in the future. China, long self-sufficient in oil, is now becoming one of the world's biggest importers. China accounted for more than half of world oil-demand growth in 2002 and 2003. The highly regarded energy analyst Daniel Yergin has noted that, over the next 10 years, Chinese and Indian oil companies will emerge as major players in the global oil industry.

Correspondingly, the International Energy Agency (IEA) forecasts oil demand in South Asia will grow by 3.3 percent per year between 2000 and 2030, the highest of any region in the world.

A comprehensive U.S. energy policy must recognize the growing impact of these new, major competitors for energy supply in the world. For the U.S. to secure energy for its economy, government policies must create a level playing field for U.S. companies to ensure international supply competitiveness. With the net effect of current U.S. policy serving to decrease U.S. oil and gas production and increase our reliance on imports, this international competitiveness point is vital. In fact, it is a matter of national security.

A Need for Action

These global realities underscore the need for action to meet the energy challenges facing the United States. Experience tells us that – in a nation with an economy and way of life so tied to energy – inaction comes at a high cost.

What is so difficult to understand is how we could have failed to act on energy at a time when the nation has been beset by energy problems. Just look back over the last four years:

- An estimated loss of one-half to a full percentage point of GDP growth already, according to published reports, to say nothing of the related job losses, caused by higher prices, a worsening trade deficit, and a loss in international competitiveness;
- Gasoline and diesel price spikes and tight supplies in the Midwest and elsewhere;
- Declining U.S. natural gas production in the face of increased demand, resulting in high prices and greater market volatility;
- Soaring heating oil prices and tight supplies in New England; and
- Electric power blackouts in the Northeast and in portions of California.

These are the results of a failed energy policy. While no energy bill will solve all the energy problems facing our country, inaction has a direct and harmful impact on all U.S. energy-users: small business men and women, home-owners, schools and hospitals, stores, factories, and businesses of all sizes and types all over this country. Failing to pass national energy legislation hurts real people – those who rely on energy to heat their homes, fuel their vehicles, and power their small businesses. They are the ones who bear the brunt of higher energy prices and supply disruptions.

Clearly, action on energy policy is long overdue. Congress needs to approve a comprehensive, national energy policy. The key word is *comprehensive*. A piece-meal approach is not the answer.

Enactment of this legislation will ensure diversity in energy supplies; promote energy efficiency, new technologies, conservation, and environmentally responsible production; modernize America's energy infrastructure; strengthen our economy; and create new jobs.

What follows are API's more detailed views on components of the energy legislation:

Defective Product Liability

Comprehensive energy legislation must address a major threat to the U.S. oil and natural gas industry. Oil and natural gas meet two-thirds of America's energy needs, but tens of billions of additional dollars in capital investment are needed to keep pace with increasing demand. That investment, the industry's future and consumer well-being are, however, being threatened by defective product liability lawsuits for companies' use of the EPA-approved fuel additive MTBE. Under a defective product claim, if the defendant simply put the product into the stream of commerce, regardless of having exercised proper care, the defendant can be found liable.

In 1990, when Congress imposed the federal reformulated gasoline (RFG) oxygen requirement in cities with the worst air quality, the authors of the legislation and others

said on the floor of the House and Senate that MTBE would have to be used in significant quantities to meet this federal requirement. There were two oxygenates available for RFG – ethanol and MTBE. Both were approved for use by EPA, but the ethanol industry was in its infancy and unable to supply adequate volumes to meet the demand for RFG. A decision to use ethanol in most areas of the country would have put supply in jeopardy and increased costs, which would have impacted consumers. Since there was insufficient ethanol to meet overall RFG demand, the only choice for most producers was to use MTBE or break the law.

Today, companies who used MTBE to comply with the oxygenate requirement are facing multi-million dollar suits brought by personal injury lawyers with claims that gasoline containing the fuel additive was a defective product. Yet, use of MTBE to meet the oxygenate mandate is exactly what Congress mandated 14 years ago.

This is, above all, an issue of fairness. Any industry that acts, as mandated by the federal government, to meet a societal need – in this case, cleaner air and improved health – should not later be victimized for doing what the government required it to do. Our companies acted in good faith and heeded the federal government's call to use MTBE to enhance air quality. What we ask is that the federal government also act in good faith to protect us against defective product lawsuits for doing what the law required us to do.

If we are not protected against this type of litigation, one need only look at the asbestos industry to see the disastrous consequences of this breach of faith by government.

Unlimited, unrestrained defective product lawsuits create massive uncertainty, discourage investment and threaten jobs. We have seen in asbestos cases the results produced by entrepreneurial trial lawyers: scores of bankruptcies, job losses, and retarded growth. Likewise, in MTBE litigation, trial lawyers are marketing these cases to municipalities and water districts. This is an opportunity for Congress to address this egregious abuse of our nation's legal system.

There is a history of the federal government protecting vital businesses and industries from unfair consequences, especially when they have acted in good faith in complying with the law. In 1976, the manufacturers of the Swine Flu vaccine responded to the government's call for the immediate mass immunization of the public by mass producing the needed vaccine. When insurance companies refused to insure the manufacturers of the vaccine over concerns regarding vaccine-related injuries, the government stepped in to protect manufacturers against personal injury claims.

Later, in 1994, Congress went so far as to provide immunity to manufacturers of small non-commercial carrier airplanes from civil liability suits for accidents involving aircraft and certain parts in use beyond their expected service lives. Businesses were being sued under defective product claims up to 40 years after manufacturing an aircraft. Again, Congress decided to take action in the interest of fairness because the general aviation industry, facing endless tort claims, was all but brought to its knees due to this exploitation of the legal system. Passage of the General Aviation Revitalization Act of

1994 insured the availability of insurance coverage sufficient to enable the industry to remain in business in the U.S.

The energy bill includes a narrowly tailored provision – approved by the House of Representatives last year - that would apply only to defective product claims under products liability law. This provision simply and fairly recognizes that when Congress mandated the use of fuels components, and when those components have been studied and approved by EPA, their mere presence in gasoline should not make it a “defective” product. Such a designation in court enables trial lawyers to bypass proof of wrongdoing.

Let me stress that the defective product provision would not affect, in any way, a company’s legal responsibility to clean up any groundwater affected by gasoline, regardless of whether it contained oxygenates. That authority remains in force in the Resource Conservation and Recovery Act (RCRA), the federal Clean Water Act, and states’ Clean Water Acts. Cleanup of any “orphan” underground storage tank release is covered by the LUST fund. Full cleanup coverage will continue in force. Moreover, EPA has determined that more than 95 percent of all cleanups have been paid for by the responsible parties, private insurance or state cleanup funds that are funded by taxes on petroleum products.

Underground storage tank laws would still apply if gasoline were released and migrated into a well or a public drinking water supply. There would be no defective product relief if EPA requirements are violated.

This is not an issue limited to the petroleum industry, but should be of concern to all businesses and industries that could face similar lawsuits for complying with congressional mandates.

We also support the LUST provisions of the fuels title that will significantly strengthen the federal underground storage tank program. These provisions would expand the LUST trust funds for enforcement, inspection, training and remediation of oxygenated-fuel releases. The bill would enhance the nation's overall cleanup efforts by ensuring that states have the funds they need to address "orphan sites," where the responsible party for a leak cannot be identified.

Refining Capacity

The expansion of refinery capacity must also be a national priority. Recent gasoline price increases, while primarily caused by increased crude oil prices, have underscored the fact that U.S. demand for petroleum products has been growing faster than – and now exceeds growth in domestic refining capacity. While refiners have increased the efficiency, utilization and capacity of existing refineries, these efforts have not enabled the refining industry to keep up with growing demand. Even with a projected expansion of product imports of 90 percent, DOE's Energy Information Administration forecasts a need for 5.5 million barrels a day of additional refinery capacity and a 2 percent increase in refinery utilization.

Government policies are needed to create a climate conducive to investments to expand refining capacity. The refining situation needs to be addressed now. The federal government needs to act as a facilitator for coordinating and ensuring the timely review of federal, state and local permits to expand capacity at existing refineries and possibly even build a new refinery. Passage of the energy bill would be an important step by encouraging new energy supply and streamlining regulations, leading to greater production and distribution flexibility.

Fuels Issues

API and its members support the fuels title that was contained in the H.R. 6 conference report approved by the House in the last Congress. The fuels title would repeal the federal oxygenate requirement for reformulated gasoline and require a national phasedown of MTBE. It also provides a renewable fuels standard phasing up to 5 billion gallons, with a credit trading program to allow the use of renewable fuels where most feasible and cost-effective.

The fuels provisions are needed to discourage state MTBE bans and other specialty fuel requirements. Individual state requirements can increase the number of fuels required within supply regions, thereby increasing the potential for fuel distribution and supply problems. Twenty states have already enacted uncoordinated MTBE bans, caps, or other limits; and other states are considering them.

API, the National Petrochemical & Refiners Association, fuel marketers, and numerous farm and ethanol interests support these fuels provisions. They offer carefully considered solutions to the fuels problems that have challenged fuel providers and burden energy consumers.

Boutique Fuels

Passage of comprehensive energy legislation consistent with the H.R. 6 conference report passed by the House last year is the best way to address the boutique fuels problem. The fuels title of H.R. 6 would repeal the federal reformulated gasoline oxygenate requirement in the Clean Air Act, a major driver of boutique fuels. It would also require that EPA consult with DOE on the supply and distribution impacts of new state requests for specialized fuels. Finally, the bill would require EPA and DOE to conduct a comprehensive study of the impacts of boutique fuels and make recommendations to Congress for addressing them, within 18 months of enactment. Given these significant changes and the benefit of the study recommendations, we urge members of Congress to resist imposition of any additional fuel specification changes outside the context of the national energy legislation.

Federal Lands

Currently, only about 1.5 percent of all federal lands onshore and one-half percent offshore are under lease and producing oil and natural gas, according to the U.S. Department of the Interior. Only 11 percent of the offshore submerged lands under U.S.

jurisdiction are available for leasing. Huge areas off the east and west coasts and in the Eastern Gulf of Mexico have been placed “off limits.”

Comprehensive energy legislation must address a number of exploration and production issues for non-park federal lands and offshore resources, including increased access; streamlined and expedited regulatory and permitting processes; and better coordination between state and federal agencies. Access should be provided to the potentially vast oil resources beneath a small portion of ANWR in northeastern Alaska that could provide the equivalent of current oil imports from Saudi Arabia for more than 20 years.

Natural Gas

Comprehensive energy legislation will also help America develop and diversify its sources of natural gas supply, both domestically and internationally, to meet increased demand for clean-burning natural gas. DOE projects total demand for natural gas will increase by 40 percent by 2025, primarily as a result of its increased use for electricity generation and industrial applications.

America’s natural gas policy has encouraged the use of this clean-burning fuel while discouraging the development of new supplies. The result is the current tight supply/demand balance and the prospect of continual future tightening, if action is not taken. Natural gas markets have distributed supplies efficiently, but prices have risen and markets have become more volatile due to the tight supply/demand balance. To ensure the long-term availability of adequate, affordable natural gas supplies, the nation must

develop its abundant domestic supplies and diversify its supplies by tapping into global supplies through liquefied natural gas (LNG).

However, there is no “silver bullet” – no single policy to alleviate the tight supply/demand balance. Rather, a balanced portfolio of policies is needed. Both comprehensive energy legislation and regulatory changes are overdue. While conservation and efficiency can have important, near-term effects and must be pursued, the urgent need to develop future supplies must also be addressed. For too long, the supply side of the equation has been ignored. Much of the domestic resource base has been placed “off limits” – either directly through withdrawals and moratoria or indirectly through constraints on operations that delay development and/or make it uneconomic.

API’s natural gas policy suggestions can be summarized in one phrase: implement the policy recommendations in the National Petroleum Council’s (NPC) 2003 study, “Balancing Natural Gas Policy: Fueling the Demands of a Growing Economy.” Key recommendation include:

- Expanding access to world gas supplies. Expediting the approval process for expanding existing LNG terminals and constructing new facilities is essential.
- Increasing access to non-park, non-wilderness onshore areas and reducing permitting costs and delays. More than half the technically recoverable resources in the Rockies are either off limits or highly restricted – that is enough natural gas (about 125 trillion cubic feet (Tcf) to heat the 60 million homes currently using natural gas for 30 years.

- Lifting constraints on key offshore areas with high-resource potential. Only 11 percent of the offshore submerged lands under U.S. jurisdiction are available for leasing. Administrative moratoria preclude exploration and development in many OCS areas until 2012 – at least 79 Tcf is off limits off the East and West Coasts and in the Eastern Gulf of Mexico (and this estimate may be low as it is based on old and limited data).
- Developing infrastructure to deliver natural gas supplies to consumers. Large resources of Alaskan natural gas will be stranded until a pipeline can be built to move this gas to consumers in the lower 48 states. A simple and timely regulatory process is needed.

The hydraulic fracturing and stormwater provisions of the energy bill will have a positive impact on natural gas, as well as oil, exploration and production:

Hydraulic Fracturing. The energy bill clarifies that hydraulic fracturing should not be regulated under the Safe Drinking Water Act. Fracturing technology plays a particularly important role in developing nonconventional resources such as coalbed natural gas (CBNG) and natural gas trapped in sand stone (in the west, near-shore and offshore Gulf of Mexico, and Alaska's Cook Inlet). Nonconventional resources must play a greater role in supplying future domestic natural gas supplies. The National Petroleum Council estimates that 60 to 80 percent of all wells drilled in the next decade will require fracturing. Any uncertainty about regulation of such operations should be removed.

CBNG, in particular, might be developed and brought to the market more quickly than more remote Arctic or deepwater reserves.

Stormwater. The energy bill provides a needed clarification that the existing exploration and production (E&P) exemption applies to E&P construction activities too. Despite an explicit exemption in the Clean Water Act for stormwater discharged from E&P operations, recent regulatory proposals have sought to subject construction at E&P sites to the type of stormwater requirements imposed on other types of construction activities like the building of shopping centers. This regulatory approach is counter to congressional intent and imposes unnecessary costs on domestic E&P operations.

Liquefied Natural Gas (LNG)

Increased import capacity for liquefied natural gas, or LNG, is absolutely critical to meeting projected natural gas demand. LNG currently provides 2 percent of the nation's natural gas, a figure that could rise to 21 percent by 2025, according to DOE. LNG can provide a dependable and competitive supply link to some of the largest, underutilized gas resources in the world. However, complicated rules stand in the way of bringing increased supplies of LNG to U.S. markets. Improved federal and state policy coordination is needed to facilitate the siting, construction and licensing of LNG import terminals.

The energy legislation will make a real contribution to the timely consideration of permit applications for the siting and construction of LNG imports and pipeline infrastructure and the delivery of natural gas to consumers. Provisions of the bill will:

- Guard against any attempts to change the FERC policy decision in the Hackberry Case. This policy decision allows companies to develop integrated LNG projects, which is important to reducing the financial risk associated with these large, complex projects.
- Clarify that FERC has exclusive authority for onshore terminal siting decisions, and require other federal and state agencies involved in permitting to work within the FERC process. Final decisions should be made within one year of the original application.
- Specify that the extensive record developed by FERC or the Coast Guard (for offshore facilities) in their certificate and permitting proceedings must be used by other agencies in any administrative appeals concerning a project that has been reviewed by either of the lead agencies.

Conclusion

All of these energy issues and concerns you will hear today add up to a need for action. America's energy problems are becoming acute. Congress needs to pass comprehensive energy legislation early in the new session. Too much is at stake for our country, our economy, and our place in the world to delay action any longer on this urgent national priority.