

Securing America's Energy Future
Clinton School of Public Service
Remarks by Jim Mulva
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As I arrived here today, it occurred to me what a vital and interesting time this is for the Clinton School. Your mission is educating and preparing individuals for public service, in an era of renewed trust in government. We are also seeing tremendous excitement over our bright young U.S. president.

It reminds me of a time a half-century ago. We had another young president, John F. Kennedy, who believed fervently in public service. You may not know that he made a tape-recording for the memoirs he would never write. On it, he said, "It is this profession, these politicians, who make the great decisions of war and peace, prosperity and recession. The decision whether we look to the future or the past. In a large sense everything now depends upon what the government decides." He could have said that yesterday.

What you in the Clinton School are doing, and what your graduates will do in the future, matters greatly to our country. But just as perceptions of government are changing, we also need to change perceptions of the energy future.

Regardless of the euphoria in Washington over alternative energy, it is time for a wake-up call. There is still oil and natural gas in America's energy future. What the oil industry does in the years ahead – or rather, what government allows us to do, also matters a great deal. To you, your children and your grandchildren. Why do I believe this?

First, let's start with green energy. Most people agree that we need renewable energy and lower carbon footprints. We believe it at ConocoPhillips too. But experts both within and outside the energy industry have reached a very telling conclusion. They have considered growing world population, economic development in countries like China and India, and likely future energy demand. They have also analyzed the potential offered by both existing and prospective energy sources. They have found that bringing enough alternative energy online to play a major role in meeting future demand will take decades. It will also cost trillions of dollars. As a result, even by 2030, fossil fuels will still supply 80% or more of total world energy. The alternatives can not be brought on fast enough to change things very quickly.

Second, there is no magic solution. There is no abundant, cheap alternative on the horizon that can quickly replace oil, natural gas and coal. The alternatives will almost certainly be more expensive. They will also impose their own environmental burdens.

And third, there is still a great deal of undeveloped fossil fuel potential. To prove this point, let's look at Arkansas. Since 1991, natural gas production here has increased by 160%. This has been achieved by using new technology to produce unconventional gas

from tight sands, and from shale rock. This is not exclusive to Arkansas. Thanks to the same technology, since 1993 U.S. gas reserves are up 45%.

Much of the new resources are onshore, on privately owned land. Which means it was available to the industry for leasing and development. Some also came from the Gulf of Mexico, one of only two places in the Lower 48 where the government allows offshore drilling. Think about what we might have achieved, if the government had opened some of the other 97% of offshore acreage. Or some of the prospective land in the western U.S. that remains off limits.

A 27-year-old offshore drilling moratorium did expire last year. But the Obama Administration has ordered a six-month delay in the process of preparing for leasing. In any event, initial lease sales are several years away, if they are ultimately allowed at all. This de facto extension of the moratorium is occurring despite the fact that the U.S. imports 60% of the oil it uses. Despite the fact that the Gulf has been one of our most important energy sources for decades. Also despite a good environmental track record. And finally, despite polls showing two-to-one public support for offshore drilling.

Drilling opponents like to point out that the U.S. uses 25% of the world's energy, with only 3% of its oil and gas reserves. But this is at least partly through choice. Our country chooses to import oil rather than allow expanded drilling here. It thus exports nearly a half-billion dollars a day to buy this oil, while also exporting countless production jobs. We could certainly replace some of these imports with domestic production, and in the process put Americans to work.

Let's talk about the choices in front of us, some recommendations, and the course that the Obama Administration has proposed.

National Energy Policy

First, the U.S. needs a balanced national energy policy – with balanced being the key word.

Congress has passed a number of constructive energy bills over the years. But taken collectively, they did not solve the problem. None of these bills dealt comprehensively with all forms of energy. They never took the opportunity to both increase supply and reduce demand. Instead, they focused on the sources that were popular at the time, while ignoring or even penalizing the others.

As my colleague David Wood, CEO of Murphy Oil here in Arkansas, points out, we need a different approach that incorporates four principles:

- Broad supply diversity,
- Greater energy efficiency,
- Technological innovation, and
- Sound environmental stewardship, including addressing climate change.

I'll explain, starting with diversity. We need more energy in all forms.

ConocoPhillips strongly supports development of alternative and renewable sources, like solar, wind and geothermal power, biofuels and others. The Obama Administration clearly does so as well, and proposes incentives to encourage their development. But more on diversity in a moment.

The second part of the policy must be improving our energy efficiency. Since the 1970s, the U.S. has doubled its economic output per unit of energy consumed. But we can still do more. The public is driving less, so gasoline demand is down. There is also greater awareness of the need for energy efficiency at home and work. But this is largely as a result of the recession, and not conservation. We believe that government can inspire further improvement. It can do this through public education, and by enacting broader efficiency standards. The Obama Administration agrees that conservation is essential.

Third, our policy would ideally promote innovation by encouraging research and development. Industry is making substantial investments already. Government can encourage further private investment by granting incentives. We also need public investment in technologies that can not be funded by industry. Such as those that require long lead times, or advanced science. Examples include natural gas hydrates, nuclear fusion, and carbon capture and storage. We would benefit too from greater support of the educational system, particularly in science and engineering. Here again, the Administration agrees on many of these points.

And fourth, our policy must ensure good environmental stewardship, including addressing greenhouse gas emissions. ConocoPhillips believes that our industry must supply cleaner forms of energy. In our case, we produce clean-burning natural gas, and blend ethanol into our gasoline. We are researching next-generation non-food biofuels. And we are developing new materials for the lithium ion batteries in electric cars.

On climate change, we acknowledge the scientific consensus that greenhouse gases from fossil fuels are contributing to global warming. Consequently, we believe that federal legislation is essential in order to create price signals for carbon avoidance. This will make it possible for the industries affected to make the investments required to reduce emissions. In support of our beliefs, we are America's only major oil company to belong to the U.S. Climate Action Partnership. Working in this organization with other industries and environmental NGOs, we have found common ground. We are calling for a mandatory national framework to slow, stop and then reverse the growth of carbon emissions. This includes principles for international action. As you know, the Obama Administration is tightening environmental standards and calling for action on climate change. So we are in broad agreement once again.

But there's a problem with the Administration's positions on energy, a big one. The U.S. and the world run on fossil fuels. The Administration has fallen into the old trap of ignoring, and even penalizing, the resources that actually keep our factories running today.

As a result, America will end up weaker from an energy standpoint in the future. We will have fewer supplies, higher energy prices, job losses and further economic pain. Let me explain, starting with what the administration has actually proposed, and its impact.

Obama Administration Policy Impacts

First, it wants substantial new taxes on the U.S. oil industry, and to end many of our current deductions. The total impact is estimated at more than \$3 billion annually. But the oil industry is already taxed quite heavily.

At ConocoPhillips, our worldwide effective tax rate last year was 46%. We paid \$13 billion in income taxes, \$5 billion in other taxes, and billions more in royalties to state and national governments.

The industry is also facing service and supply costs that have more than doubled since 2000. So there is little room for government to pile on additional taxes, without impacting our ability to develop new energy supplies.

I will mention only a few of the new proposals.

One would create a new excise tax on production in the Gulf of Mexico. The Gulf supplies 25% of U.S. production. It is the only U.S. offshore area now open that has yielded world-class discoveries. It is very expensive to operate there, in waters thousands of feet deep, a hundred or more miles offshore. Do we really want to put future development there at risk?

There is also a proposal to end a deduction allowed on marginal or “stripper” wells. These produce in low volumes, and are highly sensitive to costs. They supply roughly 15% of U.S. oil production. We could lose thousands of these wells due to this proposal. This is a serious concern here in Arkansas.

The Administration also proposes to end, for the oil industry alone, the manufacturing tax credit. This credit encourages investment and job creation in the U.S. by all industries. Again, do we really want to single out the oil industry and thus discourage investments in domestic production capacity?

Moving on, the Administration has proposed new procedures to raise royalties received from mineral production on federal acreage. This is despite a 50% increase since 2007 already enacted on offshore production. Raising the royalty rate will increase costs, which will inevitably discourage production. Incidentally, lease bonus and royalty payments yielded \$23 billion for the federal government last year.

There is also a proposal to make oil and gas production ineligible for the percentage depletion allowance. This is granted to producers of mineral resources. It recognizes that, unlike an investment in a factory, for example, mineral production is finite. You have to continually invest in finding new resources, or you eventually go out of business. Mining companies, and even producers of sand, gravel and dirt, all receive this allowance. Now,

for the first time, oil and gas producers will not. This too will discourage domestic production.

Even small producers, down to “mom and pop” operators with only a few employees, have been targeted. They would be required to extend the write-off of their geological and geophysical expenses over 7 years, instead of 2 years. These G&G expenses are at the heart of exploration for new resources, something logic suggests that the U.S. should encourage.

Another measure would charge a fee on non-producing federal leases. It’s called “Use It or Lose It.” It’s as if you bought some land, and were then charged a fee for not building and occupying a house fast enough. This despite the fact that you need time to develop building plans, obtain permits and financing, select contractors, and perform construction. At ConocoPhillips, nearly 70% of our leased federal acreage is producing energy today. Another one-quarter is being actively explored or developed – which can take years. That leaves only 5% on which work is suspended. But that is mainly for environmental reasons, such as seasonal drilling restrictions. Any unproductive acreage already automatically reverts to the government when the lease expires. And we pay hundreds of millions of dollars a year in bonus payments and rentals on our leases. The government keeps these payments even if the leases never produce anything.

Clearly, the Administration intends to encourage alternative and renewable energy. Meanwhile, it has proposed nothing to encourage oil and natural gas production. It actually seems hostile to these fuels. This is despite the fact that they still offer tremendous potential, particularly from unconventional sources.

Instead of ignoring the foundation of U.S. energy supply, or worse, penalizing it, wouldn’t we be better off using it to drive economic and employment growth?

Conclusion

In conclusion, the Administration’s energy proposals have been made by people who believe in their hearts that they are doing good. After all, they are working to create “green energy” by forcing an unpopular industry to pay for it.

But their actions will inevitably increase the cost of oil and gas production in the U.S. This will reduce domestic production, and make us more, instead of less, dependent on imported energy.

Further, unlike government, the industry can’t turn on printing presses to produce money. Any additional taxes on us will ultimately be paid largely by the public and our shareholders.

In short, the Administration is looking at the energy situation through blinders. They can see only the trendy, hot new technologies. Wind, solar, biofuels and so on. In automotive terms, they are fixated on the flashy red sports car, while ignoring the rolling stock that keeps the economy moving by carrying the heavy loads.

ConocoPhillips supports alternative energy development. But we fear that the Administration's current "alternatives and nothing else" approach will have severe unintended consequences. Even if it succeeds in tripling the contribution of alternative energy, this will still satisfy only a fraction of total U.S. demand. Meanwhile, excessive taxation and continued restrictions on access could cause the U.S. to run short of fossil fuels.

Prices would rise, the economy would be further impacted, and consumers would suffer. We would also have squandered our opportunity to secure America's energy future. That is why we must encourage responsible development of all forms of energy, alternatives, renewables and fossil fuels. While also addressing greenhouse gas emissions and environmental preservation.

Thank you.

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