

The Realities of the U.S. Energy Future: A Producer Perspective
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Remarks by Jim Mulva
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Introduction – the basic realities

I want to thank the Detroit Economic Club for putting together a challenging agenda with a diversity of views.

It was only a year and a half ago that I spoke here about the shared future of the energy and auto industries. Of course, we did not know what was ahead. The world economic upheaval. Millions of jobs lost. And severe impacts on the people of America.

The past year has proven that we all depend on each other. In that spirit, we seek common ground on some of the key issues of our times. Specifically energy and climate policy, and their role in economic prosperity.

History shows that when energy is readily available, reliable and affordable, it encourages high economic growth. But when supplies are short and prices are higher, economic growth lags. You know the saying – those who forget history are doomed to repeat it. We will need energy in the future, just as in the past – in high volumes, and at reasonable cost. But this simple statement comes with a set of hard realities.

The future energy situation

First among these is that future energy demand will grow. Why? Because world population will expand by one-third, reaching 9 billion people by 2030. Also, the developing world is catching up economically. More people are building homes, electrifying them, and buying cars and appliances. The U.S., long the world's largest energy consumer, also has a growing, energy-hungry population.

Second, modern society is inherently energy intensive. We can learn to use less energy, but there are practical limits. After all, you can't fly a 747 on Piper Cub engines.

These first two realities dictate a third – we must develop a more diverse “basket” of energy supplies. This includes alternative and renewable energy. But it also includes more fossil fuels. Fortunately for all of us, we benefit from a massive, efficient and highly successful energy infrastructure. It is based on fossil fuels. Building it required 150 years, trillions of dollars in investments, and generations of work – by untold millions of people. They drilled wells, and constructed oil and gas pipelines, fleets of tankers, coal mines and electric power plants. Their work transformed society, created affluence, and improved our quality of life. Replacing this energy foundation would take an unimaginable effort. It could not be done quickly, despite the desire to do so. There simply is not enough investment capital, skilled labor and materials available. And much of the technology needed is still being developed. So building sufficient capacity to replace fossil fuels will take – who knows, decades, perhaps even a century.

The fourth reality is that alternative energy has its own issues and detractors – just like fossil fuels. Every energy source poses unique challenges. They may be in terms of the environmental impact, the economic considerations, the regulatory requirements, or even just public acceptability. There are “not in my back yard” objections to wind turbines, just as there are to oil wells and power plants. There are hazardous chemical concerns associated with solar panels. Nuclear energy creates tremendous concern. Biofuels impact food production. And so on.

The fifth reality is that the advantages of fossil fuels are too often overlooked. They generally cost less than alternatives – which is why they are the market leaders. You will pay a lot more for “green energy” – either in utility bills, or at tax time due to the heavy subsidies it requires. Also, fossil fuels are generally more reliable. They don’t tail off when the wind dies or the sun goes down.

Altogether, these realities mean that Washington’s apparent belief – that we can choose between renewable energy and fossil fuels – is mistaken. We will need more of all energy sources. So our path forward must include five steps ...

- One, encouraging conservation,
- Two, diversifying our energy supplies by developing alternative and renewable energy,
- Three, developing our domestic oil and gas resources,
- Four, encouraging imports from secure producers,
- And last but not least, addressing climate change.

With these points, I’ve just committed blasphemy in some people’s minds. As an oil and gas producer, I’ve endorsed conservation and supply diversity. I’ve referred to the “inconvenient secret” that the U.S. still has a lot of undeveloped oil and gas. I’ve touched the third rail by suggesting that we will still need imports. And also by acknowledging that climate change is a serious issue.

Now, let’s get down to the policies needed, beginning with what our industry must do.

What industry must do

We and our peers are already investing heavily to develop new supplies – and new technologies to make our products cleaner. This must continue. We are researching ways to reduce the cost and facilitate development of alternative and renewable energy.

ConocoPhillips has already produced renewable diesel fuel, made from vegetable oil and byproduct animal fats. We are researching new biofuels made from agricultural waste and algae. We are evaluating investments in other areas, such as wind power. In the meantime, we are improving our own energy efficiency, which will help reduce our carbon intensity.

Altogether, we are investing tens of billions of dollars in our energy businesses – despite the most challenging economic environment of my lifetime. We have seen oil and gas prices fall below replacement cost at times.

Also, we are facing severe restrictions on our access to energy resources. In the U.S., drilling is banned in many areas due to environmental objections. Overseas, some of the best areas are reserved for national oil companies. These trends force us to concentrate in the mature producing basins where we do have access. But these have been picked over for years, so they are generally more expensive and offer less potential. We must do a better job of making our case to government for expanded access.

There are other financial pressures – such as higher taxes. A number of countries jumped on the tax bandwagon to get a bigger cut when prices were high. Now, they want to keep it despite today's harder times. Here too, we are working to inform these countries of the economic realities of today's energy market.

What government must do

Next, there is much that the U.S. government must do to ensure that our country remains competitive in the global race for energy. Unfortunately, we are running this race while dragging anchors behind us.

First, it must encourage greater efficiency, by setting energy performance standards throughout the economy. Its actions must be cost effective, since they would increase the cost of cars, buildings and appliances. But conservation alone is not enough.

We've said for decades that the U.S. needs an inclusive national energy policy. One that supports investment in all forms of energy, including fossil fuels. The U.S. remains the world's third-largest oil producing country. We do that with less than 4% of our 2.4 billion acres of federal acreage under lease for development. Too many unexplored areas are off limits – like the Atlantic and most of the Pacific offshore, parts of the West, and large parts of Alaska.

These resources belong to the public. But the same government that tells us to get off foreign oil is blocking development – needlessly. The industry has a good environmental record, and it can explore these areas responsibly.

Also, there is a natural gas renaissance under way. But government appears not to have noticed. Since 2005, estimated recoverable gas resources have more than doubled. This is thanks to new technology to produce from shale rock. So Lower 48 supplies are up, and prices are down. And we still have huge resources in Alaska awaiting pipeline construction.

Consider too the benefits to the environment. In power applications, gas emits half the CO₂ of coal. So we should be relying on gas as a bridging fuel while we build a low-carbon economy. Unfortunately, proposed tax increases and regulations are threatening to marginalize gas. For example, one proposal would impose standards for electricity

produced from renewable fuels. It sounds good, but it would likely force greater cutbacks in the use of gas, than coal.

Another point. Since we can not produce all the energy we need, we should encourage imports from secure and friendly sources. Like Canada. Its oil sands are one of the world's largest hydrocarbon deposits, with 8 times current U.S. oil reserves. We already process this oil here, creating U.S. jobs, income and tax revenue. It puts the Midwest at the front of the line for oil supplies.

But there is fierce opposition to importing this oil. It is based on objections to surface mining, and the oil's carbon intensity. But most new developments are not surface mines, but wells. And although the carbon intensity is slightly higher than for conventional or heavy oil, we are working to reduce the impact.

Of course, the concern over carbon intensity relates to the climate impact. We believe that government should address climate change. But it should balance its approach with the need for energy supply security. For example, climate change should not serve as an excuse to halt imports from the oil sands. That would only cause increased imports from less reliable areas – or even oil shortages.

ConocoPhillips has closely tracked the climate issue. In 2007, we joined the U.S. Climate Action Partnership. This is a group of diverse businesses and environmental NGOs that share our desire for a balanced approach. It supports legislation to set a price for carbon avoidance, linked to international agreements. This would be more efficient and less expensive than regulating carbon under existing statutes designed for other purposes. Such as the Clean Air Act, or the Endangered Species Act.

Federal legislation would hopefully preempt the current patchwork of state regulations. But it must not create new conflicts by imposing overlapping requirements. For example, current standards already mandate the greater use of renewable fuels. So a pending proposal to require the use of low-carbon fuels is redundant.

We believe too that all sectors of the economy must be treated equitably. Under current climate proposals, electricity consumers would have 83% of their carbon costs mitigated. But transportation fuel consumers would bear the full cost on day one. Meanwhile, coal-fired electricity generators would receive free allowances for half of their emissions. But cleaner-burning gas-fired generators would receive no allowances. So use of coal would be encouraged, while gas would be penalized. This is nuts.

Also, refiners would be accountable for the greenhouse gas emissions that result from use of all oil-based products. This is one-third of the U.S. total. But refiners would receive only 2% of the available allowances. So they would have to purchase credits, and then pass the costs along to consumers. This means higher gasoline prices. But competing imported fuel products would not have this cost burden. This could put domestic refiners out of business. It would also force both jobs and emissions to leak overseas. So the Administration should grant refiners allocations for any costs they can't pass on. And it

should help consumers of transportation fuel, just as it would help those in the other energy sectors.

One final area in which government can help is by encouraging innovation. It can provide incentives for technology R&D, and greater support for education. This could ease the shortage of technical personnel we see in many American industries, including energy.

What government must not do

While there is much that government can do, it should resolve first to do no harm.

It must not create unrealistic expectations for new energy sources. Neither should it attempt to pay for them at the expense of fossil fuels. After all, more fossil fuels also will be needed. The oil industry must be able to continue developing the energy needed to keep the economy going.

Further, government should not try to pick “winning” technologies. Its job is encouraging overall progress. Then, to let the market decide the best and most cost-effective sources. Consumers and investors are very good at that.

Government must also resist a fallacy. And that is that so-called “green jobs,” created by alternative energy development, will drive an economic recovery. In reality, since these sources will cost more than fossil fuels, energy prices will rise. This could actually hurt the economy and cost jobs by making the U.S. less competitive against countries with cheaper energy.

Further, government must resist the “raise taxes” mentality. Our industry already pays a U.S. income tax rate of over 40%, compared to less than 27% for all manufacturing. Last year, ConocoPhillips paid \$13 billion in income taxes, \$5 billion in other taxes, and several billion in royalties to government. The Administration’s proposed 2010 budget contains tax provisions that will reduce our ability to invest in increasing production. This would cause greater oil and gas imports, higher fuel prices, and reduced competitiveness. It could also cost many of the 6 million direct and indirect jobs supported by our industry.

We caution too against enacting unnecessary regulations. We believe that fair, balanced and well-coordinated regulatory processes are necessary and appropriate. However, the benefits of proposed regulations should equal or exceed their cost to the public in terms of making domestic energy more expensive.

Conclusion

In conclusion, the U.S. is at a crossroads. Government action is needed on energy and climate policy. And some form of legislation seems likely to pass. We hope that it is realistically based on the hard energy facts I’ve mentioned and not on politically popular hot air.

The availability of energy at reasonable cost underpins the U.S. economy. So the decisions made in the months ahead will deeply affect all of us.

We urge government to adopt wise, carefully crafted, and balanced policies. Good policies will facilitate our enduring economic health and quality of life. Bad policies will do the opposite.

None of this will be easy. We would hope that the views of energy producers are heard and considered – along with those of other constituencies.

Thank you.

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