Statement

of

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Good morning. Mr. Chairman, Mr. Sensenbrenner, Members of the Committee, thank you for asking me to testify before your committee today. I have been asked to provide testimony regarding the impact that deploying oil from the Strategic Petroleum Reserve (SPR or the Reserve) has had in the past on high oil and gasoline prices, how deploying the SPR could effect high energy prices now, how the SPR should be used to address our current energy crisis, and what policy changes should be considered to allow the Department of Energy (DOE) to more effectively manage and utilize the SPR in the future.

I am appearing before the committee today as a Policy Director from Brownstein Hyatt Farber Schreck, a Denver-based law firm with a robust Washington, D.C. office, and as Executive Director of the Energy Research Coalition. In the past, I have served as Associate Deputy Secretary of Energy and Senior Policy Advisor to the Secretary of Energy. In those positions, policy development and direction for the SPR was one of my responsibilities.

Historical Impact of Releasing Oil from the Reserve on Oil and Gas Prices

History shows that strategically releasing oil from the SPR is good public policy and can have an immediately beneficial impact on crude oil and petroleum product prices. Equally important to the downturn of gasoline prices is the mere announcement or anticipation of a release. The events leading up to the release of oil before the first Gulf War, the announcement of the sale in 1996, the 2000 exchange and the announcement of a release after hurricane Katrina in 2005 are each good examples of this concept. In addition, the various authorities that may be utilized to release oil from the Reserve each offer different opportunities to provide emergency response to real, anticipated or perceived oil, and in some cases product supply shortages or to send messages to overly heated markets that the U.S. government is prepared to use the Reserve to protect consumers.

1991 Sale: One sale of oil from the SPR occurred in January 1991 after President George H. W. Bush found a "severe energy supply interruption" in anticipation of the impending military conflict that would be the first war in Iraq, Desert Storm. The disruption on which the finding was based had not actually occurred and the Bush Administration, in the face of an impending military conflict, utilized the SPR's anticipatory authorities for the drawdown. According to DOE records, on January 16, 1991, President Bush in a nationally televised address announced that the U.S. and allied warplanes had begun attacks against Baghdad and other military targets in Iraq. Simultaneously, the President announced that the U.S. would begin releasing a portion of the Reserve stocks as part of an international effort to minimize world oil market disruptions.

On January 17, the day after the announcement of the sale, the price of oil fell from $32.25 per barrel to $21.48. That is the single largest one day drop of oil prices in history. The original plan was to release 33.75 million barrels from the Reserve. However, the four million barrel test sale in October 1990 that preceded the President's televised announcement in January, coordinated actions by the members of the International Energy Agency and the success and brevity of the war were sufficient to calm the market. As a result, when DOE issued the crude oil sales notice on January 28, 1991, there were bids for only about 17.3 million barrels of oil. In comparison, the drop of $6.48 last Tuesday, July 15, 2008, was the largest single day drop in the price of oil since 1991. As a percentage of the total price of oil, however, the 1991 decline dwarfs the decline last week.

1996 Sale: In the Omnibus Appropriations Act for FY 1996, Public Law 104-134, signed April 26, 1996, the Congress directed DOE to sell $227 million worth of oil to allow the achievement of the overall budget target for that year. At that time, retail gasoline prices were climbing and shortly after the law was enacted President Clinton implemented the sale of approximately 12 million barrels from the SPR. While the foundation of the law was a desire to meet federal budget targets, the major driver in the plan to implement the law was to maximize the value and minimize the amount of the oil that would be sold. Coincidentally, the decision to sell the oil immediately resulted in a downturn in gasoline prices which continued through the first week of October that year.

The sale was announced on April 29, 1996. As former Energy Secretary Hazel O'Leary pointed out in testimony before the Senate Energy and Natural Resources Committee on May 9, 1996, "[t]he announcement by the White House of this directive, along with the actual availability of the extra supply, was immediately accounted for by the markets, which moved down on April 29 and 30."

Further, Secretary O'Leary stated, "[the] principal impact [of the announced sale] was psychological, temporarily halting the bullish pressures in the market and leading to a reversal in both crude and product prices…[which] [s]everal oil traders…attributed…directly to the President's firm and rapid action." As mentioned above, gasoline prices continued to decline through the first week of October that year.

2000 Exchange: Selling oil from the Reserve is not the only way to use the SPR to help alleviate oil supply and price problems. In August 2000, home heating oil inventories were extremely low, and on September 22, 2000, President Clinton gave then Energy Secretary Bill Richardson the authority to loan 30 million barrels from the SPR to the market, with the option of loaning another 30 million barrels. Even before the oil was released, the announcement of this directive had an immediately positive psychological effect on the market: 1) there were sufficient heating oil supplies that winter; 2) the exchange lessened the need for supplies coming in from Europe, thereby lowering the price in the U.S. and in Europe (oil prices dropped 34% by the end of the year, going from $30.94 to $20.38 per barrel); and, 3) netted a return of 35.1 million barrels of oil (that is 5.1 additional million barrels of oil at no taxpayer cost) due to the interest that had to be paid to the Reserve.

2005 Hurricane Katrina Drawdown: After Hurricane Katrina in late August 2005, oil prices began to rise dramatically due to the disruption of production capacity in the Gulf of Mexico. On September 2, 2005, President George W. Bush issued a finding of "severe energy supply interruption" and directed the Secretary of Energy to withdraw and sell oil from the Reserve. The day before the announcement oil closed at a peak of $69.50. The price fell to $66.91 the next day and continued a steady decline for several months. The price did not exceed the peak until April of 2006.

2006 Action: In April 2006, the President recognized the importance of keeping as much oil as possible on the market in order to quell high fuel prices. On April 26, 2006, the White House, apparently motivated by a concern about rising fuel prices due to a shortage of crude, issued a *Fact Sheet: President Bush's Four-Part Plan to Confront High Gasoline Prices*. One element of the plan was to halt deposits of oil to the SPR for a short period of time. Subsequently, deposits into the Reserve were halted for that summer. In explaining the action, the *Fact Sheet* says, "Our Strategic Petroleum Reserve is sufficiently large to guard against any major supply disruption over the next few months. Deferring deposits until the fall will leave a little more oil on the market – and when supplies are tight, every little bit counts." At the time of that announcement, there were approximately 688 million barrels of oil in the Reserve. The fill of the reserve was suspended until April 2007.

Potential Impact of Deploying the SPR on Current High Energy Prices

It is difficult to know the exact price impact of a release of oil from the SPR. However, as indicated above, experience suggests that the release—and even the mere announcement of the release— of substantial volumes of oil from the SPR whether by direct sale or an exchange sends a clear message to the market that the government is prepared to act. This message has had and should continue to have the effect of quelling speculation and calming markets, resulting in immediate crude oil and product price reductions.

Accordingly, if the Administration announces the sale of a significant amount of oil from the SPR, or if the Congress were to pass a law directing a sale or exchange, the oil and petroleum products markets can reasonably be expected to respond as they did immediately after the emergency sale in 1991, the Congressionally directed sale in 1996, the exchange in 2000, the Hurricane Katrina drawdown in 2005, and the 2006 halt. There is no shortage of oil in the SPR; it has a current inventory of 706 million barrels of oil. Therefore, there should not be a fear that there is not enough supply in the SPR. Instead, a release—and even just the announcement of a release—of a significant amount of oil could send a message to speculators that there is more supply on the market, which will then likely drive down prices for some period of time. Prices would still remain at historic highs, but consumers could benefit from some relief and allow for more fuel efficient or alternate fuel vehicles and other consumer products to penetrate the market to provide more permanent relief from our dependence on oil.

How to Use the SPR to Address Current Energy Crisis

Today, we have a unique opportunity to utilize the SPR to address the current energy crisis in a way that can add up to significant funding which can be spent on efforts to provide relief for consumers to high energy prices or for such things as research and development on new technology to create opportunities to deploy clean sources of energy more rapidly. One way to create additional revenue for such purposes is to exchange some of the light grade crude oil in the Reserve for a like or greater amount of heavy oil. The oil that is currently stored in the SPR is only light and medium grades. In recent years, however, U.S. refineries have been upgraded to process more heavy oil, which, according to the Government Accountability Office (GAO), is on average about $12 cheaper than the lighter grades of oil.

Congress should take immediate action to enact proposals such as H.R. 6067, the Invest in Energy Independence Act. Consistent with recommendations made by the GAO in a report released on April 24, 2008, "Improving the Cost-Effectiveness of Filling the Reserve," this bill calls for the exchange of about 70 million barrels of light crude oil from the SPR with a like or greater amount of heavier oil. This exchange is important to our future energy security and supply for two reasons.

First, it would fulfill the GAO and DOE recommendation to make the composition of the SPR oil be more compatible with modern U.S. refineries, thereby increasing the energy security of the country. According to GAO analysis of 2006 Energy Information Administration data, the crude that currently fills the SPR would not be fully compatible with 36 of the 74 U.S. refineries that are considered vulnerable to supply disruptions. In addition, the DOE estimates that if these 36 refineries had to operate solely with crude oil from the SPR, U.S. refining throughput would decrease by 735,000 barrels a day – that is 5% - which would further exacerbate the supply disruption. And, the GAO estimates that the potential disruption could be even worse than that suggested by the Department of Energy.

Second, the average $12 price differential between the more expensive light types of oil and the cheaper heavy types of oil has the potential to return of hundreds of millions in funds that may be used to pay for important research, development demonstration and commercialization of energy technologies to transform our energy infrastructure to the new generation of clean, domestic energy resources. It is important to note that current law does not support the monetization of this differential; a statutory change is required to do so.

Additional Policy Changes To Foster DOE's More Effective Future Utilization of SPR

Several additional changes should be considered to improve the efficiency and effectiveness of the SPR. These changes include:

- *Greater Secretarial Flexibility*: Recognizing that the SPR is designed to be used in situations beyond emergency supply disruptions, the Secretary of Energy should be given greater authority and flexibility. The Secretary could then use this greater flexibility to maximize the potential utility and effectiveness of the SPR to accomplish broader public policy goals such as providing to consumers some relief to unbearably high prices of oil and gas.
- *Study of the Appropriate Mix of Oil Grades for the Reserve*: DOE and GAO have both concluded that the Reserve should contain at least 10 percent heavy oil. However, with the growing global demand for oil it is likely that our refineries will continue to be upgraded to run more heavy oil. Care should be taken to ensure that the Reserve is optimized to provide maximum protection for the Nation's energy supplies.
- *Leverage the Reserve as a Tool in the Effort to Make the U.S. Less Dependent on Oil*: Certain actions, such as exchanging light oil in the Reserve for heavy oil will generate revenue due to the price differential between light and heavy crude. That revenue could be used for energy technology R&D. Pending legislative initiatives to exchange 70 million barrels of light oil for heavy oil could generate more than $800 million.

Thank you again for inviting me to come before the Committee to testify about the great opportunity we have today to use the SPR in a strategic and constructive manner.