

API

BLOGGER CONFERENCE CALL

MODERATOR:

Jane Van Ryan, API

SPEAKERS:

Lou Pugliaresi, President, Energy Policy Research Foundation

Rayola Dougher, Senior Economic Advisor, API

Ron Planting, Manager of Statistics, API

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Bloggers on the call included Carter Wood from Shopfloor.org, Cindy Kilkenny from Fairly Conservative, Dave Schuler from The Glittering Eye and Outside the Beltway, Devil's Advocate from Copious Dissent, Gail Tverberg from The Oil Drum, Geoff Styles from Energy Outlook, Greg Balch from Goat's Barnyard, Joules Burn from The Oil Drum, Robert Rapier from R-Squared Energy Blog, Steve Atkinson from The Conservative Voice of America, Wilson Cruz from Vulcan's Hammer, Brian Westenhaus from New Energy and Fuel, The Bear from The Absurd Report, and Ken Moyes from Broken Government.

00:12 RAYOLA DOUGHER: Okay, just a quick summary. We have had 14 oil companies put their third quarter earnings up, and their profit margins are averaging about 9.6 cents on every dollar of sales. That's the net income divided by the revenue. We're also tracking the Dow Jones Industrial companies, and we have 24 out of 30 companies reporting, and they're averaging about 10.7 cents on the dollar. So while oil is about 1.1 cent behind, we're waiting for one other major company to report and that's Chevron. In terms of prices, of course, they're dropping like a rock. Crude oil prices are down from about \$100 a barrel about a month ago; \$63 dollars the other day. They were at \$67.50 last night, and I think they're around \$65 today, but who knows what they'll close at or whether we're really at the bottom yet. Gasoline prices have followed that decline. Retail gasoline prices are averaging about \$2.55 a gallon, and that's down from \$3.09 a gallon from a month ago. And diesel fuel prices are also down about 74 cents a gallon. So that's a brief summary and Ron is going to talk a little bit about the supply and demand figures.

01:32 RON PLANTING: This is Ron. We've had sluggish demand here in the U. S. in the last year or two because of higher prices and changes in consumer behavior, and a peak in July, as you probably know, product prices have been coming down, but the economic uncertainty has been increasing, and that has led us to fourth quarter U.S. petroleum deliveries of just 19.7 million barrels per day, according to our API data we published just a week or so ago. It's down 5.2% from just a year ago, and it's the lowest third quarter in 10 years for U.S. petroleum consumption. Gasoline consumption by itself was down 4 percent for the quarter from a year ago; that was the lowest third quarter in six years. So, you know, if it's not higher prices and their effects, it's the state of the economy. Lou, do you have something you'd like to say?

02:30 LOU PUGLIARESI: Yeah, I mean, I think if you look at the decline over the last year, we have – most of this decline is OECD. In fact, year on, year out, I think our latest numbers showed a consumption down about one-and-a-half million barrels a day, and the non-OECD up about 200,000 barrels a day, which I think is pretty consistent with the numbers you guys have.

02:56 MR. PLANTING: We just focus on the U.S. This is Ron.

03:00 JANE VAN RYAN: Okay, we've had a couple of other people join us. May I ask who came on the call and then will open this up to questions?

03:08 GAIL TVERBERG: This is Gail Tverberg from The Oil Drum.

03:10 MS. VAN RYAN: Hi, Gail. Nice to hear your voice. Who else do we have? Anybody just join us within the last two minutes? Okay, well, we'll move forward then. Who would like to ask the first question of our experts today?

03:29 BRIAN WESTENHAUS: Ready?

03:31 MS. VAN RYAN: We're ready.

03:34 MR. WESTENHAUS: I'm ready. I noticed that diesel is not following gas down nearly as fast. When do you expect the gap to close up?

03:40 MR. PUGLIARESI: Rayola, would you like me to take a whack at that?

03:45 MS. DOUGHER: Sure, if you'd like.

03:47 MR. PUGLIARESI: Yeah, you know. First, we are joined at the hip with the world market, and this is an interesting – I mean, this whole question of the disparity between diesel and gasoline has been going on for some time. And it's – there is in fact a rather substantial imbalance between diesel and gasoline demand related to – and that imbalance is the demand versus the configuration of the world refining structure capacity.

Around 2004, the Chinese pulled a lot of coal out of industrial uses and began a kind of world-wide growth in demand for the middle of the barrel. This was followed by increasing dieselization in Europe, and essentially, what's been happening over the last few years is that as the world refining centers move to hit the diesel targets, they are producing a lot of gasoline for which there is no local market. Now, they can swing this production 3 to 4 percent with existing capacity; but in Europe they're already at the limit. And we, in the U.S. are importing roughly a million barrels a day of gasoline from the finished gasoline and blend stock, mostly blend stock. And in fact, we have been exporting a distillate over the last few months. And I think last month, it might have been as 5 to 6 hundred thousand barrels a day.

And so our view is, look, this is a relatively – this is a short-term or medium-term problem which will get fixed when the world refining capacity comes more in line with the structured world demand. And of course it's been exacerbated even in the U.S. If you think about refineries, they're sort of like producing steaks and leather. You can't really produce more distillate without producing more gasoline. I mean, as I said, we can swing a little bit. And so what's happening is that, in order to meet – until we get more hydro-cracking, hydro-treating, and more distillate capacity online, and the world refining configuration can rebalance itself a bit, we're going to have this disparity.

06:09 MR. PLANTING: This is Ron. I think that's all a good description of what's going on, I'd just point that what's being exported is not ultra-low sulfur diesel; it's not highway diesel. It's something that's got more sulfur in it than can be used on highway. It's a category for which the market has gotten a lot smaller here in the U.S. because of the –

06:34 MR. WESTENHAUS: Well, I'll buy it. I got it for farm uses. What's your time frame?

06:36 MR. PUGLIARESI: You mean how long is this going to take?

06:39 MR. WESTENHAUS: Yeah.

06:40 MR. PUGLIARESI: Well, that's a good question. I mean, we, you know the – some of this is going to be related to the pace at which foreign refinery centers come online. The Indians have a million barrels a day of capacity coming online, and some of their – largely aimed at the world distillate market. The – I would say, in the first quarter next year, they're going to be moving some of their lower-spec – let's say the middle of the barrel that doesn't quite meet the European specs – but over time they will be pulling more sulfur out of the middle of the barrel; to the extent that the U.S. refining industry can begin to make some capital investments, you know, maybe five – take as much as 10 years, it could happen as quick as three. It really depends upon whether we're going to get any recovery in some of these margins, and people are willing to put some risk capital to make these projects go forward.

07:43 MR. WESTENHAUS: Huge groan.

07:46 MR. WESTENHAUS: How about propane? Propane – I've been watching it on the New York Merc, and it doesn't seem to move much. When do you expect to get some motion from propane?

07:54 MR. PUGLIARESI: You know, I think propane is – I don't really have a good answer; I don't really have a good theory for that. But, you know, propane is, it's really going to be related to the – if you can get the number of runs up, you can get more propane out.

08:09 MR. WESTENHAUS: Yup.

08:10 MR. PUGLIARESI: And I think we're going to be suffering – Look, if you're a refiner, and you are in the wrong spot, and you've got the wrong configuration now, you're forced to cut runs. I don't know what else you can do. And your ROI is just taking a beating.

08:26 MR. WESTENHAUS: Well, propane's higher than gasoline with tax now. So I'm just a little paranoid about buying propane.

08:31 MS. DOUGHER: It's down about 50 cents or so in the past month, but it certainly hasn't come down at the same rate as distillate or gasoline.

08:39 MR. PUGLIARESI: Yeah, but I think it is important and, of course, this is something I don't need to tell you guys about. We really have two markets here. We have the market for the feed stock, and then we have the manufacturing facilities that turn that feed stock into the whole product slate. And we have been arguing for over a year that the feed stock was way out of line, that what we saw in terms of oil prices was the result of some unique conditions in the market. And that it was not sustainable.

We just – you know, we published an article on this in July in The Oil and Gas Journal, we've done a lot of presentations on this, and we just didn't see – we really believe that when you get up to the level of 130, 140, 150 dollars a barrel, you're way beyond the long-run backstop for petroleum. I know it's hard for a lot of people to get around that, but, I mean, you know, you could – a lot starts to happen when you go between \$70 and \$90 a barrel. Both in terms of alternatives, non-conventional supplies, and conservation.

09:39 MR. WESTENHAUS: How is natural gas supplied? I go through and I comparatively speak on the huge amount of natural gas in the form of anhydrous ammonia. Is it on course with the NYMEX for being price parity for oil right now?

09:53 MR. WESTENHAUS: I was quoted \$1,060 for a ton of anhydrous ammonia, which is \$187 two years ago, so I'm learning to watch natural gas really close now, too.

10:06 MR. PUGLIARESI: Yeah, natural gas is – that's something we need to spend a lot more time on. I mean we have this big growth in natural gas production over the last few years, up about 9 percent. There appeared to be a – you know, when we saw this big decoupling between the price of natural gas and crude, where you had natural gas selling at half – at a BTU value – at half, you can say well, that's got to get fixed one way: Either crude's got to come down, or gas has got to go up. (Chuckles.)

And I do think there is a lot of evidence that the U.S. – I mean, this is an interesting issue because the U.S. may be – either we are the leading edge of a major decoupling of gas from oil, in which case we may see a real renaissance of chemical plants and fertilizer back in the U.S. – you know natural gas in the U.S. is about half the price in Europe and Asia. It's just amazing what's going on, and I think that's something worth looking at. Or, are we going to see the rest of the world see gas – because you know, in the U.S., gas now competes either with other gas or coal. There's no more resid fuel to compete against. And that's not quite the case in Europe or in the Asian markets yet.

11:20 MR. WESTENHAUS: Well, they're down almost one supplier from the east, aren't they?

11:23 MR. PUGLIARESI: No, actually there's more. I mean, there is LNG, there's North Sea gas, there's a lot more competition in the European market than you would expect if you look into more detail. The problem with the European gas market is that it's probably the most untransparent gas market in the world.

11:39 MR. WESTENHAUS : Oh. Okay. So we're not at parity yet, with natural gas and oil again?

11:45 MR. PUGLIARESI: Absolutely not. We're still probably a good – I mean, oil price keeps dropping; I have to go back and recalculate. But my guess is we're still 60 percent of the value of crude.

11:55 MR. WESTENHAUS : Okay, there's enough to, you know, heat the houses and stuff? The hurricane that came through has not got us behind the 8-ball, so to speak?

12:05 MR. PUGLIARESI: Yeah, I think that from that production is starting to come back on, and we still have a ways to go in the Gulf, the refining sector as well.

12:14 MR. WESTENHAUS : I don't need to expect a natural gas scare between now and March?

12:16 MR. PUGLIARESI: I would doubt it.

12:19 MR. WESTENHAUS: Okay, super. Thank you.

12:25 MS. TVERBERG: This is Gail Tverberg from The Oil Drum. I was going to ask about the connection between the credit crisis and the current low prices of oil and gas.

12:35 MR. PUGLIARESI: In what sense?

12:37 MS. TVERBERG: Well, I think we've been seeing various indirect effects of, you know, the hedge funds selling and the rising dollar; there's been a variety of different – but this is affecting the oil price and such.

12:53 MR. PUGLIARESI: Yeah, I mean – You know the last time we looked at it, the swing in the price of oil just swapped. You know, I've never been a big fan of – I mean, if you look between our July 1, 2008 to October 8, 2008, the dollar's been up about 7 percent. But crude oil prices fell by nearly 40 percent. The trouble with this dollar/crude oil issue is you never know which end – whether you're chasing or falling – or the dog is wagging the tail or the tail is wagging the dog. Because it's possible that the reason the dollar got beat up so much is because our import bill is rising so fast. The cause and effect is something I'm not prepared to say we fully understand. But I do think that you can make a pretty strong case that 80, 85, 90 percent of the movement is driven by fundamentals. And the fundamentals here are slower economic activity and people responding to high prices. So we have what we call income effect and a price effect, right? Some guy rides his bicycle to work because the price is too high. Another guy rides his bicycle downtown because he doesn't have a job. Well, one of them is a price effect; the other is an income effect – (chuckles). But it's going to take a while to sort it out.

14:20 MS. VAN RYAN: Rayola, Ron, do you have comments on that?

14:23 MS. DOUGHER: Well, I would agree that what we're seeing are strong fundamentals primarily and that the credit crisis is hitting all industries and all commodities right now, not just the oil industry.

14:36 MR. PUGLIARESI: Yeah, you know there's a lot of discussion about being – you know, one of the things I think we're concerned about is this kind of – you know, we need to move to alternative fuels at any cost. You know, well, that's kind of – we do need to have a

strategy to transition to the fuels of the future, but we shouldn't be silly about it. We produce, the U.S. with 5 percent of the people, produces 30 percent of the world's gross domestic product. And we're doing that with – actually more efficiently than the Middle East, China, or India. We use a lot of oil, but people keep forgetting that we also produce a lot of goods and services.

15:14 DEVIL'S ADVOCATE: Hi, this is Devil's Advocate from Copious Dissent. I just have a quick question on how the recent moratorium lapse as well as the discovery of Cuba's new oil has impacted the price at all.

15:29 MR. PUGLIARESI: Well, this is a good question. You know, Nancy Pelosi said that we shouldn't do offshore leasing because it won't happen for 10 years and it will only have a two cents effect, and you know –

15:45 DEVIL'S ADVOCATE: Yeah, but Cuba just discovered 20 billion barrels if –

15:46 MR. PUGLIARESI: I don't know what they discovered, but I do take your point, and we have argued – if you go to our website, there's a couple of really good pieces on there where we look at the history of price changes in the oil market. And I would argue that, going back to '73 and '74, large swings in the price of oil are driven much more by a new set of expectations on shifts in future production than what's happened in the current period.

So, you know, in '73 and '74, the production of oil out of the Middle East did not decline at all – it actually went up, slightly. But the expectation was that the world was going to develop its resources at a much slower pace, at a pace with much more government involvement, and so the price went up – it went up a lot. So, yeah, if the world sees these finds in Brazil and Cuba and around the world as fundamentally changing their perception on future supply, it could affect prices in the current period, but can you sort it out? It's pretty hard.

16:50 GEOFF STYLES: This is Geoff Styles, and I've got a related question about the future supply. With the new report out of the IEA looking at really severe decline rates – I believe they're talking about 9 percent on the large fields – are you worried that the combination of low prices and the credit crunch could actually put us sufficiently far behind on the development curve that we might actually never catch up with the decline rate?

17:20 MR. PUGLIARESI: Yeah, well I guess the first question is, what do you think – I don't know the answer to this question, but I can talk about it. What do you think the major oil companies, both the -national oil companies and the international oil companies – what are they using as the hurdle-rate when they were evaluating long term projects? They were never using \$140, \$130, \$90 a barrel.

My guess is – and I don't – I only know this number by rumor on the edges of conferences and talking to people – they're using some number between \$40 and \$60-\$65 a barrel and maybe the tar sands or oil sands guys are using \$70 to \$80 – somewhere in there – thinking they can get the costs down and fuel prices fall and everything. So, in terms of the major companies, I think the existing price structure – I don't think it's affecting their willingness to go and find new prospects.

Here's the interesting question: Does the new dynamics – these lower prices – does it begin to change behavior in Venezuela, Russia, you know, off the African coast and even in the Gulf a bit – do people begin, you know, the kind of excessive resource nationalism we had, violation of contract sanctity – all the kinds of counterproductive behavior we saw from these national governments – is that going to start to unwind?

And I think you can see some movement already. So I'm less concerned about these price swings than access to the resource bit. And the question – that's something to watch very carefully.

19:01 MR. STYLES: Right, and I certainly agree that it's unlikely the majors' price expectations have been affected much by this, but I suspect that their weighted average costs to capital have.

19:12 MR. PUGLIARESI: Yeah, okay. I mean, there's no doubt it's going up – the question is, how much. And I suspect – a lot of that is their weighted cost – for many of the majors, that's a number they have to make up, because they're operating on a retained earnings often, and –

19:30 MS. VAN RYAN: Lou, Rayola's got some thoughts on that as well.

19:33 MS. DOUGHER: I was just going to say that it's been a challenge for a lot of the smaller producers.

19:41 MR. PUGLIARESI: Absolutely. That's where I think the issue is.

19:41 MS. DOUGHER: And there have been a number of companies announcing delays in operations for some of the things that they were investing in to move forward, so it is having an impact on different segments of the industry and refiners and others. The credit crunch is affecting some investment, but so far, for the majors, not so much.

20:04 MR. PUGLIARESI: Yeah, I think, actually, it's very important to understand that the refiners face a completely different set of issues – a completely set of different problems – than the upstream oil producers. There are two different markets now. You could argue, perhaps, that some of the refining operations attached to the tar sands and oil sands is the kind of way to monetize that asset – that may be a unique way you view as part of the upstream oil production process, but for the most part, refiners face a completely different set of constraints and problems.

20:40 ROBERT RAPIER: Hi, this is Robert Rapier. I have a question, but, first, I'll make a comment on that price band. As I worked for a major until earlier this year, that price band you quoted is pretty accurate and there is great reluctance to move that up, because I had some deep discussions internally about moving that up because I expected oil prices higher in the future and there's a very conservative bent there – (audio break) – number down in the \$40 range or so and do economics based on that.

And I hear from friends, other companies, that that's pretty consistent.

21:18 MR. PUGLIARESI: Yeah, you know, here's the thing. I mean, I know there's a lot – I know there's a couple of peak-oil guys on the call now. (Chuckles.) I don't want to get into that story, but I do think it's – this is a good time to back away a bit and say, okay, what do we think the long-run backstop price might be for petroleum in the sense that there's a price out there which, you can't really drive it a lot higher long term because of availability of non-conventional supplies, alternative fuels, conservation, new technologies.

And, you know, I was on a conference call with a bunch of folks, with Bob Tippee and the Oil & Gas Journal when the price was like \$140. And I said, does anyone think we are in – not above the long-run price of oil? And everybody said, no, we agree; we're way above the long-run price of oil, which I think is a really interesting view. I mean, it might be wrong. Okay, I'm not saying we know the answer to this, but it is clear that government policy, if you look at ethanol, so all the mandates are based on some concept that the price of oil is \$500 a barrel or something.

I mean, if you just look at the policies that are being rolled out now – and so, another interesting question is, how are they going to deal with that dissonance? You know, how is the policy going to deal with that dissidence as we go to a market in which the price of oil is \$60 or \$70 a barrel?

22:48 MR. RAPIER: Okay, my question is, I had a chance to review the API primer, "The Truth about Oil and Gasoline" before the call. And, as you read through there, you see just an absolute disconnect between the information there and I think what the average person on the street might believe. One of the issues I wanted to touch on was on the stock buy-backs. There's been a lot of stories out there that oil companies are spending, you know, record amounts of money to buy back stock and the graph that was shown there was that it's actually lower than the average for the – the average S&P company.

But that was from 2006. My impression is, that's substantially gone up since then and wondered if you knew how that fares now? My feeling is, it's probably above S&P average now, the stock buy-back number.

23:40 MS. DOUGHER: No, we just don't have that number; we haven't compiled it so I really can't say for certain. But it's been pretty consistent since over the 10-year period from 1996 to 2006. It was below the S&P industrials, but it's just hard to know what 2007 data look like. This data is put together by the EIA and they always have a long lag time. I think they won't be updating it until probably December. And so we won't even have the 2007 until then and we don't have any other source to use. So I just don't have a good feel for it.

24:15 MR. RAPIER: Okay. One more question from me, a political question: If you look at political contributions, the contributions from oil companies to Republicans are – tend to outweigh those of Democrats and, subsequently, Democrats have a pretty hostile view toward oil companies. And I'm wondering how we improve that relationship. This is one thing that's

always frustrated me, was that there just seems to be this incredible distaste from Democrats and I never understood why we don't open up a better relationship here with them, the Democratic leadership.

I think we're about to have a Democrat in the White House who's threatening windfall profits and all kinds of things and I can't understand why we don't sit down and open up a better dialogue with the Democratic leadership.

25:01 MR. PUGLIARESI: You know, I have a little story to tell you about that. I happen to have been in a little meeting with Bennett Johnston, the former, as you know, the former senator from Louisiana. And he's a Democrat. And he said, you know, he was talking about – I sort of asked him a similar question. You know, why is the Democratic Party at war with the oil industry? I mean, in 2006, it was a cash cow. It generated like \$130 billion of revenue to the government. I mean, compare that to the problems they're having with GM. You know, they should be doing award dinners for these guys. And he said, you know, when we had Democrats from oil-producing states, we didn't have these problems, because then, the party was afraid – (chuckles) – to overdo it. So you may be – we may be ending up in that direction in the next year if the polls turn out the way they seem to be.

26:05 GREG BALCH: Uh, this is Greg from the Barnyard. I want to follow-up on that a little bit. Aren't Democrats really using energy and fuel as a means of social engineering, then, in this? Telling people where they can live, where they can work, how far they can drive – you know, on and on.

26:23 MR. PUGLIARESI: Yeah, that's a very sort of fundamental – I mean, that's sort of above my pay grade. (Laughter.) I mean, that's a really basic issue about, you know, how involved should the government be in these energy markets and what's the costs and benefits of them being involved in that. I think it's a debate we ought to have.

26:53 CINDY KILKENNY: This is Cindy Kilkenny from Fairly Conservative. And I trained as a political scientist and I have to say it's definitely a wedge issue and it's very insightful. And I grew up in Oklahoma. My family – my brother is still in the oil patch and he's been, so I see both sides of this and I know how it's being used and it's just about what it redeems for whoever wants it at that point.

Um, I have a couple of questions. One is with regard to the information that we had the link to. On page nine, there's a second quarter earnings by industry there. Oil and gas is at 6.8 – do you expect that to climb up on the scale, given this pretty remarkable return on the third quarter?

27:31 MS. DOUGHER: Well, I'm sure. We already have returns from about 14 of the industries so far. And their reported earnings about 9.6 cents on the dollar.

27:40 MS. KILKENNY: Okay, so 9.6. There was a lot of crackling earlier, and I missed some of the numbers. I heard 10.7, but I –

27:47 MS. DOUGHER: That was for the 24 of the 30 Dow Jones –

27:50 MS. KILKENNY: Okay, Dow Jones, so on average – but we don't know who else is shifting around there. I suspect we'll see some other shifting.

27:58 MS. DOUGHER: There'll still be a little bit more – we do have to wait for Chevron tomorrow, but generally once we have these 14 or 15, we get a pretty good idea of the earnings and it shouldn't change that much from the 9.6 that we're reporting. It may come down a little bit; I'm not sure which way it will go. But it probably won't be that much different.

26:18 MS. KILKENNY: Well, not going down is the issue here. (Chuckles.) Not moving below – okay.

28:22 MR. PUGLIARESI: By the way, this gets back to the question on, you know, prices of gasoline. You know, our data show that – people always claim that the prices go up, but they don't come down as fast – but actually, we show in the last quarter – the last month – that gasoline prices actually fell at a much faster rate than crude, at least in the – and I can send this to you, Rayola, if you like – we have this compression of margins and refiners gasoline prices – some data we just pulled up, but –

28:56 MS. DOUGHER: Well, at least in the past month, that was so. I mean gas prices came down much faster than crude oil prices, but the hurricanes in September did lift those products –

29:06 MR. PUGLIARESI: Right, right. Well, that's where you get the volatility and I think that's why it happened that way.

29:09 MS. DOUGHER: That just depends on which point – (background noise, inaudible) – measured.

29:15 MR. PUGLIARESI: By the way, I think another issue people aren't thinking a lot about now is what happens to ethanol at these lower gasoline prices. I don't think anyone has really – I don't think the Congress has really confronted this enough, because we are now going to be getting very close to where – because, you know, after you get to 2 to 3 percent of the gasoline blend up now, where we are now at 7 percent – where ethanol is going head to head with gasoline, except it gets much poorer gas mileage, save for E-85 or something.

And you may be getting to the point where you cannot produce the corn – in other words, your cost of production for the corn – you can't deliver it at a price that allows someone to produce and distribute ethanol cost-effectively.

30:04 MS. KILKENNY: Well, where has corn gone, in relation to oil? That would imply that the price of corn would be going down, 'cause I know that commodities – but I haven't watched it.

30:13 MR. PUGLIARESI: Corn has dropped like a stone.

30:15 MS. DOUGHER: AAA keeps track of these prices and the current price for ethanol is about \$2.75 a gallon – that’s adjusting for the BTU content, and regular gasoline is selling for about \$2.55, so about .20 a gallon more right now.

30:33 MR. PUGLIARESI: Yeah, actually, E-85, when you adjust it for MPG, always is more expensive than regular.

30:40 MS. DOUGHER: Right, well –

30:42 MR. RAPIER: Yeah, hi Robert Rapier here again. One comment on that, because I actually asked the EIA about this – the mandate – and the funny thing about ethanol is that the demand is guaranteed to go up, because it’s mandated to go up. So even though gasoline demand is down, ethanol demand is – there’s a floor level, and that floor level will increase on January 1st, 2010, 2011, and so forth – every year, it’s going to increase. It doesn’t mean anybody will make money at it, but the demand is going to go up.

31:16 MR. PUGLIARESI: Yeah, under the man – this is a really good point – under the mandate, now you have to keep moving – ethanol has to keep moving up to, what – 15, 16 billion gallons a year at 10 percent of – which the Congress thought was 10 percent of the gasoline pool. But, actually, it’s going to exceed 10 percent of the gasoline pool within the next couple of years, depending on what happens to gasoline demand – there’s clearly a scenario.

And if you look – if you read around, you know, well some people are saying, well maybe we should move to E-12. The problem with E-12 is there’s a – you have a mania, first, in the boat-owners already – but if you just – there’s like \$1 trillion of small engines out there; those guys will just go crazy – they just – and the manufacturers will pull the warranties. But this is the real dilemma with that: At the extensive margin, it’s going to be very, very expensive to get ethanol blended everywhere.

And some guys are going to say well, you know, it’s just not worth it to me and I’ll just pay the – I’ll just buy some RINs. And there’s actually some scenarios out there where some guy in the Florida Keys is buying some RINs to get his obligated parties requirement and some guy in Iowa is dumping the ethanol in the river. I mean, I just think this is an issue that has to be revisited.

32:36 MR. STYLES: In fact, aren’t we seeing – this is Geoff Styles again – aren’t we seeing that whole market shift right now, because of the inversion of gasoline and ethanol prices where, until pretty recently, there was an incentive for refiners to over-blend – in other words to blend more ethanol than was legally required and we’re seeing that in the statistics. Now you’ve got gasoline priced under ethanol again, in fact in some places by more than the amount of the blender’s credit, and part of the fallout that we’re already seeing is, you know, perhaps the imminent bankruptcy filing of one of the biggest ethanol producers in the country, VeraSun.

33:14 MR. PUGLIARESI: Yes, I think that this is only the beginning. This issue is going to have to be revisited.

33:20 STEVE ATKINSON: Jane, Steve Atkinson from Conservative Voice.

33:22 MS. VAN RYAN: Yes, Steve, please go ahead.

33:34 MR. ATKINSON: Yeah, I'm going to jump in here. First of all, a previous speaker, quote, "felt optimistic" about the chances of one of these presidential candidates. I do not share that optimism. And secondly –

33:41 MR. PUGLIARESI: I missed that comment. Who made that comment?

33:45 MR. ATKINSON: Steve Atkinson.

33:46 MR. PUGLIARESI: Okay. (Chuckles.)

33:49 MR. ATKINSON: For me, Ron also threw a key phrase out there earlier that really piqued my interest and that was – and it's just part of a phrase – consumer changes. For me, artificiality, that's my key operative word. And all the discussion thus far, to me, has been one of dealing with and addressing the after-effects of something that I feel is of supreme and paramount importance.

One, number one for me, as it relates to energy especially: the troubling nature of political meddling in the affairs of corporate entities. And that, of course, may take the form of tax increases, so-called alternative energy demands – or it could also manifest itself in pressures on the auto industry as a corollary to comply with the net effects of their demands. And I believe, then, that therefore, there are no so-called magical, silver-bullet answers to most of these questions. Consequently, I think it boils down for me, at least – the question I had, for giving this statement – how much of an impediment is this to sound energy policy development in the United States?

35:16 MS. VAN RYAN: I want to be sure I understand your question and that others do. You're saying that the tendency, in your view, of politicians to meddle in corporate affairs, whether it be in the energy industry or in the auto industry, perhaps could be an impediment to having a sound energy policy, correct?

35:36 MR. ATKINSON: Correct. I think the industry itself is forced to deal in a, quote, in the "after-effect" manner, of dealing with all of these pressures.

35:48 MR PUGLIARESI.: Here's the – let me fire here – if you think about this, you want – the reason that we have prices out there is that it helps us allocate capital to its most efficient use. To the extent that government intervene – the government has a view that it should intervene in this market based on some vague notions of what energy security is, or that the market's unable to transition to the fuels of the future at either fast enough or it doesn't know – the market can't pick the right fuels of the future – whatever that is. And if you go back to the '70s, there's plenty of dead carcasses around from the last attempt the government did at this.

So I do think you're right in the sense that the real cost to this is the Congress and those people who think we have to direct how we're going to transition and the pace at which we're going to transition to the fuels of the future, they may impose very high costs on the economy – lots of inefficiencies, and ultimately, we're just going to grow slower as a result of that. And we're going to have a lot of distortions and impediments to the kinds of investments we actually need to make. But to make that argument, you really have to believe that you can somehow educate the Congress in the way that capital markets should function and stuff, and it's really a hard job.

37:15 MR. ATKINSON: It may be a hard job, but how about this: You were talking about the inversion of pricing vis-à-vis ethanol and gasoline earlier. Gee, isn't it amazing. Something Congress might want to consider is that ethanol, which is free, mind you, of the subsidization of the enhanced food prices in America; if the inversion example is true, then would there not be a net benefit to applying a different strategy that would have the net effect of reducing food prices and therefore by removing that –

37:55 MR. PUGLIARESI: Right, the mandate is obviously a misguided policy. At least the blender's credit gave the market a chance to adjust against the implicit subsidy in it, but the mandate is binding – it doesn't really allow the market to adjust at all. You know, ethanol has been used for 30 years – Getty's been using it forever – but they used it when it was very valuable, for 2 to 3 percent of the gasoline pool, as an oxygenator and an octane booster. It's only when Congress intervened and said, no, no, you have to – the benefits of reducing net demand for gasoline are some huge number – they're so high, we're willing to pay any cost to expand ethanol production. That's just – frankly, that's a crazy way to do it.

38:44 MR. STYLES: This is Geoff Styles again. Can I just throw something in there, because it seems like the missing piece of this whole discussion is climate policy, because at the end of the day, the last couple of years, a lot of the measures that have been taken on energy really have been a form of back-door regulation relative to climate. And in the next year or two, it seems like we're likely to see more of a front-door approach on climate. How will that change all of these back-door approaches that have been tried over the last few years?

39:17 MR. PUGLIARESI: Yeah, I mean, first, all the climate folks and everything, they should have a little humility after the ethanol debacle because most of the major environmental groups are pulling away from ethanol because they think it's not even reducing global greenhouse gases net-net.

But here is the interesting question from a political point of view, going into next year. We're going to be probably in a recession or have very, very sluggish growth. We're going to have a huge deficit. We're going to have relatively moderate gasoline prices. And so how – what's the Congress going to do? I mean, the idea of cap-and-trade is – I mean, I think cap-and-trade – all this Fannie Mae – all this stuff is a way -- Congress wants to do things but it doesn't want to pay for it. But what happens when it becomes apparent that what Congress is planning to do is to replace \$2.50 gallon gasoline with \$3.50 a gallon gasoline? I mean, that's going to be the net effect of what they're going to try to do. I think you might see some political resistance

to that. You may see a real stretch out in the enthusiasm for a lot of these onerous strategies that deal with climate.

40:31 MR. ATKINSON: That may in fact be dealt with at, say, a Hilton hotel in London, England on this very day. (Laughter.) They have to do something though.

40:40 MS. VAN RYAN: May I ask who – is that you, Steve?

40:43 MR. ATKINSON: Yes, it is. I'm sorry.

40:45 MS. VAN RYAN: That's all right.

40:46 MR. ATKINSON: I just happen to think that in London today, unless the sidewalks are shoveled clear of the earliest snowfall in their history that – I have problems when it comes to discussions on the climate. I really do.

41:05 CARTER WOOD: This is Carter Wood at the NAM. I just note in passing that over the last week, I've seen three or four pieces bringing back up the idea of a 50-cent-a-gallon gas tax or a \$1.00-a-gallon gas tax. Now that the price of gas is falling again, what a wonderful opportunity it is to increase it. Most of those arguments are not environmental but are economic. That is, we can use the money, and fuel-efficiency more oriented, it seems to me. But anyway, it's kind of seasonal, I guess.

41:38 MR. PUGLIARESI: Right, but you know, the lower gasoline prices, Larry Goldstein, our former president of EPRI and now one of our directors, he came up with – I think it was – it depends on how you do it. But he came up with 250 to \$300 billion. The lower gasoline prices may be just the liquidity and the stimulus package the economy needs.

41:59 MS. VAN RYAN: Do you have a comment on that, Rayola?

42:01 MS. DOUGHER: Oh, just in terms of API or the industry in terms of gas taxes, our policy has always been, if it is increased that it go toward the roads and that we use it in that way.

42:13 MS. KILKENNY: This is Cindy Kilkenny from Fairly Conservative. Does the industry have a response to Obama's plan for a windfall profits tax? Is there a written response?

42:21 MS. DOUGHER: A written one? I don't know if it's written. But we certainly don't approve of it. I mean, we really think that when you tax the industry, we'll have less money, less investment, less supply.

42:33 MS. KILKENNY: Yeah, well, I mean –

42:34 MS. DOUGHER: You set yourself up for a future with less supply and that would have its own adverse impact on prices too, probably.

42:45 MS. KILKENNY: Right, well, I mean, I know that's my response. But I just didn't know if there was anything to point to as to the industry showing history or that kind of thing.

42:54 MR. PUGLIARESI: Yeah, I suspect that they're going to get together and do the – this is Lou again. I mean, the industry is a huge contributor to the federal budget, huge. I was just shocked when I looked at the data last week. I'm just surprised, all the effort in vilifying these guys, I mean –

43: 11 MS. KILKENNY: It's nice of you, considering how evil you are. But yeah.

43:14 MR. PUGLIARESI: Yeah, it's amazing. (Chuckles.)

43:18 DEVIL'S ADVOCATE: This is Devil's Advocate from Copious Dissent. Just on a quick related note to that. I've heard a lot of stuff that – I mean, this may end up not mattering at all over the next week, but did Sarah Palin actually have a windfall profits tax in Alaska or was it something different, because I know Larry Kudlow said it wasn't. And then everyone said it was. And so, I don't know if that would be pushed regardless of what party gets elected.

43:40 MR. PUGLIARESI: I'm guessing she renegotiated the severance taxes. But I don't know the answer.

43:46 MS. KILKENNY: Yeah, I've actually done some work on that, and yes. But it's coming of Alaska's oil, so that's the way it goes, which is different than what might be considered a windfall tax –

43:57 MR. PUGLIARESI: Here's a question I have on offshore leasing. Offshore leasing has the potential to generate a lot of cash to the federal government. And I'm wondering whether the financial pressures the government is going to find itself in next year, whether that might be a main motivator to open the program up and start to look at more prospects, because if they really do go with a pay-go program, this is one of the only sources I can see out there where you can get substantial revenues in a relatively short period of time through the bonus-bid process.

44: 34 MS. DOUGHER: Well, we keep our fingers crossed. But so far this year, we spent \$6.8 billion just on the bonus bids alone. So that's quite a bit of money just for those new leases. In terms of royalties, last year it was \$8.7 billion. So states, the federal government have a lot to gain by taking a serious look at this.

I think the problem for the industry moving forward is to have certainty, legislative certainty – even though the moratorium has been lifted, we have a number of members of Congress saying they're going to bring it back again.

45:08 MS. KILKENNY: It does not feel certain, that's true, yeah.

45:09 MS. DOUGHER: So you need to have that certainty going forward to make that investment. And if we don't have it, you're going to be very hesitant about going ahead with any exploration at all.

45:18 MR. PUGLIARESI: Yeah.

45:20 MR. PUGLIARESI: The issue actually, what the Congress doesn't even understand is that if you want people to make commitments to drill ships, to learn petroleum engineering, to do all these long-term things, what we ought to have is the largest possible inventory of opportunities as possible, partly because the whole geologic discovery process, the information is a real force multiplier in how you do something in other basins. And the notion that we should have parcel stuff and little bits and wait to see if someone finds something before they open up a little bit more is entirely the wrongheaded way to sort of maximize the value of the exploration process, including the revenues to the government.

46:09 MS. VAN RYAN: Any additional questions involving offshore drilling or bonus bids?

46:14 MR. BALCH: Well, one thing – this is Greg from The Barnyard. One thing I know is out here in California, there is over 2,000 known natural seeps off our coast that we know where the oil is. You know, it's not like it would take a long time to access that or to find it.

46:29 MR. PUGLIARESI: Right, actually, I heard that the city of Santa Barbara, because of two geologic studies, voted to increase drilling because the existing studies showed that the drilling was reducing the amount of natural seeps in Santa Barbara Channel.

(Cross talk.)

46:50 MR. BALCH: Sorry, I saw where some of these seeps leaked as much as a couple hundred barrels a day into the – some of these into environmentally sensitive areas.

47:01 MR. PUGLIARESI: According to the National Academy of Sciences, 63 percent of the petroleum loading into the marine environment is from natural seeps; less than 1 percent is from offshore operations. And some of the major companies claim that it's actually even less than that.

47:22 MS. DOUGHER: Well, I think the MMS shows that in the Gulf of Mexico something like one one-thousandth of 1 percent. And it's the seepage too it's much greater than any of the spills that occurred and that's where we had most of our operations. So you don't get much better than nature.

47:39 JOULES BURN: This is Joules Burn of the Oil Drum. And I have – I want to jump back to the economic discussion, because a couple of assumptions that seem to be swirling around with some of the discussions is that the lower gasoline prices and oil prices are sort of here to stay for the foreseeable future. When the – it seems that the recent drop in oil prices and

gasoline prices has very much to do with the decreasing demand, which may have some economic reasons, but the economy in general – but also related to the previous high prices, which drove demand down. So we're in a situation where we have lower prices but less people are actually – less gasoline is being used.

So trying to move forward and into a situation where the economy might be growing at some point in the future would imply an up-tick in the usage. And is there – does the API believe that production will be increasing during that period to keep the prices low? Or is there a possibility of prices again going above \$3.00 a gallon and higher, just based on the fact that more people, including the developing countries and China are using more gasoline?

49:12 MS. DOUGHER: We really don't have any forecast for the future. If we just think back to last summer, there were a number of analysts calling for \$200 a barrel oil by Christmas. And here we are at 60, 65. So I think anyone would be pretty hesitant to make a forecast right now moving forward.

49:32 MR. PUGLIARESI: Yeah, I mean, I do think you –

49:33 MS. DOUGHER: We're going to need the investments out there and we're going to need steady investment moving forward –

49:38 MR. PUGLIARESI: This is Lou again. Our view was that if you go to the beginning of the new millennium, 2002, 2003, actually you could make a forecast as to how much oil was going to be produced over the next 8 or 9 years just field-by-field analysis. And it wasn't that bad. And with some normally distributed errors – you might get a little bit here that fell off but a little bit of field that came on early.

And if you go through the analysis – I won't spend a lot of time on this – but everything that could go wrong went wrong. You know, our view is that this is a kind of silent disruption. And lots of production got hammered through a lot of different reasons – resource nationalism, civil strife, a failure of Bush to open up ANWR and the Congress, offshore leasing, the Iraq war. And so a lot of that production – so in a way, we went through a kind of disruption in terms of expectations. The path we were on – even though we have production sort of didn't really decline dramatically. It started to flatten out around 2006, 2007.

And of course, I agree, we were moving up a price curve in the sense that demand was expanding. But there's no reason – if you look sort of historically and you look at what's going on in the market, it's hard to believe that we should be up in the mid-150s range long-term. It's just too much that can happen below that.

51:06 MR. BURN: Well, one thing though that's sort of a bigger picture issue is there is a belief from certainly a lot of the voices on this call that a free-market economy is generally a stable thing. And all a government has to do is stay away and it's going to be this nice, stable, upwardly sailing vessel, which is just going to lift us all.

51:29 MR. PUGLIARESI: Well, I don't think that's what free-market economics says. It says that –

51:33 MR. BURN: Well, I think but there is the impression though that there will be less instability. And clearly in the last year, we've had instability in all fronts. And you know, it's possible that instability is the norm as opposed to predicting that we're going to have moderate gas prices for the next year, for example. We might have big price swings in both directions again.

51:58 MR. PUGLIARESI: Of course, anything is possible. But clearly some of the instability is kind of self-inflicted. If you look at – not just the policies of the U.S. government but other governments. And obviously, probably there are more black swans out there than we expected.

52:18 MR. BURN: Well, another point is that – something that's not been mentioned in this call is the effect of speculation in the market, because the amount of dollars that is traded in a speculation market for oil vastly exceeds the amount of quantity that is there. I mean, by many orders of magnitude, it's a huge amount of money that's floating around looking for a place to land. And so, both moving into the market and moving out of the market can have a big impact on the price that is being paid, which feeds back into the demand. People will buy less when it's very expensive.

52:54 MR. PUGLIARESI: Yeah, but did you see the last CFTC report on this where they actually got all the trades? And I actually encourage people to look at that. I mean, I'll be very honest, our view is that these prices were driven by fundamentals of supply and demand. And the speculators didn't play. And remember, there's somebody – I don't quite understand. There's somebody on both sides of those deals. Now, maybe the bets all went one way. And they were not – I don't think they were quite leveraged the way the CDOs and these other things were. And the CFTC needs to show that. But it's really worth looking at it because they finally got all the data. And we have never been – we think the speculators might have had some modest effect at the margins here or there. But it's overwhelmed by the fundamentals.

53:42 MS. KILKENNY: Where would I find the data?

53:44 MR. PUGLIARESI: If you go to the CFTC website or if you e-mail me, we have a copy back at the office. And I'll e-mail it to you. But I think you can pull it right off the CFTC website. And it's a really interesting report. I mean, they finally got all the data. And then, there was a set of hearings, which also the transcriptions are worth looking at.

54:05 MR. PLANTING: This is Ron. Wasn't it true that they found that the so-called speculators were actually getting out of the market while prices were still rising?

54:14 MR. PUGLIARESI: Yes, yes. They have – actually got – I think they got 90-some odd percent of all the trades. It was really – it's really some of the best work they've ever done.

54:26 MS. VAN RYAN: We've been going about an hour now. Do we have any additional questions? Normally, we go about an hour and then close out the blogger conference calls. I do have a couple of questions that were sent to me by a blogger earlier who could not attend the blogger call. But we've had a pretty lively discussion today, so I'll get back to him personally later. Is there anything else?

54:52 MS. KILKENNY: No, but if you come up with a statement on the windfall profits, do let me know.

54:57 MS. VAN RYAN: I'll do that. Thank you very much. Okay, we'll call it a day then. Thank you all for joining us. Again, we're going to post the audio file and transcript as quickly as we can. Thank you for joining us. Bye, everybody.

(END)