Prepared Statement of
Rob Routs
President and CEO
Shell Oil Products US
Before The
Senate Governmental Affairs Committee
Permanent Subcommittee on Investigations
April 30, 2002

Mr. Chairman, members of the committee. For the record, my name is Rob Routs and I am the President and CEO of Shell Oil Products US.

Shell Oil Products US is a marketer of fuels, lubricants, services and solutions to consumer and business-to-business customers in automotive, commercial and industrial sectors. Shell Oil Products US operates refineries, a lubricants business and a pipeline and terminal system. Together with its affiliate Motiva Enterprises LLC, Shell Oil Products US supplies nearly 22,000 branded service stations.

I have been asked to share with the committee our thoughts on the United States' motor fuels market and the factors that contribute to the volatility of the price our customers pay at the pump.

America's growth has been fueled in large part by the stable supply of reasonably priced energy. In fact, the price of gasoline has remained fairly constant when adjusted for inflation.

A recent analysis by the American Petroleum Institute stated: "In inflation-adjusted 2002-dollar terms, today's price is low compared to the historical 84-year record of recorded pump prices. In fact, motor gasoline prices are 45 percent lower than the 1981 record high of $2.64 per gallon. Between then and now, the real cost of motor gasoline to consumers fell by $1.19 per gallon. This decline can be attributed largely to lower crude costs, but manufacturing, distribution, and marketing costs are lower as well."

Shell remains committed to ensuring that we meet the needs of our customers by providing them with a reliable supply of quality fuels at a competitive price.

Still, there are a number of factors that have contributed to the volatility of the recent past. These factors still exist today and will continue to influence the price of gasoline in the future.

One of the greatest challenges we face as an industry is supplying an ever-increasing number of "boutique" fuels to an ever-expanding number of niche markets. Prior to 1990 there were 6 kinds of gasoline sold in the United States. Today, requirements imposed by federal, state and local governments have contributed to the creation of an ever-expanding number of motor fuels and other petroleum products. Again, according to the American Petroleum Institute "One pipeline company, Atlanta based Colonial, delivers 90 different products for 85 shippers to 270 terminals and more than 1,000 storage tanks. In any given month, Colonial may ship 30 different grades of gasoline."

When a region, state or city requires a unique fuel it becomes a "fuel island," unable to utilize nearby supply should the delivery of their special blend be interrupted. The smaller the market, the more isolated they become, and the more difficult it is for us to move product into that area on short notice.

Not only are we being asked to supply a greater number of fuels, but the specifications of these fuels often change with the seasons. These seasonal fuel variations require us to draw down inventories as we switch from one fuel to another. We conduct this fuel switch in April and May and September and October. When we switch fuels in the spring, we must draw down inventories to ensure that our fuel remains compliant. During this time markets are particularly exposed to volatility should a supply disruption occur.

In an effort to address the proliferation of the fuels in America, we have been working with Congress on the establishment of a study to look at the issue. This study is included in the Senate's energy bill. We look forward to participating in the development of policies and programs intended to reduce the number of fuels used in this country without compromising environmental quality.

At the same time, the infrastructure for producing and distributing fuels has been running at very high utilization rates. America's refineries, for example, were running at 94% utilization last summer. At these high rates there is little reserve capacity that can be turned on when demand peaks or another source of supply shuts down. Likewise, pipelines, particularly those that bring product to inland markets, are also operating at or near capacity.

In recent years oil has been as low as $10 per barrel and as high as $30. Today that same barrel costs $25.

The factors influencing the cost of crude are global in nature. Crude oil is a commodity that is traded on various exchanges around the world. As with most commodities, supply and demand – real and perceived – determine what participants in the market are willing to pay for a barrel of oil. As a result, factors that range from regional conflict to the shut in of platforms in the Gulf of Mexico can all influence the price of crude oil. These types of events can often contribute to short term price volatility.

Finally, the business of refining and marketing fuel is itself changing as merchant refiners and non-integrated marketers have grown. They rely on the spot market for selling and acquiring product and it is often the gasoline spot market that leads prices higher during disruptions in the supply and distribution system.

Together: boutique fuels; high utilization rates; seasonal fuel requirements; fluctuating crude prices and the growth of merchant refiners, have all contributed to the volatility in the price of gasoline that has become common over the past few years.

Given that the price of a gallon of gasoline is determined by a marketplace that is influenced by a variety of factors, many of which are not within the control of those who refine, market and distribute fuel -- is there anything that can be done to help ease this volatility?

- First, we must stem the proliferation of boutique fuels so that product can be shifted from one market to another when supply disruptions occur or demand peaks. As I said earlier, we support the establishment of a study to look at this issue and provide recommendations.
- We must look for ways to streamline the permitting and construction of new and expanded facilities used in the production, transportation and distribution of fuels.
- Most importantly we must let the free market work and avoid the development of schemes intended to control or influence the price of gasoline.

In the years ahead I expect that we will continue to see mergers, acquisitions and divestments in the oil industry. Like any business, we continually search for opportunities that will make us more competitive relative to our peers. The efficiencies and synergies we often recognize through these types of transactions allow us to continue to provide our customers with a competitively priced product.

In some instances, the consolidation in the industry (particularly refining) is being driven by the huge capital investments needed to meet ever more demanding regulatory requirements. Many smaller companies simply cannot justify the investment in plants and facilities needed to produce today's cleaner burning fuels.

Finally, the committee has expressed an interest in how we price our product. Let me first say that the members of our industry never discuss among ourselves how we price our product. Not only would that be illegal under federal antitrust statutes, but it would also disadvantage our ability to stay competitive in the marketplace. I can tell you that we price our product relative to the market and that we are constantly striving to provide our customers quality motor fuels at a price that is competitive. Of course, the cost of crude oil is the single greatest cost in a gallon of gasoline. Many other elements contribute to the price of a gallon of gasoline. According the Energy Information Agency:

- **"Federal, State, and local taxes are a large component of the retail price of gasoline.** Taxes (not including county and local taxes) account for approximately 28 percent of the cost of a gallon of gasoline. Within this national average, Federal excise taxes are 18.4 cents per gallon and State excise taxes average about 20 cents per gallon. Also, some States levy additional State sales taxes, some of which are applied to the Federal and State excise taxes. Additional local county and city taxes can have a significant impact on the price of gasoline.

- **"Refining costs and profits comprise about 14% of the retail price of gasoline.** This component varies from region to region due to the different formulations required in different parts of the country.

- **"Distribution, marketing and retail station costs and profits combined make up 12% of the cost of a gallon of gasoline.** From the refinery, most gasoline is shipped first by pipeline to terminals near consuming areas, then loaded into trucks for delivery to individual stations. Some retail outlets are owned and operated by refiners, while others are independent businesses which purchase gasoline for resale to the public. The price on the pump reflects both the retailer's purchase cost for the product and the other costs of operating the service station. It also reflects local market conditions and factors, such as the desirability of the location and the marketing strategy of the owner."

Remember, the final price for a gallon of gas is determined by the retailer. And that price, which is included in the last 12% from above, is set after he or she adds their costs or profits to the price they pay for the product.

I hope that I have helped you to understand the many factors that influence the price of a gallon of gasoline and why that price can sometimes be volatile. I hope you can also appreciate the substantial capital investments and long range planning that is required for the oil industry to quench the thirst our country has for the fuels that keep us mobile.

Yet despite all of the challenges I have outlined, and many more I have not, I believe a gallon of gasoline remains a great bargain in constant dollars. I look forward to answering any questions you might have.